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INTERNATIONAL CAPITAL MARKETS SECTION

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§1. Introduction

The securities markets of Europe are in a state of significant transition. The European Community (EEC or Community), essentially a Western Europe institution at present,[1] has already passed significant legislation designed to reduce regulatory barriers to the free flow of capital across national boundaries. When fully implemented, EEC directives will allow companies to make stock offerings throughout the Community on the basis of a single prospectus approved by the home state and banks and brokerage firms to provide financial services throughout the Community on the basis of a single license issued by the home state. The countries of Central Europe are undergoing an even greater transformation in their conversion from centrally planned to free market economies, privatization of state-owned enterprises and establishment of new securities markets and systems of securities regulation. The Budapest Stock Ex-

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1. The full members of the EEC are Belgium, Germany, France, Italy, Luxembourg, the Netherlands, Denmark, Ireland, the United Kingdom, Greece, Spain and Portugal. West Germany was a founding member of the Community; East Germany became a member not by accession but by reunifying with West Germany.

change, closed by the communists in 1948, re-opened for trading in June 1990 with a mission "to facilitate efficient capital flows." In 1990 the Republic of Hungary (Hungary) enacted legislation designed to regulate the stock exchange and other aspects of the new securities market. Czechoslovakia, or more precisely, the Czech and Slovak Federated Republic (Czechoslovakia), enacted stock exchange legislation in April 1992 and constituted stock exchanges in Prague and Bratislava although they are not yet operational. This article is a case study of the securities markets and regulation of Hungary and Czechoslovakia, but it should be noted that similar changes are also occurring in Poland.[2]

Central European securities markets may best be understood in context of the political and economic environment in which they exist. As discussed more fully below, Hungary is politically stable and the regional leader in the implementation of free market economic reforms. About 5,000 companies with some measure of foreign ownership were established in Hungary in 1991.[3] Czechoslovakia is in the process of splitting into two independent republics, the Czech Republic and the Slovak Republic, although negotiations are still underway concerning details of the Federal dissolution. Each Republic will establish its own central bank and distinct national currency and is in the process of forming ministries that will assume responsibilities once reserved for Federal authorities. The division of Czechoslovakia is likely to increase the pace of economic reform in the Czech Republic and decrease it in the Slovak Republic. Approximately 4,500 companies with some degree of foreign ownership had been registered in Czechoslovakia by the beginning of 1992,[4] but presumably foreign investment may moderate temporarily due to political uncertainties facing the nation.

A study of the securities markets and laws of Central Europe is instructive from a number of points of view. First, U.S. and other foreign investors purchasing interests in companies or engaging in joint ventures in this region should be familiar with securities laws which may complement commercial, joint venture, foreign investment or privatization laws applicable to their investment. Second, portfolio managers, institutional investors and others investing globally for purposes of geographic or risk diversification or for other reasons should also be aware of securities laws that may directly apply to their purchases and subsequent resales. Indeed, all investors should have a general understanding of the nature of the securities markets that may provide liquidity for their investment.

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2. Hungary, Czechoslovakia and Poland are commonly associated as "Central European" rather than Eastern European countries. Poland enacted the Act on Public Trading in Securities and Trust Funds and the Act on the Establishment of the Warsaw Stock Exchange in 1991, re-opening the Stock Exchange 52 years after its closure in 1939.

3. COOPERS & LYBRAND, CENTRAL & EASTERN EUROPE: HUNGARY 14 (1992) [hereinafter HUNGARY INVESTMENT GUIDE]. "Total foreign investment over the past two years has exceeded US $2.5bn, of which 50 percent came from European companies." *Id.*

4. COOPERS & LYBRAND, CENTRAL & EASTERN EUROPEAN GUIDE: CZECHOSLOVAKIA 20 (1992)[hereinafter CZECHOSLOVAKIA INVESTMENT GUIDE].

Third, foreign companies setting up operations and concomitantly selling securities in the region obviously must be aware of applicable laws, although market participants should, of course, consult with counsel in the case of actual transactions.

From a more academic perspective, the emerging systems of securities regulation in Central Europe provide a useful vehicle for examining many of the contemporary themes in the field of international securities regulation: capital adequacy, universal banking, foreign stock exchange membership, "transparency" (disclosure of trade information), off-exchange trading and direct bank access to stock exchanges. These issues, currently under consideration by, among others, the Community and the International Organization of Securities Commissions (IOSCO), are among the most important issues of the day in the field of international securities regulation. They have arisen in Hungary and Czechoslovakia as elsewhere but clearly transcend national boundaries due to the internationalization of the securities markets which proceeds apace.

Hungary and Czechoslovakia (as well as Poland) have entered into association agreements with the EEC[5] which, in the words of EC Commission President Jacques Delors, mark " 'the reconciliation of Europe with itself.' "[6] These agreements have an unlimited duration, ten-year transition period and "may lead to future accession to the European Community."[7] The parties obligate themselves to take actions necessary progressively to liberalize restrictions against the rendering of of cross-border services.[8] The EEC, Hungary, Poland and Czechoslovakia also entered into interim agreements designed to facilitate on a more immediate basis the objectives of the association agreements.[9] Hungary and Czechoslovakia are clearly contemplating full EC membership in the not too distant future and their securities laws bear an indelible European mark. They will be able to integrate themselves into the EEC system, at least as far as their securities laws go, although both countries and especially Hungary will clearly be required to amend their laws to bring them into full compliance with EEC directives upon accession to the Treaty of Rome.

A brief comparison of the laws of Hungary, Czechoslovakia and the EEC as they apply to several of the salient issues mentioned above provides a useful overview of Central European securities laws and their relation to the EEC system of regulation. The analysis begins with financial

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5. *EC and Eastern European States Conclude Association Agreements*, 1 Doing Bus. in E. Eur. (CCH) 1 (January 1992).

6. *EC Agreements With Eastern Nations Seen as First Step to EC Membership*, 1 E. Eur. Rep. (BNA) 226 (Dec. 23, 1991).

7. *EC and Eastern European States Conclude Association Agreements*, *supra* note 5, at 2.

8. *See id.*

9. *EC-Eastern Europe Interim Agreements Approved in European Parliament*, 2 Doing Bus. in Eur. (CCH) 28 (February 1992).

services. One of the most important contemporary issues in the international market for financial services involves the question of universal banking — the rendering of both commercial and investment banking services by the same institution, prohibited at least in theory in the United States by the Glass-Steagall Act. EEC law will allow banks to provide both commercial and investment banking services throughout the European Community on the basis of a single license issued by the home state, provided the license authorizes both types of activities. Czechoslovakia, like the EEC, permits universal banking[10] but Hungary only allows banks to engage in securities activities through subsidiaries.[11]

Capital adequacy for securities firms is another controversial issue worldwide having recently been resolved, however, at least in principle, by the EEC.[12] Under Hungarian legislation, an underwriter or dealer must have at least Ft 50 million (about US $650,000) in capital while an ordinary broker must have either Ft 10 million (about US $130,000) or Ft 5 million (about US $70,000) depending upon whether it is organized as a limited liability company or joint stock company, respectively.[13] These requirements compare to capital adequacy requirements in the European Community of ECU 730,000 (about US $970,000) for all firms that do not fall within one of the following two categories; ECU 125,000 (about US $170,000) for firms that hold client funds but do not trade for their own account; and ECU 50,000 (about US $70,000) for firms that do not hold customer funds or trade for their own account.[14] Legislation that would establish capital requirements for brokers operating in Czechoslovakia has not yet been enacted, but minimum bank capitalization requirements in Czechoslovakia are Kes 300 million[15] (US $11 million) compared to Ft 2 billion (US $25 million) in Hungary[16] and ECU 5 million[17] (US $6.7 million) in the EEC.

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10. *New Law Allows Foreign Branches, Sets Rules for New Banks, Subsidiaries*, 2 E. Eur. Rep. (BNA) 164 (March 2, 1992).

11. *Parliament Adopts Statute Establishing Western Standards*, 1 E. Eur. Rep. (BNA) 110 (Nov. 25, 1991).

12. *Progress on EC Capital Adequacy and Investment Services Directives*, Int'l Sec. Reg. Rep. (Buraff) (Aug. 10, 1992).

13. *See infra* notes 202-211 and accompanying text.

14. *EC Finance Ministers Reach Agreement on Investment Services, Capital Directives*, Int'l Sec. Reg. Rep. (Buraff) (July 14, 1992). The standards reflect a recent compromise reached by the Council of Ministers and and are subject to final approval within the EEC decision-making structure. *Id. See also* Fox, *EC Faces "Messy" Capital Adjustment - UK Sources*, Reuters (June 24, 1992); *Progress on EC Capital Adequacy and Investment Services Directives*, *supra* note 12.

15. *New Law Allows Foreign Branches, Sets Rules for New Banks, Subsidiaries*, *supra* note 10, at 165.

16. HUNGARY INVESTMENT GUIDE, *supra* note 3, at 12. Lesser capitalization requirements apply in the case of certain types of specialized banking institutions.

17. Council Directive 89/646/EEC of 15 December 1989 On the Coordination of Laws, Regulations and Administrative Provisions Relating to the Taking Up and Pursuit of the Business of Credit Institutions and Amending Directive 77/780, 1989 O.J. (L 386) 1, art. 4.

Hungary[18] and Czechoslovakia[19] allow foreign ownership of domestic banks, with some restrictions, Czechoslovakia allows foreign banch branking[20] and the EEC allows ownership, branch banking and direct provision of services by foreign banks from member countries and from outside the EEC in certain cases.[21] An important issue recently resolved in the EEC involves bank access to stock exchanges.[22] The European Community recently decided to permit direct bank access subject to transition rules,[23] Czechoslovakia followed suit but Hungary resisted the measure, stating " '[n]aturally all these EC rules cannot be introduced immediately.' "[24]

Issues concerning listing and trading securities on national stock exchanges and trading securities off the exchanges have been the subject of vigorous international debate. British and German exchanges permit off-exchange trading while France, Italy and Spain prohibit it,[25] such disparate treatment contributing heavily to a year-long impasse over the EEC's Investment Services Directive.[26] The EEC recently reached a compromise pursuant to which member states may but are not obligated to require

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18. *New Banking Law Expected to Encourage Foreign Investment*, 1 E. Eur. Rep. (BNA) 152 (Dec. 9, 1991)("[f]oreign and domestic investors. . .will be limited to 25 percent of a bank's equity under the law").

19. *New Law Allows Foreign Branches, Sets Rules for New Banks, Subsidiaries*, *supra* note 10, at 164 (foreigners may open branch banks, bank subsidiaries or new banks subject to regulatory approval).

20. *Id.*

21. *See* Samuel Wolff, *Securities Regulation in the European Community*, 20 DENV. J. OF INT'L L. & POL. 99, 120-125 (Fall 1991).

22. Some EC member states, such as Germany, permit direct bank access to stock exchanges, while others, including France, Italy and Spain disallow it. Roberta S. Karmel, *The Stalled Investment Services Directive*, N.Y.L.J. 3 (June 18, 1992), *citing* Huang & Stoll, MAJOR WORLD EQUITY MARKETS: CURRENT STRUCTURE AND PROSPECTS FOR CHANGE 30 (1991).

23. *Progress on EC Capital Adequacy and Investment Services Directives*, *supra* note 12.

24. *New Banking Law Expected to Encourage Foreign Investment*, *supra* note 18, at 152. In the United States, banks may become stock exchange members but "the Glass-Steagall Act continues to make this freedom of access a nugatory right." Karmel, *supra* note 22.

25. Karmel, *supra* note 22.

26. *See id.*; *Finance Ministers Deadlocked On Off-Exchange Trading Regulations*, Int'l Sec. Reg. Rep. (BNA) 6 (Dec. 1990); *Off-Exchange Trade Compromise Unlikely to Succeed*, 4 Int'l Sec. Reg. Rep. (BNA) 4 (January 14, 1991). Professor Karmel summarized the EC debate as follows:

> [French proposals concerning off-exchange trading, transparency and bank access to stock exchanges] led to a North-South split, with the United Kingdom, Germany and the Netherlands arguing for latitude in the publication of trade information (to suit SEAQ International market makers); permission to engage in off-exchange trading (urged by the London Stock Exchange and the universal banks), and bank access to stock exchanges (of great importance to German banks). France, Italy and Spain, more interested in protecting their national brokers and retail investors, fought for prompt public reporting of trade information, the prohibition of off-exchange trading and the restrictioin of stock exchange membership to securities firms (which could be bank subsidiaries).

supra note 22.

that trading occur on the exchange or other regulated market unless the customer instructs otherwise.[27] In Hungary listed securities may not be traded off the Exchange[28] and, while Czechoslovakia's Stock Exchange Act permits listed securities to be traded off the exchange to the extent allowed by the stock exchanges,[29] the Bratislava Stock Exchange has determined to disallow the practice.[30] Czechoslovakia and Hungary thus have followed the French model in prohibiting off-exchange trading. Czechoslovakia and Hungary both permit foreign persons to become shareholders of domestic stock exchanges, subject to certain limitations.[31] A subsidiary of Credit Suisse First Boston based in Prague is one of twenty shareholders of the Prague Stock Exchange and several other applications from foreigners are pending,[32] while subsidiaries of both Citibank and Credit Suisse First Boston are shareholders of the Budapest Stock Exchange. Foreign securities may be traded on the Budapest Stock Exchange if they are issued in accordance with foreign law and otherwise meet applicable listing requirements.[33] Legislation in Czechoslovakia permits listing of foreign shares only if accepted by the stock exchange, and Bratislava has stated that at present foreign securities will not be listed.

§2. HUNGARY

§2.01 Overview

Hungary has, for the time being, avoided the political paralysis hindering the process of economic reform that characterizes the political climates of Poland and Czechoslovakia. Hungary should be regarded as the most stable of the three nations as well as a leader in the implementation of free market economic reforms. Hungary's success has much to do with the presence of a functioning government that has been able to pursue its objectives consistently since the parliamentary elections held in the spring of 1990. There can be, however, no absolute assurance that the process of reform will continue in light of the fragile political equilibrium that currently exists, although the prospects for reform appear to be much brighter than in any of the other former Council of Mutual Economic Assistance (CMEA) nations.

Following the parliamentary elections in 1990, a coalition government led by Jozsef Antall and dominated by the Hungarian Democratic Forum was established.[34] This coalition, somewhat weak to begin with, became

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27. *Progress on EC Capital Adequacy and Investment Services Directive*, *supra* note 12.

28. *See infra* note 66.

29. *See infra* note 234 and accompanying text.

30. *See infra* note 237 and accompanying text.

31. *See infra* notes 43, 234 and accompanying text.

32. *See infra* note 285 and accompanying text.

33. *Id.*

34. Barnabas Racz, *The Hungarian Parliament's Rise and Challenges*, RFE-RL RESEARCH REPORT, Feb. 14, 1992, at 22-23.

increasingly ineffective as economic benefits from the reforms failed to meet public expectations.[35] Progress on economic reform slowed as parliamentary activity became highly politicized and threatened to halt the transitional steps completely.[36]

The coalition government did not disintegrate, however, and continued gradual progress has been made toward necessary market reforms. The mere preservation of a fairly effective parliamentary process stands in marked contrast to the situations in Czechoslovakia and Poland.[37] As long as an effective government with a coherent program can be maintained, economic development and reform will likely press forward.

There is reason for a certain degree of optimism in this regard. The Hungarian economy, although still in transition, is by no means in as critical condition as the economies of Czechoslovakia and Poland. The 1991 inflation rate in Hungary was 35.2 percent, as compared to 46 percent in Czechoslovakia and 70 percent in Poland.[38] Hungary has compensated for the fall of the Soviet Union and the resulting loss of trade among former CMEA nations by focusing on expanding trade with western industrialized nations, especially the members of the Community.[39] Furthermore, Hungary signed an association agreement with the EEC in December of 1991, demonstrating its commitment to continue the process of economic reform in order to meet the criteria for EEC membership after an association period of ten years.[40]

A faltering of the current coalition government is a distinct possibility. Public opinion has been trending negatively toward the government and in the highly politicized environment of parliament, unpredictable events could fragment the current structure and slow or halt economic reform. Both internal and external pressures are at work; for example, pressures from a discontented citizenry displeased with a lack of benefits anticipated from the economic reforms may increase and disputes between Hungary and its neighbors concerning the fate of Hungarian minorities in Romania and Slovakia may arise.[41] In May and June, 1992

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35. *Id.*

36. *Id.*

37. *Id.* at 24. Despite the fragile foundations of the coalition government, it was able to pass 104 major legislative acts in 1990, which demonstrates the degree to which the Hungarian situation, however shaky, surpasses the deadlocked parliaments in Czechoslovakia and Poland. *Id.*

38. Karoly Okolicsanyi, *Hungarian Foreign Trade Turns From East to West*, RFE-RL RESEARCH REPORT, April 10, 1992, at 35 [hereinafter *Foreign Trade*]; Jan B. de Weydenthal, *Czechoslovakia, Hungary and Poland Gain Associate Membership in the EC*, RFE-RL RESEARCH REPORT, Feb. 7, 1992, at 26 [hereinafter *Associate Membership*].

39. *Foreign Trade*, *supra* note 38, at 34-36. Trade with western industrialized nations accounted for 70 percent of Hungarian trade in 1991, including a 48 percent increase in the amount of trade with the EEC. *See id.*

40. *Associate Membership*, *supra* note 38, at 24.

41. Interview with Professor Grzegorz Ekiert, Center for European Studies, Harvard University (Sept. 1992).

elections, voters expressed their dissatisfaction by voting for candidates of the main opposition party to the Hungarian Democratic Forum, the Free Democrats.[42]

Despite these obstacles Hungary has established a system of securities regulation and reestablished its stock exchange. The Act on Securities and the Stock Exchange (the Securities Act)[43] was adopted in January 1990 and is the principal law in Hungary concerning the issuance and trading of securities and establishment of the stock exchange. This law is interpreted and supplemented by the Hungarian State Securities Supervisory Board (the SSB)[44] and is soon to be amended.[45] Some of those amendments have been foreshadowed by amendments to certain rules of the Budapest Stock Exchange (the Exchange). In addition, the Hungarian Parliament in November 1991 adopted a law regulating investment funds.[46]

Hungary moved swiftly to reestablish the Exchange and after a forty-two year hiatus, the Exchange officially reopened on June 21, 1990.[47] In adopting the Securities Act, the government stated that a stock exchange was necessary in order "to facilitate efficient capital flows, asset valuations and to share risks inherent in fluctuations of quotations."[48]

Performance on the Exchange has been mixed. At the end of 1991, there were securities of twenty five issuers trading (six of which were listed) on the Exchange[49] and a total of about 14,500 transactions were executed in 1991.[50] In 1991, there were 19 new issues with a par value of

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42. HUNGARY INVESTMENT GUIDE, *supra* note 3, at 2 (Sept. 24, 1992).

43. Act VI of 1990 on the Public Issue of and Trade in Securities as well as on the Stock Exchange, *official translation as* Act on Securities and the Stock Exchange, Public Finance in Hungary, vol. 64 (Ministry of Finance, 1990)[hereinafter Securities Act]. The Securities Act is translated in the above source and also at 8 HUNGARIAN RULES OF LAW IN FORCE 447 (1990). The Ministry of Finance translation is relied upon here; however, the authors have also considered the other translation for purposes of interpretation. The Hungarian text of the Securities Act should be consulted in the case of actual transactions.

44. *See infra* text accompanying notes 50-59.

45. *See Likely Amendments to Securities Law*, MTI ECONEWS, Aug. 6, 1992 [hereinafter *Likely Amendments*].

46. Act LXIII of 1991 on Investment Funds, *unofficial translation*, 1991 U.S. Dep't. of Commerce - NTIS Central & Eastern Europe Legal Texts (Nov. 4, 1991) (LEXIS, Europe Library, EELEG file).

47. Reuter Textline, *Hungary: The Budapest Stock Exchange Re-Opens on June 21*, DIE PRESSE, June 19, 1990 (LEXIS, NEXIS library, Reuter File). *See also* DAVID E.BIRENBAUM & DIMITRI P. RACKLIN, 1 BUSINESS VENTURES IN EASTERN EUROPE AND THE SOVIET UNION: THE EMERGING LEGAL FRAMEWORK FOR FOREIGN INVESTMENT, ch. 3, n.54 (1990) [hereinafter *Business Ventures*] (describes the beginning of the Exchange in 1864, its closure in 1948 and the rebuilding of Hungarian securities markets started in 1983).

48. Securities Act, *supra* note 43, § 42(1).

49. HUNGARIAN INVESTMENT GUIDE, *supra* note 3, at 3 (Sept. 24, 1992).

50. Memorandum from Júlia Romhányi, Public Relations, Budapest Stock Exchange, to Daniel Nelson, Holme Roberts & Owen (Sept. 21, 1992) (regarding salient figures on the performance of the Budapest Stock Exchange in 1991).

approximately Ft 12.1 billion (about US $150 million).[51] Average daily trading volume was about Ft 40 million (about US $500,000) in 1991.[52] For the first six months of 1992, there were a total of about 5,700 transactions executed, four new issues with a par value of approximately Ft 165 million (about US $2 million) and an average daily trading volume of approximately Ft 111 million (about US $1.4 million).[53]

§2.02 Regulatory Authorities

As is the case in the United States and throughout Europe, regulation of securities markets is accomplished both by governmental and self-regulatory authorities.

[1] *State Securities Supervisory Board*

The SSB has the responsibility of administering, interpreting and enforcing the Securities Act and supervising the operations of the Exchange.[54] The SSB is a governmental agency that operates under the supervision of the Hungarian Ministry of Finance.[55] The head of the SSB is appointed by the Hungarian Council of Ministers[56] and the structure and operations of the SSB are set by the Ministry of Finance.[57] The principal offices of the SSB are located in Budapest.

The SSB has broad rule-making authority enabling it to determine those transactions subject to the Securities Act[58] and to expand the disclosure requirements for prospectuses.[59] In this capacity it is subject to applicable administrative procedure rules[60] and the oversight of the Ministry of Finance. The oversight authority of the Ministry of Finance, however, is limited in that it can neither annul nor revise rules adopted by the SSB.[61] Nevertheless, the final determinations of the SSB generally are subject to judicial review.[62] The exception to this general rule concerns decisions by the SSB to suspend the trading of securities on the

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51. *Id.*

52. *Id.*

53. Memorandum from Júlia Romhányi, Public Relations, Budapest Stock Exchange, to Daniel Nelson, Holme Roberts & Owen (Sept. 21, 1992) (regarding salient figures on the performance of the Budapest Stock Exchange in the first half-year of 1992).

54. Securities Act, *supra* note 43, § 4(2)-(3). The scope of the SSB's authority may be expanded to include the "Commodity Exchange." *Likely Amendments*, *supra* note 45.

55. Securities Act, *supra* note 43, §§ 4(1) and 6(1).

56. Currently the SSB is headed by Zoltan Pacsi. *Likely Amendments*, *supra* note 45.

57. Securities Act, *supra* note 43, § 6(2).

58. *Id.* § 4(3).

59. *Id.* § 8(4); *id.* at pmbl. § 8. The SSB has broadened the prospectus disclosure requirements with regard to securities traded on the Exchange. *See* Listing Rules, *infra* note 66.

60. Securities Act, *supra* note 43, § 4(4).

61. *Id.* § 4(5).

62. *Id.* § 4(6). Determinations of the SSB may not be appealed within the public administration system. *Id.* pmbl.to § 4.

Exchange.[63]

[2] *Budapest Stock Exchange*

The Budapest Stock Exchange is a self-governing and self-regulatory authority whose legal existence is authorized under the Securities Act.[64] Its activities, organization and functions are determined by its Charter[65] and Rules.[66] General parameters for the Charter and Rules of the Exchange are included under the Securities Act.[67] The Exchange's governing instruments must provide for, *inter alia*, a procedure for accepting, suspending, excluding, terminating and disciplining members[68] and a system of administering and applying sanctions.[69] Listing and quotation requirements must also be included.[70]

The highest governing body of the Exchange is the General Meeting of members of the Exchange, which meets at least annually.[71] Only the General Meeting may amend the Charter, elect and remove officers of the Exchange, approve the budget and approve extraordinary matters such as liquidation, reorganization or combination involving the Exchange.[72] Each member is entitled to one vote;[73] however, a member may be denied its vote if it fails to meet certain trading performance criteria.[74]

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63. *See* Securities Act, *supra* note 43, §§ 4(6), 69-71.

64. *Id.* § 42. It should be noted that the Securities Act does not prohibit the creation of more than one stock exchange in Hungary; rather, the Securities Act sets forth certain conditions that must be met for founding an exchange. *Id.* pmbl. to § 42. To date, the only stock exchange existing in Hungary is the Budapest Stock Exchange.

65. Charter of the Budapest Stock Exchange (June 19, 1990) (as amended Nov. 16, 1990) [hereinafter Charter].

66. The rules of the Exchange include, *inter alia*, Rules Regarding the Transactions to be Carried Out on the Stock Exchange and Trading on the Floor of the Stock Exchange (Oct. 5, 1990) (as amended May 9, 1991, Sept. 6, 1991, Dec. 6, 1991) [hereinafter General Rules]; Rules Regarding the Requirements of the Listing and Trading of Securities on the Stock Exchange (Jan. 10, 1992) [hereinafter Listing Rules]; Rules of Settlement (May 24, 1991); Rules Regarding the Depository of the Budapest Stock Exchange (July 30, 1992) [hereinafter, collectively, Rules]. The General Rules have been amended since December 6, 1991; however, they are not currently available in English translation. Letter from The Budapest Stock Exchange to Holme Roberts & Owen (Oct. 6, 1992). The Securities Act requires that the Charter and Rules of the Exchange and foundation of the Exchange be approved by the Council of Ministers upon motion of the Ministry of Finance. Securities Act, *supra* note 43, § 43(2)-(3). Approval of the Rules has been delegated to the SSB.

67. Securities Act, *supra* note 43, § 44.

68. *Id.* § 44(1).

69. *Id.* § 44(1). Although the Securities Act is not explicit on this point, presumably such rules must provide a fair procedure. *Cf.* U.S. Securities Exchange Act of 1934, §§ 6(b)(6) and (7), as amended by Pub. L. No. 94-29 § 4 (1975, § 15A(b)(6), as amended by Pub. L. No. 94-29 § 12(2) (1975), 15 U.S.C. §§ 78f(b)(5) and (i)0o(b)(6).

70. Securities Act, *supra* note 43, § 44(2).

71. Charter of the Budapest Stock Exchange, *supra* note 65, § VII (A)(13).

72. *Id.* § VII(A)(2).

73. Securities Act, *supra* note 43, § 52(2); Charter, *supra* note 71, § VII(A)(13).

74. Charter, *supra* note 65, § VII(A)(14) (stating a member "who had traded less than 10 percent of the average trading volume or number of transactions per Member during the

The Stock Exchange Council is the chief managing body of the Exchange, the members of which are elected by the General Meeting.[75] Members of the Stock Exchange Council represent many distinct constituencies, including the members of the Exchange, issuers of listed securities, investors and stock exchange dealers.[76] The Stock Exchange Council is responsible for, *inter alia*, determining the Rules of the Exchange, admitting new members, supervising Exchange activities and suspending trading on the Exchange.[77]

The Exchange also has several other bodies within its organizational structure. The Charter establishes a Supervisory Committee to oversee the finances and operations of the Exchange.[78] It establishes an Ethics Committee to promote fairness in trading on the Exchange[79] and a Securities Trading Committee responsible for trading operations, information collection and dissemination and registration procedures, among other things.[80]

§2.03 Securities Markets

The distribution market is the market in which companies first issue securities to the public.[81] The distribution or primary market is distinct from the trading or secondary market in that special selling efforts, for example, by the issuer or a licensed underwriter are made. Conditions for sale in the distribution market under the Securities Act are discussed below together with the requirements for becoming a licensed underwriter.[82]

Securities traded in the secondary market on the Exchange may be either listed or unlisted, but in either case must meet certain basic criteria. The main distinction between listed and unlisted securities in this regard is that the former must meet certain requirements over and above the minimum ones.

The Listing Rules set forth several basic criteria for admission of securities (listed or unlisted) to the Exchange, including: (1) the securities must be issued in accordance with Hungarian law,[83] (2) the issuer must

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one year preceding the General Meeting, is not entitled to vote").

75. *Id.* § VII(B)(3.1). The number of its members may range from five to thirteen. *Id.* § VII(B)(4).

76. *Id.* § VII(B)(3.1)-(3.3). The representative for issuers is nominated by the Hungarian Chamber of Commerce and the SSB nominates the representative for investors. *Id.* § VII(B)(3.3).

77. *Id.* § VII(B)(2).

78. *Id.* § VII(C)(1).

79. *Id.* § VII(D)(1). The Securities Act contains provisions applicable to the Exchange in order to promote fair trade in securities and prevent manipulative acts and practices. *See* Securities Act, *supra* note 43, pmbl. to §45.

80. Charter, *supra* note 65, § VII(E).

81. Technically, the distribution market also includes "secondary distributions," *i.e.*, public offerings by selling shareholders.

82. *See infra* notes 202-211.

83. Listing Rules, *supra* note 66, II(1.1)(a). Foreign securities may be traded on the

apply to the Exchange for admission,[84] (3) the issuer must meet the prospectus delivery[85] and periodic reporting requirements under the Listing Rules,[86] (4) the issuer must not have been subject to a bankruptcy or insolvency proceeding within two years before listing,[87] (5) the issuer must hold a public offering permit from the SSB,[88] (6) the admission must be sponsored by a member of the Exchange whose role as a sponsor must be indicated in the issuer's prospectus which such member must sign and the member must act as a market maker in the securities for a specified period[89] and (7) certain technical provisions must be satisfied.[90]

In addition to the basic criteria, securities traded on the Exchange, but not listed, must meet the following requirements: (1) the par value of the issue must exceed Ft 100 million,[91] (2) at least ten percent of the issue or at least Ft 200 million in value (based on the market price of the securities) must be publicly owned,[92] (3) there must be at least twenty five owners of the issue,[93] (4) the issuer or its predecessor must have at least one year end balance sheet audited by an auditor registered with the Exchange[94] and (5) such securities may not be traded other than on the Exchange.[95]

The stricter requirements for listing on the Exchange include the basic criteria and those requirements for securities traded on the Exchange specified above, plus: (1) the total value of the issue must be at least Ft 200 million,[96] (2) at least twenty percent of the issue or at least Ft 500

Exchange as well if such securities are issued in accordance with the law of the foreign jurisdiction. *Id.*

84. *Id.* § I(6). In the case of bonds issued by investment funds, the fund manager must apply for admission. *Id.* t § II(1.1)(a).

85. In the case of an application for listing by an issuer of a traded but unlisted security, a supplementary prospectus must be delivered to the Exchange. *See id.* § III(4).

86. *Id.* § II(1.1)(c) *See infra* notes 170-83 and accompanying text.

87. Listing Rules, *supra* note 66, § II(1.1)(d).

88. *Id.* § II(1.1)(f).

89. *Id.* § II(1.1)(g). If the security admitted to the Exchange is a new issue, the member-sponsor must act as a market maker in the security during the first 15 days of trading on the Exchange. During that period the member must offer to purchase or sell at least Ft 300,000 (at market value) of the securities each day. *Id.*

90. *See id.* § II(1.2) (specifies that denominations and float should be set to facilitate trading, among other things).

91. *Id.* § II(1.3)(a).

92. *Id.* § II(1.3)(b). For purposes of the Listing Rules, securities held by less than five percent holders and those owned by public investment funds and securities in foreign custody are counted for determining the amount of securities publicly owned. Listing Rules I(5). In addition, for an issuer relying on the 10 percent standard to meet the trading requirements, the value of the securities publicly held must be at least Ft 50 million. *See id.* § II(2.2).

93. *Id.* § II(1.3)(c).

94. *Id.* § II(1.3)(d). The Listing Rules specify only that a balance sheet be audited and do not expressly require any other financial statements. *Id.*

95. *Id.* § II(1.3)(e). *Cf. infra* note 100. *See also supra* note 3, 25-31 and accompanying text for a discussion of off-exchange trading.

96. Listing Rules II(1.4)(a). This requirement probably relates to the par value al-

million in value (based on the market price of the securities) must be publicly owned,[97] (3) there must be at least fifty owners of the issue,[98] (4) the issuer or its predecessor must have been in business for at least three years and the financial statements for such years must have been audited by an auditor registered with the Exchange[99] and (5) such securities may not be traded other than on the Exchange.[100] If the issuer fails to meet these requirements after becoming listed, after a six month period during which the issuer may remedy any default, the Stock Exchange Council may de-list the security but continue to allow it to trade on the Exchange.[101]

Generally certain fees must be paid for all securities upon admission to the Exchange. For an unlisted security to be traded an admission fee of Ft 400,000 (Ft 200,000 in the case of investment bonds) is required.[102] For an unlisted or other security to be listed, a Ft 200,000 listing fee in the case of investment bonds and Ft 400,000 listing fee in the case of other securities must be paid to the Exchange.[103] In addition, a continuous trading fee must be paid annually for securities whether listed or not.[104] The primary exception to this general rule is for Hungarian government securities which are not subject to any admission or listing fee.[105]

§2.04 "Security" Defined

The Securities Act does not set forth a general definition of "securities" nor does it define what "transactions" are covered. Those provisions are left to the general provisions of the Civil Code[106] and interpretations of the SSB.[107] Thus, Section 2 of the Securities Act provides:

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though the translation does not expressly so state.

97. *Id.* § II(1.4)(a). In addition, for an issuer relying on the 20 percent standard to meet the listing requirements, the value of the securities publicly held must be at least Ft 200 million. *See id.* § II(2.3).

98. *Id.* § II(1.4)(c).

99. *Id.* § II(1.4)(d).

100. *Id.* § II(1.4)(e) The requirement as to compulsory trading of listed securities on the Exchange differs from that concerning unlisted but traded securities in that the latter may apparently be traded off the Exchange under certain defined circumstances. *See id.* §§ II(1.3)(e) and (1.4)(e).

101. *See id.* § III(1.4)(c). The issuer, on its motion, may also request that its securities be de-listed. *Id.* § III(4)(d). Once de-listed, the security may not be listed again for one year from the date of the Stock Exchange Council's de-listing resolution and the issuer forfeits any listing fee. *Id.* §§ III(4)(e)-(f). There are also several conditions on which listing may be canceled. *See id.* § IV.

102. *Id.* § V(2.1).

103. *Id.*

104. *Id.* § V(2.2). Bonds and investment fund securities are entitled to a 20 percent and 50 percent discount, respectively, from the otherwise applicable continuous trading fees. *Id.*

105. *Id.* at § II(4.1). Government securities are exempt from the listing requirements otherwise applicable to other securities. But certain data is required in the application for admission. *Id.* at II(4.2).

106. Securities Act, *supra* note 43, pmbl. pt.a.

107. The Listing Rules of the Exchange specify investment bonds issued by closed-end

> The public issue of, and the trading in the following securities are governed by this Act:
> a. bonds (unless transferability is constrained either by law or the issuer),
> b. shares, and
> c. all other types of securities representing transferable rights and obligations arising from a legal relationship (lending or membership) between the issuer and the securities holder, issued in large series in accordance with the provisions of Act IV:1959 on the Civil Code in ways and forms as defined therein.[108]

Under the Civil Code, securities include debt instruments such as bonds[109] and shares representing interests in companies.[110] Certain instruments that would otherwise fall within the definition of securities for purposes of the Civil Code, however, are excluded from the purview of the Securities Act. Thus, checks, deposit savings instruments, certificates of deposits, credit notes, target credit notes of and business stakes in cooperatives, and bills of exchange are excluded.[111]

§2.05 Public Offerings of Securities

[1] *Prospectus Filing and Approval*

If securities are publicly offered by an issuer in Hungary, the offering will generally require the filing of a prospectus with and approval of the prospectus by the SSB.[112] This filing and approval process has as its objectives to create "a transparent and well-informed securities market" and to provide investor protection.[113] SSB approval does not amount to approval or endorsement of the issuer or the offered securities, but "only

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investment funds, government securities and compensation notes (form of security issued by the National Compensation Office) in addition to those specified in the Securities Act. *See* Listing Rules, *supra* note 66, at §§ II(3)-(4).

108. Securities Act, *supra* note 43, § 2(1). The Securities Act defines "bonds" as a credit relationship "in which the issuer (the debtor) acknowledges receipt of a certain amount of money and binds himself to repay the amount received (principal) as well as the interest or any other yield (hereinafter interest) calculated in a predetermined manner for interest-bearing securities and to render other services to the securities holders (creditors)." *Id.* § 3a. "Shares" are defined as a security "in which the issuer acknowledg[es] the receipt for possession or use of a certain amount of money or other property, whose value has been determined in terms of money and binds himself to assign certain proprietary or other rights to the holders of such securities." *Id.* § 3b.

109. *See* Civil Code, ch. XXVIII/A, § 338/A(2) ("A document possessing the requisites determined by statute and issue (drawing) of which is allowed by statute shall be considered a security"). Shares, bonds, exchequers' bills, deposit savings bonds, property certificates, bills of exchange and checks are referenced. Securities Act, *supra* note 43, § 2(2)(a).

110. *See* Civil Code, ch. XXVIII/A, § 338/C ("A security may be drawn - according to separate legal rule - on ownership or another right concerning a thing or on an entitlement originating from membership as well").

111. Securities Act, *supra* note 43, § 2(2)(b).

112. The term "prospectus" is not defined in the Securities Act.

113. Securities Act, *supra* note 43, pmbl. to §23.

implies that the [p]rospectus includes the data and analyses as required by the provisions of the [Securities] Act."[114]

In Hungary, the issuer may publicly offer its securities directly or enlist a licensed underwriter to act in its stead.[115] If the issuer enlists an underwriter, the underwriter rather than the issuer must secure approval of the SSB under the Securities Act; otherwise the issuer must obtain such approval.[116] In either case, the prospectus must be approved before its publication, which approval becomes stale thirty days from the date upon which approval was granted.[117] The issuer or the underwriter as the case may be is required to make "post-effective" amendments to the prospectus after approval by the SSB but before the closing of the offering.[118] Such amendments, however, need only be made with respect to "essential facts or circumstances."[119] Post-effective amendments may be ordered by the SSB on its own motion.[120] Failure to obtain approval of a prospectus by the SSB makes the issuance and sale of securities on the basis of such prospectus null and void.[121]

[2] *Issuer-Specific Public Offering Preconditions*

In addition to the prospectus approval requirements, the Securities Act contains several conditions to the public issuance of securities. For bonds and debentures, the issuer must have at least a twelve-month operating history.[122] Apparently an issuer may tack the operating history of its predecessor to meet the operating history requirement. The purpose of the operating history requirement is to provide potential investors with historical information enabling them to appraise the investment risk associated with the offered securities and the issuer's past results and performance.[123] Public offerings of bonds and debentures generally must be accomplished through a licensed underwriter.[124] The Securities Act exempts issuers of shares in an initial public offering from the operating

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114. *Id.* pmbl. to §8.

115. In the case of a public offering of bonds or debentures, the issuer generally must enlist a licensed underwriter. *Id. See infra* note 124 and accompanying text.

116. Securities Act, *supra* note 43, § 8(2).

117. *Id.* §§ 8(1) and (5). It should be noted, however, that at the issuer's request, the SSB may extend by sixty days the subscription period and presumably extend the date upon which the prospectus becomes stale. In such event the SSB may require the issuer to update the prospectus. *Id.* § 32(1).

118. *Id.* § 9(2). The term "post-effective" is used by analogy from the concept of a registration statement being declared effective under the U.S. securities laws. There is no procedure under the Hungarian Securities Act for the SSB to declare a prospectus effective.

119. *Id.*

120. *Id.* § 9(3).

121. *Id.* § 24(a).

122. *Id.* § 23(1)(a). This requirement does not apply with respect to securities issued by the Hungarian government. *Id.*

123. Securities Act, *supra* note 43, pmbl. to § 23.

124. Securities Act, *supra* note 43, § 23(1)(c). and pmbl. to § 23. This rule does not apply to financial institutions that issue their own bonds. Securities Act § 23(1)(c).

history requirement; however, where the public offering of shares would increase the issuer's registered capital, the operating history requirement applies.[125] This exemption seems aimed at facilitating access to capital markets by newly established issuers.[126]

[3] *Contents of the Prospectus*

The contents of the prospectus are prescribed by the Securities Act the requirements of which may be supplemented by the SSB.[127] More complete disclosure guidelines have been adopted with respect to securities that are admitted to trade on the Exchange.[128] The Securities Act requires that a prospectus include: (1) a description of the issuer[129] and its business,[130] (2) current certified financial information,[131] (3) use of proceeds disclosure,[132] (4) a description of the share capital of the issuer and the securities to be issued,[133] (5) other information about the offering,[134]

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125. Securities Act, *supra* note 43, §§ 23(2) and (3). It is unclear under what circumstances a public offering would not increase registered capital; thus, this exception appears inconsequential. Increases in registered capital are discussed in Act VI of 1988 on Economic Associations, §§ 301-309. *See also* Securities Act § 27 (discussing use of prospective information in the prospectus).

126. Securities Act, *supra* note 43, pmbl. to § 23.

127. *See supra* note 59 and accompanying text. The disclosure required by the Securities Act should be compared to that required under Regulation S-K in the U.S. Some items of disclosure are similar, although Regulation S-K is much more detailed. Nevertheless, the drafters of the Securities Act seemed to have contemplated that capital markets would work to cause issuers to follow international practice in preparing their prospectuses. Securities Act, *supra* note 43, pmbl. to § 26. It was announced recently, however, that the SSB has begun work on amendments to the Securities Act that will include more thorough disclosure guidelines applicable to Prospectuses. *See Likely Amendments*, *supra* note 45.

128. *See infra* notes 129-131, 136-137.

129. Such description must include the name of the issuer, its address, date of foundation, the scope of its activities, its duration (*i.e.*, whether perpetual or limited), the amount of its registered capital, number of employees and information concerning the experience and qualifications of its senior management and directors. Securities Act, *supra* note 43, § 26a. The Listing Rules require that the prospectus specify the following additional information about the issuer: (1) a breakdown of registered capital at formation and at the time of drafting the prospectus, (2) the date of the issuer's contract of association, (3) its fiscal year and (4) place where the issuer publishes announcements. Listing Rules, *supra* note 66, § II(6.2.1). As to employees, the issuer also must disclose the average incomes of employees comparing such current amounts with those applicable to prior years. *Id.* § II(6.2.10).

130. The issuer's business must be described in depth and include "information about production, sales, [research and development] and investments." Securities Act, *supra* note 43, § 26(b). *Cf.* Listing Rules, *supra* note 66, § II(6.2.6).

131. Securities Act, *supra* note 43, §§ 25(2) and 26(c). The Listing Rules require both summary and more detailed financial information. Listing Rules, *supra* note 66, §§ II(6.2.3) and II(6.2.8). Some consolidation of financial information concerning the issuer's subsidiaries may be required. *See id.* § II(6.2.8).

132. Securities Act, *supra* note 43, § 26(d)(2).

133. *Id.* §§ 26(d)(3) and (4).

134. The Securities Act enumerates the following: (1) the governing body of issuer deciding to make the offering and the date of that body's decision, (2) the amount of funds to be raised, (3) the number of the series and serial numbers of securities to be offered, (4) the

(6) a description of the procedures that will be followed in the event of over- or under-subscription,[135] (7) a discussion of the history of prior offerings of the issuer's securities,[136] (8) disclosure as to the security holdings of the issuer's senior management,[137] (9) disclosure of major risk factors concerning the issuer's business,[138] (10) a statement that the issuer and underwriters, if any, are jointly and severally liable for any damage incurred by the holder of securities as a result of misleading information in the offering materials[139] and (11) a statement of the role of the public prosecutor and the SSB in protecting investors.[140]

If bonds or debentures are offered, the prospectus must include, in addition to the disclosure described above, a description of the bonds or debentures including their maturity, terms and conditions and any financial guarantees underlying such instruments.[141] In the event that a legal entity is a guarantor of such instruments, information about such guarantor must be included.[142]

The Listing Rules contain special rules with respect to disclosure for investment fund securities. No such rules are included in the Securities Act. Those rules require, *inter alia*, (1) the disclosure of the fund's investment and dividend policies, (2) a description of the fund's portfolio, (3) the method of calculating the sales price of investment bonds, (4) a description of fees, (5) rules regarding distribution or reinvestment of the fund's assets, (6) a description of the fund manager and (7) risk factor disclosure.[143]

[4] *Delivery and Publication Requirements*

The Securities Act contains no specific prospectus delivery require-

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opening and closing date of the subscription and the place of subscription, (5) the opening and closing date of the sale and place of sale, (6) a description of preemptive rights, (7) the expected price at issuance and (8) the identity of the underwriter. *Id.* § 26(d).

135. *Id.* § 26.d.13. *Cf.* Act VI of 1988 on Economic Associations §§ 255 (describing over-subscription in the case of the initial foundation of a joint-stock company) and 256 (describing under-subscription procedures).

136. Securities Act, *supra* note 43, § 26(e). The amount of funds raised in previous offerings must be described. The Listing Rules require special emphasis on public offerings within one year prior to admission on the Exchange and contain a detailed list of items that must be covered in such disclosure. *See* Listing Rules, *supra* note 66, § II(6.2.5).

137. Securities Act, *supra* note 43, § 26(f). The Listing Rules require a list of the "major" owners of the issuer and their share ownership. Listing Rules, *supra* note 66, § II(6.2.2) ("major" is not defined).

138. Securities Act, *supra* note 43, § 29(3). The drafters of the Securities Act contemplate highlighting the risk factors by printing them in red or other colors that differ from the rest of the print used in the prospectus and using a prominent typeface. *Id.* pmbl. to §29.

139. *Id.* §§ 29(4) and 83.

140. *Id.* §§ 29(4) and 84.

141. *Id.* § 28.

142. *Id.* § 29(2). *See also* Listing Rules, *supra* note 66, § II(6.2.4).

143. Listing Rules, *supra* note 66, §§ II(6.3)(a)- (d).

ment. An offer can be made by advertisement[144] but only after such advertisement and the prospectus are approved by the SSB.[145] The advertisement must include a statement about the fact of the public offering, the SSB approval number and the location, time and method of inspecting the prospectus.[146] The advertisement must "be published in two national daily newspapers as well as the official gazette of the [Exchange] at least seven days before subscription."[147]

The Securities Act does not deal specifically with the release of information about an issuer after the issuer's determination to make a public offering of its securities but before the prospectus is approved by the SSB. As discussed above, however, clearly it would be impermissible for an issuer to advertise the fact of a proposed public offering before such approval. Moreover, any issuance or sale of securities will be null and void if such issuance or sale precedes an approved prospectus.[148] In addition, the Securities Act provides that subscriptions may be accepted only during the subscription period.[149] What is lacking then are the parameters of what may be released by an issuer that may be tantamount to "conditioning the market" for the proposed public offering. Clearly, the Hungarian government and the SSB will have to consider clarifying or adding rules applicable to "gun-jumping" by issuers and underwriters.

The Securities Act's treatment of issues such as the timing of subscription and the issuance and sale of securities is unclear. The Securities Act defines "subscription" as "the process whereby customers, intent upon purchasing securities as a result of the public offering, sign the subscription-sheet, undertaking in accordance with the said sheet to make either a cash payment or pledge non-cash assets to be made available to the issuer via" the underwriter.[150] By operation of Section 30 of the Securities Act, which contains the seven-day, pre-subscription advertisement requirement, Section 23(4), which requires SSB approval prior to advertisement, Section 8(5), which sets forth a thirty-day period after which the prospectus becomes stale and Section 32(1), which contains the sixty-day subscription period extension rule, it appears that the subscription period may begin no earlier than seven days after SSB approval and will close within thirty days after SSB approval unless extended for an additional sixty-day period. The closing date for the offering, however, may occur before the designated closing date if the offering is fully subscribed and the option to have a sooner closing date was disclosed in the prospectus.[151]

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144. Securities Act, *supra* note 43, § 30.
145. *Id.* § 23(4).
146. *Id.* § 30.
147. *Id.*
148. *Id.* § 24.
149. *Id.* § 32(4).
150. *Id.* § 3(m).
151. *Id.* § 32(2). The results of the offering must be reported to the SSB within seven days following the closing of the subscription period. *Id.* § 32(3).

How the foregoing will work in the context of a managing underwriter assembling an underwriting syndicate for a firm commitment underwriting is unclear. In that context it is standard practice in the U.S., for example, for a managing underwriter to assemble an underwriting syndicate after the filing of a registration statement but before the registration statement is declared effective. The commitments of the underwriting and selected dealers groups then are memorialized in underwriting and selected dealer agreements that generally set the number of shares agreed to be purchased, the public offering price, the underwriters' discount and dealers' commissions. Presumably such activities by the underwriters and selected dealers will not be deemed a part of the subscription; otherwise the Securities Act would unnecessarily frustrate these important selling efforts.

[5] *Filings Required by the Exchange*

For a security that will be traded on the Exchange, in addition to the advertisement required in the Exchange's official gazette,[152] the Listing Rules of the Exchange require a prospectus to be delivered[153] and compliance with certain periodic reporting requirements.[154] The Listing Rules specify the same type of information be included in a prospectus delivered to the Exchange as that prepared under the Securities Act; however, the Listing Rules are more detailed than the Securities Act and in some cases provide for disclosure necessary to analyze whether the issuer meets the requirements for trading on the Exchange. The prospectus disclosure requirements are discussed above.[155] The periodic reporting requirements under the Listing Rules of the Exchange are much more detailed and more extensive than those specified under the Securities Act.[156] An issuer must publish a quarterly report and submit it to the Exchange for each quarter including year end.[157] The annual report of the issuer prepared under Law XVIII of 1991 on Accounting[158] (the Accounting Law) must be submitted to the Exchange.[159] The Listing Rules to some extent also track the Securities Act with regard to interim reporting of certain events.[160] Matters that must be included in such periodic reports are dis-

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152. *See supra* text accompanying note 144.

153. Listing Rules, *supra* note 66, § II(6.1).

154. *Id.* §§ III(1)-(3).

155. *See infra* text accompanying notes 127-143.

156. *See* Listing Rules, *supra* note 66, § III and discussion *infra* § 2.07.

157. Listing Rules, *supra* note 66, § III(1.1). These reports are referred to as "quick" reports and are similar to the Form 10-Q reports required under the U.S. securities laws. Quick reports must contain financial information, changes in the issuer's structure, changes in share ownership and an assessment of the quarter plus a summary of all extraordinary interim reports. *Id.*

158. Law XVIII of 1991 on Accounting (May 14, 1991), *unofficial translation*, II/15 HUNGARIAN RULES OF LAW IN FORCE (Aug. 1, 1991).

159. Listing Rules, *supra* note 66, § III(1.2.1).

160. *Id.* § III(3) and discussion infra § 2.07.

cussed below.[161]

§2.06 Exempt Offerings

The Securities Act exempts from its coverage the non-public issue of securities.[162] This exemption is similar to that available under Section 4(2) of the U.S. Securities Act of 1933 for transactions not involving a public offering.[163] The "public issue" of securities is defined as the sale of securities by a public offering.[164] For there to be a "public offering" two conditions must be satisfied. First, a statement calling for the purchase of or subscription for securities must be published either in the press or in other media.[165] Second, the statement must be aimed at potential customers whose range has not been predetermined.[166]

Although private placements are likely to be a significant part of the Hungarian capital markets, the uncertainties regarding the scope of the Securities Act and its application to such transactions will be determined by practice over time. Obviously, the contours of a non-public offering are not well defined by the Securities Act and will be interpreted by the SSB and Hungarian courts and possibly future law. Until then one should, at a minimum, rely on international standards concerning private placements, *i.e.*, deal with only sophisticated investors, limit the size and scope of the offering, avoid anything which could be deemed a publication constituting a solicitation of offerees and the like.[167]

§2.07 Periodic Reporting Requirements

The Securities Act requires issuers of securities to report periodically to the SSB, the Exchange, security holders and the public.[168] As described above, the reporting requirements under the Listing Rules of the Exchange differ in certain respects from the requirements of the Securities Act.[169]

[1] *Annual Reports*

An issuer's annual report must be prepared according to the provisions of the Accounting Law, and include the issuer's financial statements and a report on the issuer's business.[170] Issuers must file with the SSB

161. *See* accompanying text *infra* notes 172-176, 178, 180-82.

162. Securities Act, *supra* note 43, § 2(2)(a).

163. 15 U.S.C. § 77d(2) (1988).

164. Securities Act, *supra* note 43, § 3(n).

165. *Id.* § 31.

166. *Id.*

167. An issuer or other person contemplating an actual private placement or other transaction in Hungary should consult with counsel prior to the transaction.

168. *See* Securities Act, *supra* note 43, §§ 33-4.

169. *See supra* text accompanying notes 154-160.

170. Listing Rules, *supra* note 66, § III(1.2.1). Under the Securities Act the annual report must include: (1) a summary of events of the issuer for the year covered by the annual

and deliver to security holders an annual report by May 31 following the end of the year for which the annual report is prepared.[171]

The annual report must include: (1) general information about the issuer;[172] (2) a description of its share capital, including, *inter alia*, classes of securities, their par values, their denominations (apparently for debt securities), rights attaching to such securities and changes in such rights during the past year;[173] (3) disclosure about the issuer's management and employees, such as share ownership of senior management, changes in senior management and information concerning the number of employees and wages;[174] (4) information about the business of the issuer and an analysis of its financial position, including the prospects and plans of the issuer for the current year and a "description of all. . .factors which are necessary for the assessment of the Company;"[175] and (5) an updated risk factor disclosure.[176]

[2] *Quarterly "Quick" Reports*

Issuers with securities listed on the Exchange, in addition to annual reports, must publish and file quarterly reports (referred to as "Quick" reports) with the Exchange.[177] Quick reports must be filed within 30 days after the end of each quarter, presumably the calendar quarter. A Quick report is required at the end of the year even though much of the information contained in that report will otherwise be included in the issuer's annual report.

Quick reports are required to include certain financial information about the issuer, changes in the issuer, its management and employees

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report, (2) certified financial statements for that year and an auditor's report, (3) material information regarding new issuances of the issuer's securities during the year and (4) a description of new senior management employed during the year. Securities Act, *supra* note 43, § 33(4). At the time of this writing, the SSB had begun work on amendments to the Securities Act that would provide for fuller disclosure guidelines applicable to annual reports. *See Likely Amendments*, *supra* note 45.

171. Securities Act, *supra* note 43, § 33(3). The annual report must also be delivered to the Exchange by such date. Listing Rules § III(1.2.1). Investment funds must prepare a biannual report in accordance with the Accounting Law and submit such report to the Exchange by August 29 of the applicable year. *Id.* § III(1.2.4). Investment funds must also prepare and submit annual reports within 120 days after the end of their business year. *Id.* § III(1.2.5).

172. Specifically, the general information must include, *inter alia*, the date of the issuer's foundation, the location of its headquarters, the date of its incorporation (or the equivalent), the amount of the issuer's initial capital and current capital, the activities for which it is registered to undertake, the identity of its auditors and a description of its ownership structure. Listing Rules, *supra* note 66, § III(1.2.3)(b).

173. *Id.* § III(1.2.3)(b).

174. *Id.* § III(1.2.3)(c).

175. *Id.* §§ III(1.2.3)(d)-(e). Apparently, the Listing Rules contemplate a discussion of "material" factors.

176. In particular, the Listing Rules require that "[a]ny changes in risk factors occurring in the course of the year" be disclosed. *Id.* § III (1.2.3)(f).

177. *Id.* § III(1.1).

and the share ownership of its management, changes in ownership affecting five percent or more of the issuer's share capital and an assessment of the issuer during the reporting period including a summary of any interim event reports issued during such period.[178]

[3] *Interim Reporting of Extraordinary and Certain Other Events*

Interim reporting is required with respect to certain extraordinary events. To the extent the issuer has published previously any untrue statement that may affect the value of the issuer's securities, the issuer has an obligation to publish corrective information.[179] Examples of reportable events include: (1) proposed or actual changes in the rights of security holders, (2) an issuance of new securities, (3) the declaration of dividends, (4) conclusion of an agreement that includes securities transfer restrictions, (5) a change in the issuer's business activities, (6) regulatory and other changes in law that may affect the issuer's performance, (7) changes in senior management and other key personnel, (8) a significant change in ownership of the issuer's share capital, (9) a merger, consolidation, reorganization or other substantial change to the issuer's organization,[180] (10) the loss of ten percent or more[181] of the issuer's capital assets, (11) material legal proceedings initiated against the issuer, (12) the loss of material subsidies, (13) a material debt undertaking or issuance of securities by the issuer and (14) the announcement of a General Meeting of security holders.[182]

At present the time for disclosure of such events differs under the Listing Rules and the Securities Act. Issuers must report such events to the Exchange within one business day and to the SSB and the public within two days from the date of such event, provided that the event was not previously referenced in the issuer's most recent periodic report.[183]

§2.08 Insider Trading

Part VI of the Securities Act contains the provisions directed at trad-

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178. *Id.* §§ III(1.1.a)-(d). There is no requirement that the financial information included in such report be audited.

179. Securities Act, *supra* note 43, § 34(3). The correction must be published within two working days. *Id.*; Listing Rules § III(2.4). The Securities Act and the Listing Rules, however, do not specify when the two-day publication requirement begins to run. The period probably commences from the date the issuer discovers the untrue statement, although arguably it could begin on the date the issuer should have discovered the untrue statement.

180. Stock splits are dealt with under separate regulation in the Listing Rules, however, such events are reportable as extraordinary events requiring interim reporting. *See* Listing Rules, *supra* note 66, § III(2.1).

181. The Listing Rules set forth a 15 percent criterion. *Id.* § III(2.1).

182. *See* Securities Act, *supra* note 43, § 33(2); Listing Rules, *supra* note 66, § III(2.1).

183. Securities Act, *supra* note 43, § 34(1); Listing Rules, *supra* note 66, § III(2.1). Section 34 of the Securities Act contains a two day notification requirement with respect to the Exchange, however, until amended, the rule, at least for issuers whose securities are admitted for trading on the Exchange, is one day.

ing on the basis of inside information.[184] The Securities Act prohibits the entering into and payment of commissions with respect to securities transactions if insiders are involved or if such transactions are based on inside information.[185] The trading of securities in such transactions is referred to as "insider trading."[186]

The Securities Act defines inside information and enumerates certain classes of persons that are insiders. Inside information includes certain non-public information that "may materially influence either the value or the quotation of the securities."[187] For purposes of the Securities Act, insiders include "senior staff members or senior managers of the issuer, traders in securities or the legal entity in which the issuer has a major stake, or which has a major stake in the issuer . . . as well as those of the bank keeping the accounts of the issuer;" relatives of such persons; ten percent holders and their relatives; and auditors, legal counsel and tax consultants who within six months prior to the suspect transaction were employed or had some other relationship with the issuer.[188] In addition a tippee may be an insider if he has been given inside information or could have had access to such information and was aware that the information acquired was inside information.[189]

Liability runs not only to the insider undertaking a transaction for his own benefit, but also vicariously for transactions undertaken for the benefit of third parties.[190] Insider trading is presumed in the event of a purchase and sale or a sale and purchase of securities by certain statutory insiders[191] within a three-month period.[192] However, unlike Section 16(b) liability under the U.S. Securities Exchange Act of 1934, which imposes strict liability for certain transactions by specified insiders within a six-month period, the Securities Act provides a defense in the event that the insider can prove he had no inside information available to him.[193] The insider's burden of proof in such circumstances will probably be extremely difficult to satisfy and, thus, the availability of this defense

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184. Securities Act, *supra* note 43, §§ 75-80.

185. *Id.* § 75(1).

186. *Id.*

187. *Id.* § 75(2). The Securities Act lists examples of the types of information that may be material, including "information concerning the financial, economic or legal status of the issuer, trader in securities, guarantor or the party providing surety or any change therein" and "data on new security issuers, significant business deals, organizational changes, economic rehabilitation or winding-up procedures." *Id.* The list is not exclusive. *See id.* pmbl. to § 75.

188. *Id.* § 76(1).

189. *Id.* § 76(2).

190. *Id.* § 77.

191. This provision applies only to transactions by senior staff members or senior managers of the issuer, traders in securities or the legal entity in which the issuer has a major stake, or which has a major stake in the issuer as well as those of the bank keeping the accounts of the issuer and relatives of such persons. *Id.* §§ 76(1)(a)-(b) and 78.

192. *Id.* § 78.

193. *Id.*

should be limited.

Certain transactions are specifically excluded from those considered insider trading. Thus, it is not insider trading if the insider "had to sell the securities as a liquidator in order to satisfy creditors" or "has transacted the deal with a person who also had the same insider information available to him."[194]

The SSB may exercise certain remedial action in the case of a violation of the insider trading provisions of the Securities Act. The SSB may "call upon the observation of the terms and conditions" under Section 75 of the Securities Act, suspend the quotation, sales or trade of an issuer's securities, constrain or suspend transactions within certain lines of activity, cause dismissal of senior management and staff, withdraw a previously granted license and investigate and initiate appropriate legal or administrative action against violators.[195] In addition, the public prosecutor or the SSB may initiate suit against an issuer, underwriter or insider to seek to make null and void the transaction conducted on the basis of inside information.[196]

The Securities Act also sets forth a reporting requirement for transactions conducted by insiders (but not tippees).[197] Thus, a transaction constituting insider trading must be reported to the SSB. A failure to report may result in liability imposed by the SSB.[198] The penalty may range from 200 to 500 percent of the market value of the securities traded in the insider transaction.[199]

Despite its insider trading provisions, the Securities Act does not explicitly make insider trading unlawful as a manipulative or deceptive practice.[200] It also does not require the insider trading information reported to the SSB be made publicly available.[201]

§2.09 Licensing of Broker-Dealers and Underwriters

A person must be licensed in order to "engage in the trading of securities."[202] This requirement parallels those in the U.S. and Europe. An underwriter, broker or dealer may be licensed to engage in certain securi-

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194. *Id.* § 79.

195. *Id.* § 17(1).

196. *Id.* § 84(1). The Municipal Court of Budapest has jurisdiction in such cases. *Id.* § 84(2).

197. *Id.* § 80.

198. *Id.* § 18(1)(e).

199. *Id.* § 19(2)(e). The Securities Act establishes a statute of limitations on the SSB's ability to fine a reporting violator. Thus, "[n]o penalty shall be imposed on anyone by the SS[B] after 6 months from the date it has first received information about the violation . . . or after two years from such violation." *Id.* § 18(3).

200. *See* 1 *Business Ventures*, *supra* note 47, ch.3, n. 56, (indicating that this omission has been criticized by Western commentators).

201. Beata Majer, *Investors Protected*, THE HUNGARIAN OBSERVER, June 1992.

202. Securities Act, *supra* note 43, § 10(1). The SSB is responsible for licensing broker-dealers and underwriters. *Id.*

ties transactions,[203] provided that criteria enumerated in the Securities Act are satisfied. The licensee must be organized in Hungary either as a limited liability company or a joint stock company.[204]

An underwriter or dealer must meet a higher standard for capitalization than a broker; otherwise the licensing criteria are the same. An underwriter or dealer must have at least Ft 50 million of issued and paid-up capital and a broker must have either Ft 5 million or Ft 10 million of issued and paid-up capital depending on whether the broker is organized as a limited liability company or joint stock company, respectively.[205] The standard licensing requirements that must be met regardless of whether the proposed licensee is an underwriter, dealer or broker are that: (1) its only business must be the underwriting of and trading in securities (if an underwriter or dealer) or brokerage activities (if a broker),[206] (2) it must demonstrate the capability of conducting the activities sanctioned under the license[207] and (3) it must have its governing documents (*i.e.*, articles of association) approved by the SSB.[208]

The Securities Act includes certain restrictions on licensed underwriters, dealers and brokers designed to, *inter alia*, minimize the potential for market manipulation and promote market transparency vis-a-vis the ownership structure of securities firms and their interests in issuers.[209] Thus, limits are imposed on the direct and indirect ownership by securities firms of shares of other securities firms.[210] In addition, securities firms are prohibited from trading in their own securities or the securities of an issuer in which they have a direct or indirect in excess of certain prescribed limits.[211]

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203. *Id.* § 11(1).

204. *Id.*

205. *Id.* §§ 11(1)(a) and 11(2)(a). In the event a license is granted to an underwriter (or dealer) that will also be licensed as a broker, the higher capitalization requirement under Section 11(1)(a) applies. *Id.* § 11(3).

206. *Id.* §§ 11(1)(b) and 11(2)(b). The Securities Act limits the application of these restrictions somewhat. Thus, a licensed underwriter, broker or dealer is not prohibited from engaging in "investment consultancy, securities deposit management and securities management," for example, and transactions not subject to the Securities Act. *Id.* §§ 11(4)(a)-(b).

207. In this regard, the applicant must show that it has "all the facilities and technical conditions required for such activities" and that it "employ[s] a specialist to manage the activity and the transactions - or a limited liability company has a member providing such ancillary services - who has a clean criminal record, at least two years of experience in securities transactions and has passed the examination required by the SS[B]." *Id.* §§ 11(1)(c)-(d).

208. *Id.* § 11(1)(e).

209. *See id.* pmbl. to §12. These conditions apply to applicants as well. *Id.* § 12.

210. Securities Act, *supra* note 43, §§ 12(1)-(3).

211. *Id.* § 12(4).

§3 CZECHOSLOVAKIA

§3.01 Overview

[1] *Political and Economic System*

The events leading to the separation of the Czech and Slovak Republics render the future of economic reforms uncertain. Paralysis at the federal level and rapid movement toward the creation of two sovereign states has signaled the demise of the Czechoslovak federation. The program developed for the transition to a market economy will meet with different responses in each of the two newly constituted republics and it is likely that reforms currently underway will be altered or reversed, especially by the Slovak Republic, once the separation has been accomplished.

The current political situation in Czechoslovakia is one of stalemate in the Federal Assembly juxtaposed with two republican parliaments having majority parties. As a result of parliamentary elections held June 5 and 6, 1992, the Civic Democratic Party gained control of the Czech National Council, while the Movement for a Democratic Slovakia attained a majority position in the Slovak National Council.[212] These two ruling parties "pursue widely disparate political and economic agendas"[213] that prevent them from arriving at a common policy which might provide for the continued existence of the Czechoslovak federation.

Vladimir Meciar, Slovak prime minister and head of the Movement for a Democratic Slovakia, and his Czech counterpart Vaclav Klaus, of the Civic Democratic Party, reached agreements on June 20, 1992, for the proposed course of federal dissolution.[214] Part of these agreements stipulate that the reform measures enacted by the Czechoslovak federation will remain effective until the separation is finalized,[215] but pragmatically this accord is questionable in light of Meciar's plans articulated before the elections to modify the course of Slovak economic reform. Specifically, Meciar proposed more state control of economic activity in the Slovak Republic,[216] contrary to the "shock therapy" policies initiated in 1991.[217] Such a drastic change in policy would entail "reversing or modifying the reform policies of the previous Slovak and federal governments."[218] Presumably, this would require the eventual passage of new

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212. *See* Jan Obrman, *The Czechoslovak Elections, RFE-RL Research Rep.*, June 26, 1992, at 12 [hereinafter *Elections*].

213. Jiri Pehe, *Scenarios for Disintegration, RFE-FL Research Rep.*, July 31, 1992, at 30, 32 [hereinafter *Scenarios*].

214. *Id.* at 30.

215. Jan Obrman, *Czechoslovakia: Stage Set for Disintegration? RFE-RL Research Rep.*, July 31, 1992, at 30 [hereinafter *Czechoslovakia*].

216. Jiri Pehe, *The New Slovak Government and Parliament, RFE-RL Research Rep.*, July 10, 1992, at 33 [hereinafter *New Slovak*].

217. Peter Martin, *Slovakia: Calculating the Cost of Independence, RFE-RL Research Rep.*, Mar. 20, 1992, at 33. *See also infra* note 221.

218. *New Slovak*, *supra* note 216, at 36.

legislation by the Slovak National Council to countermand the existing federal laws. Since Meciar's party has the majority necessary to enact such legislation, the continued applicability of federal economic reform policies in the Slovak Republic seems extremely doubtful in long-term perspective.

In the Czech Republic, the continuance of economic reform seems to be much more certain. Klaus, in his negotiations with Meciar, sought to postpone any changes in economic policy until after the separation of the two republics was complete in order to preserve the integrity of the reform program currently being implemented by the federal government.[219] It seems highly unlikely that the tenor of economic reform will change in the Czech Republic; in fact, the prospect of accelerating such reform is one of the principal reasons that Klaus and the Civic Democratic Party are unwilling to perpetuate a federal impasse.[220]

The principal reason for the differing attitudes toward reform held by the Civic Democratic Party and the Movement for a Democratic Slovakia involves the dissimilar economic situation of the two republics. The Slovak economy contains major components of heavy industry and armaments manufacture, whereas the Czech economic structure is more diversified. The transition pains caused by the "shock therapy" program affected the Slovak economy to a much greater extent than the Czech. As a result, Slovak public opinion is "more critical of the overall economic situation"[221] and is uncomfortable with the current pace of economic reform. This attitude, coupled with nationalist pressures, provides the main impetus for the departure from the current path of economic transition and the aversion to the federal structure.

Events subsequent to the June 1992 elections have demonstrated just how irreparable the split between the Czech and Slovak republics has become, underscoring the notion that Czechoslovakia actually "consists of two societies."[222] A government program based on the assumption that Czechoslovakia would dissolve was approved by the Czech National Council on July 13, 1992, followed closely by a declaration of sovereignty from the Slovak National Council on July 17.[223] Meciar and Klaus adopted a common position regarding the impending divorce and proposed the drafting of a constitutional law pursuant to which the Federal Assembly would divide Czechoslovakia into separate republics.[224] The Slovak National Council signed the new constitution for the Slovak Republic into law on September 3,[225] paving the way toward the establish-

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219. *Czechoslovakia*, *supra* note 215, at 30.

220. *Id.*

221. Kamil Janacek, *Survey of Major Trends in 1991*, *RFE-RL Research Rep.*, Mar. 20, 1992, at 32.

222. *Elections*, *supra* note 212, at 19.

223. *Scenarios*, *supra* note 213, at 30.

224. *Id.*

225. *Foreign Broadcast Information Service*, 92 *Daily Rep. E. Eur.* (BNA) No. 179-5,

ment of an autonomous republic on January 1, 1993.[226] As of this writing, negotiations were still underway concerning the details of the dissolution agreements and the formal procedures for the partitioning of Czechoslovakia.

The separation of the Czech and Slovak Republics will go beyond a division in form alone. Each republic will establish its own central bank and distinct national currency,[227]and each is in the process of forming ministries that will assume the tasks once reserved for federal bodies. For example, the newly formed Czech Finance Ministry has a mandate to supervise the development of the republic's capital markets.[228] These indications suggest that, while existing federal legislation and institutions will remain relevant for a time,[229] new legislation implementing the specific economic policies and institutions to be developed in the republics should be expected once the separation has been achieved.

The division of state assets and the future of the privatization program are two contentious issues that must be resolved in the separation process. The Movement for a Democratic Slovakia has drafted a constitutional law based on the Meciar and Klaus accords that would divide federal property between Czech and Slovak parties at a ratio of 2:1.[230] It is quite likely that this agreement will be subject to intense rounds of negotiations that may slow the divorce proceedings significantly. Furthermore, the second round of mass privatization may be halted due to Slovak resistance based on the widespread desire to curtail the ambitious reform program being pursued by the federal government. These issues will be considered top priority items by the respective National Councils.

The disintegration of Czechoslovakia is underway, but the exact timetable for the establishment of fully functioning Czech and Slovak republics is still uncertain. In general, the process of division will likely serve as an impetus to speed up economic reforms in the Czech Republic and curtail such reforms in the Slovak Republic.[231] The relevance of the current regime of economic reforms will remain until new programs are put forth by the respective National Councils. More significant changes in economic orientation should be expected from the Slovak Republic, while the Czech Republic will probably adopt a program quite similar to the one currently being followed by the federal government. No major changes are expected, however, until the two republics put their houses in

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Sept. 15, 1992, at 1.

226. Boris Gomez, *Common Currency-For Now*, PRAGUE POST, Sept. 1-7, 1992, at 1.

227. *World Wire*, WALL ST. J., Sept. 21, 1992, at A8.

228. Bill Hangley, Jr., *Czechs Lead Drive Toward Division*, PRAGUE POST, Aug. 11-17, 1992, at 1.

229. *See id.* and accompanying text.

230. *Foreign Broadcast Information Service*, *supra* note 225, at 11.

231. Ales Capek, The Past and the Future of Czecho-Slovak Economic Relations (March 1992) (on file with the Minda de Gunzburg Center for European Studies, Harvard University) (Program on Central and Eastern Europe, Working Paper Series #22).

order and address the central questions of legal and financial separation.

[2] *Securities Market and Regulation*

Against this backdrop it is evident that the development of a system of securities regulation is not Czechoslovakia's highest priority. The nation presently is consumed, first and foremost, with carrying out the plans for disintegration described above and is not likely, in the near term, to devote significant national resources to enacting and implementing comprehensive federal securities legislation. Secondly, even if securities regulation were a top item on the national agenda, the unsettled state of the country's law-making institutions undermines the status of new legislation. It is possible that the Federal Assembly will pass a new general securities statute by the end of 1992,[232] but the utility and effect of such legislation is unclear. Theoretically, upon finalization of a secession agreement Federal legislation might no longer have any legal effect, so that enactment of additional legislation at this time might be considered fruitless. On the other hand, the secession agreement may provide for the continuation of certain laws, or the independent republics may enact into their laws all or part of previously enacted federal laws, so that the enactment of new federal legislation, including securities legislation, during the transition period may not be pointless. Presumably, the republics eventually will enact their own securities laws, but no significant legislative efforts by the republics themselves in the securities area have been publicized to date. All laws enacted by the post-communist Czechoslovakian government, including the stock exchange legislation discussed below, will reportedly remain in effect until the finalization of the secession agreement between the Slovak and the Czech republics.[233] The secession treaty is "officially" expected in 1992, but progress has been slow and realistically is not anticipated until the first quarter of 1993. Understanding the relevant Federal laws that have been enacted (principally, the Stock Exchange Act)[234] is instructive not only due to the possibility that such laws will somehow survive the political transformation through provisions in the secession treaty or otherwise, but also because such laws serve as the best available indicator of the shape of securities laws that eventually may be enacted by the independent republics.

As mentioned, Czechoslovakia's Federal Assembly has passed the Stock Exchange Act pursuant to which stock exchanges in Prague and Bratislava will operate, but further securities legislation, including a gen-

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232. Letter from Mária Kuniková, asst. to the Chief Executive, the Bratislava Stock Exchange, to Holme Roberts & Owen (Sept. 18, 1992).

233. Telephone conference between Holme Roberts & Owen and the Czechoslovakian Embassy in Washington, D.C. (Sept. 23, 1992). *But see supra* note 215 and accompanying text (discussing possibility that Slovakia may, as a pragmatic matter, modify the course of Slovak economic reforms).

234. Legal Act of April 21, 1992, on Securities Stock Exchange [hereinafter *Stock Exchange Act*].

eral securities statute, has not yet been able to transcend the political impasse. Without a general securities law statute regulating public offerings, fraud and the like an atmosphere of *caveat emptor* generally prevails in the fledgling markets.[235] The stock exchanges in Prague and Bratislava, described below, have been constituted but are not yet operational although it is anticipated that the exchanges will commence operations by the end of 1992 or in early 1993.[236] Pending the commencement of trading on the exchanges, a small amount of secondary market activity is occurring privately among institutions.[237]

The privatization process, by creating a large supply of shares, will increase the need for securities market structures in Czechoslovakia. Although the supply of and demand for securities in Czechoslovakia are currently low, both are expected to increase as the privatization process unfolds. In the privatizations, Czech citizens will become shareholders *en masse*; approximately 8.5 million of them bought vouchers in a mass privatization program in 1992[238] which will allow their holders to purchase stock in companies being privatized[239] by participating in a multi-part bidding process. The bidding process, which began in May 1992, is expected to result in the transfer of over fifty percent of Czechoslovakia's state-owned enterprises to the public.[240] Stock exchanges are considered necessary to increase liquidity for the shares that are purchased in the mass privatization.

Czechoslovakia signed an Association Agreement with the European Community in December 1991 which calls for Czechoslovakia to implement a number of reforms as a prerequisite to membership in the Com-

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235. CZECHOSLOVAKIA INVESTMENT GUIDE, *supra* note 4 (Sept. 24, 1992)("a Securities Act governing the regulatory environment has still not been finalised, despite the critical importance of efficient securities markets to the privatisation programme"). *But see* Stock Exchange Act, *supra* note 234, § 28 (duties of stock brokers) and § 31 (sanctions against participants in trading and issuers of listed securities for violating provisions of Stock Exchange Act or stock exchange rules or purposefully disseminating false or misleading information that affects the rates of securities).

236. *See* Philip Crawford, *Equity Opportunities Multiply as Eastern Europe Goes to Market*, INT'L HERALD TRIB., Aug. 29, 1992 ("stock markets are already up and running in Budapest and Warsaw, and the inaugural bell of the Prague bourse should ring before the year's end").

237. IVAN SVITEK ET AL., CZECHOSLOVAK BUSINESS GUIDE: INVESTMENT 1992/93, 93 (1992) [hereinafter GUIDE] states that "[b]ecause the volume of traded securities is still small, the Czechoslovak State Bank in cooperation with other commercial banks has set up a provisional secondary securities market. The State Bank is responsible for technical and organizational aspects, accounting, rate setting, mediation, central evidence, and publishing information."

238. *Prague to Set Up New Stock Exchange*, PRIVATISATION INT'L, Apr. 1992.

239. *CSFR Plans Stock Exchanges*, PRIVATISATION INT'L May 1992; *see also Foreign Investors' Access to Stock Markets Could Be Limited*, FIN. E. EUR., May 8, 1992 (voucher privatization system will turn 8.5 million Czechs and Slovaks into shareholders by the end of 1992).

240. *Open For Business*, FIN. E. EUR., May 21, 1992.

munity.[241] Czechslovakia hopes to attain full membership by the year 2000, although it is unclear how this goal will be affected by the impending division. The objective of someday attaining EEC membership may have influenced the shape of Czechoslovakia's securities laws and policies. Indeed, the Czechoslovakian Stock Exchange Act seems to have been shaped more by European than U.S. traditions.

§3.02 Regulatory Authorities

As mentioned above, a general securities law governing public offerings of securities, fraud and related matters (*Zakon o Cennych Papiteh*) has been under consideration in Czechoslovakia but has not been enacted. Draft legislation reportedly would create independent regulatory authorities, the Securities Commission of the Czech Republic and the Securities Commission of the Slovak Republic.[242]

Securities exchanges in Czechoslovakia are presently supervised by the Ministry of Finance of the Czech Republic or the Ministry of Finance of the Slovak Republic,[243] depending upon where the exchange is located. The Ministries, in this regard, will act through a "Stock Exchange Commissioner" who is authorized, *inter alia*, to control trading and stock broker activities and countermand decisions of the stock exchange chamber (defined below).[244] Although the stock exchanges in Czechoslovakia are private legal entities organized as joint stock companies,[245] they will have certain supervisory responsibilities over market participants just as securities exchanges in the U.S. and most countries have self-regulatory responsibilities.

The Prague Stock Exchange (PSE) was constituted in Prague on July 9, 1992,[246] subject to approval by the Ministry of Finance.[247] It is anticipated that the Exchange may open for operations in the first quarter of 1993.[248] Rules of the Prague Stock Exchange are not available in

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241. CZECHOSLOVAKIA INVESTMENT GUIDE, *supra* note 4. *See also* James Doty, *Capital Market Developments in Central and Eastern Europe: The SEC Perspective*, *in* INTERNATIONAL SECURITIES MARKETS 37 (1991).

242. CZECHOSLOVAKIA INVESTMENT GUIDE, *supra* note 4. "Once the securities law is passed. . .the exchanges will be regulated by independent supervisory bodies, the Securities Commissions of the Czech and Slovak republics, which are to be set up under the act." *Id.* at 18 (Apr./May ed.)

243. *Stock Exchange Act*, *supra* note 234, § 32.

244. *Id.* (control stock exchange trading, "revise" stock broker activities, countermand decisions of the stock exchange chamber under certain circumstances, require reports from stock exchange governing bodies, persons involved in clearance and settlement, and stock brokers).

245. *Id.* § 1.

246. *BCPP Set Up*, EKONOMICKE ZPRAVODAJSTVI, July 9, 1992, at 8.

247. *Czechoslovakia: Securities Market to Become Independent Company*, HOSPODARSKE NOVINY, July 15, 1992. *See* Stock Exchange Act, *supra* note 234, § 2 (requiring approval of Czech Ministry of Finance for foundation of stock exchange based in Czech Republic).

248. *Cf. Czechoslovakia: Securities Market to Become Independent Company*, *supra* note 247.

English as of September 1992. The Bratislava Stock Exchange (BSE) formed on November 5, 1991,[249] has issued Rules on Listing Securities (BSE Listing Rules) and Rules on Trading on TBSE Floor and Types of Transactions (BSE Trading Rules), discussed below. The Bratislava International Commodities Exchange, created in November 1991,[250] reportedly trades bonds as well as commodities.[251]

The Czechoslovak State Bank, the country's central bank, supervises the country's banking system. Previously the State Bank functioned as both central bank and a commercial bank but as of the beginning of 1990 divested itself of its commercial banking activities.[252] The Commercial Bank in Prague and the General Credit Bank in Bratislava succeeded to the CSB's commercial banking activities,[253] while long-term financing has been taken over by the Investment Bank (*Investicni Banka*).[254]

Other peritnent regulatory authorities include the Federal Ministry of Finance, Federal Ministry of the Economy, Federal Agency for Foreign Investment, Czech Ministry of Finance, Czech Ministry for Economic Policy and Development, Czech Ministry of National Fund and Privatization, Slovak Ministry of Finance, Slovak Ministry of the Economy, and Agency for Foreign Investment of the Slovak Republic.[255]

§3.03 Securities Laws and Related Laws

As indicated above, the Federal Assembly of the Czech and Slovak Federative Republic passed the Stock Exchange Act in April 1992.[256] This statute governs, among other things, stock exchange authorization, membership, and governance; listing and trading securities on the stock exchange; insider trading; periodic disclosure; sanctions; and dispute resolution. Czechoslovakia has not yet enacted general securities legislation governing public offerings, fraud and the like[257] although additional legislation may be passed by the end of 1992.[258] The ultimate fate of the Stock Exchange Act is unclear in view of the country's impending split. The

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249. GUIDE, *supra* note 237, at 27.

250. *Id.* 94.

251. *Id.* 94. *See also Stock Exchanges in Czechoslovakia*, EKONOMICKE ZPRAVODAJSTVI, July 9, 1992, at 8.

252. *Czechoslovakia: Ambitious Plans are Underway to Create Capital, Money and Foreign Exchange Markets*, EUROWEEK March 23, 1990.

253. *Id.*

254. *Id.*

255. GUIDE, *supra* note 237, at 129-138.

256. Stock Exchange Act, *supra* note 234. The translation of the Stock Exchange Act relied upon herein was obtained from the Bratislava Stock Exchange. It is believed to constitute an official translation, although this is uncertain. Other translations exist and reflect some differences in the statutory language. The text of the original statute should obviously be consulted in the case of actual transactions.

257. CZECHOSLOVAKIA INVESTMENT GUIDE, *supra* note 4.

258. Letter from Bratislava Stock Exchange to Holme Roberts & Owen, *supra* note 232.

BSE has issued Listing Rules and Trading Rules[259] which are analyzed below. The PSE apparently has formulated rules but as of this writing are not available in English.

The Federal Assembly enacted an investment funds law (*Zakon O Investicnich Spolecnostech a Investicnich Fondech*) in April 1992 applicable to both open- and closed-end funds.[260] Among other things, the law provides that an investment fund cannot own more than twenty percent in any one company,[261] and regulates the amount of fees that may be charged to customers.[262]

Banking legislation was enacted on December 20, 1990. Foreign banks may engage in banking activities in Czechoslovakia through a representative office, subsidiary or joint venture.[263] According to one source, "[u]nder the Banking Law, foreign banks are now able to use the licenses granted in their home country to receive a license to operate in Czechoslovakia,"[264] although foreign banks still must obtain regulatory approval (from the Czechoslovak State Bank) to operate.[265] As is the case under European Community Directives,[266] the banking law permits universal banking.[267] Under a universal banking system, banks may engage in both commercial and investment banking activities.

The Commercial Code,[268] passed by the Federal Assembly in November 1991, regulates a wide range of commercial activities in Czechoslovakia.[269] "The Code constitutes a comprehensive system of law that applies to entrepreneurial activity in Czechoslovakia and replaces approximately 80 previous acts, decrees and regulations."[270] Under the Commercial

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259. The Bratislava Stock Exchange Board passed the Trading Rules on July 25, 1991 [hereinafter TBSE Trading Rules]. Zakon c. 17/1991 Sb. The Board approved the Listing Rules on July 25, 1991 [hereinafter TBSE Listing Rules]. Zakon c. 17/91 Sb., *amended by* Zakon c. 35/1991 Sb. The Trading Rules and the Listing Rules were issued in Slovak and English. "In case of any doubts [the] Slovak version controls." Zakon c. 17/1991 Sb.

260. *See Foreign Investors' Access to Stock Markets Could Be Limited*, *supra* note 239.

261. *Id.*

262. *CSFR Plans Stock Exchanges*, PRIVATISATION INT'L, May 1992.

263. GUIDE, *supra* note 237, at 90. "At the end of November 1991, 41 representative offices of foreign banks and 38 banks had been established. . ." *Id.*

264. *Id.*

265. CZECHOSLOVAKIA INVESTMENT GUIDE, *supra* note 235. Persons desiring to carry on the banking business in Czechoslovakia must apply to the State Bank, which acts on the application in consultation with the appropriate Ministry of Finance, depending upon the proposed location of the bank's headquarters. *Id.*

266. Council Directive 89/646, 1989 O.J. (L 386) 1 (allowing banks authorized in an EEC member state to provide commercial and investment banking services throughout the Community, provided such activities are covered by the home state authorization).

267. GUIDE, *supra* note 237, at 90.

268. Zakon c. 513/1991 Sb.

269. *See* GUIDE, *supra* note 237, at 37.

270. CZEHOSLOVAKIAN INVESTMENT GUIDE, *supra* note 4. "The law is influenced by German and Austrian legislation and reflects pre-1938 Czechoslovak civil and commercial law." *Id.*

Code, foreigners may acquire Czechoslovakian companies, form wholly owned local subsidiaries or establish joint ventures with Czechoslovak persons,[271] subject in some but not all cases to governmental approval.[272]

The so-called "Small Privatization Law" governs the transfer of small businesses from the state to private citizens.[273] The "Large Privatization Law"[274] was enacted on February 26, 1991 and became effective in April of that year. This law generally concerns the privatization of state-owned property other than small businesses.[275]

§3.04 Exchange Regulation

[1] *Characteristics and Authorization*

The Stock Exchange Act defines "Securities Stock Exchange" as a legal entity authorized to "organize" at a certain place and time "a demand for, and an offer of, securities."[276] Shares and other securities "bearing the rights of property and capital sharing in business, bonds, as well as, dividend and interest coupons (warrants), are traded [on] the exchange."[277] Thus both debt and equity securities are authorized to trade on regulated exchanges in Czechoslovakia. Permission to establish a stock exchange is requested by filing an application with the Czech or Slovak Ministry of Finance, depending upon the business residence of the exchange to be formed.[278] The decision regarding the establishment of the stock exchange must be made within sixty days of the filing date of the application.[279] A stock exchange may not be established by means of a public offering,[280] and shares of the exchange are transferable only with the consent of the exchange.[281]

[2] *Ownership; Foreign Ownership*

The Stock Exchange Act makes the following provision concerning foreign ownership of shares in a stock exchange governed by the Act:

> The foreign nationals[282] and the legal persons with foreign national's capital share exceeding 50 % of the basic assets, residing on the territory of the Czech and Slovak Federative Republic, can acquire the

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271. *Id.*
272. *Id.*
273. Law on Transfers of State Property with regard to Some Objects to Other Legal or Physical Persons, Oct. 25, 1990. BUSINESS VENTURES, *supra* note 47, at c-5.
274. Act on the Conditions of Transfer of State Property to Other Persons, February 26, 1991. *Id.* at c-4.
275. *Czechoslovakia's "Large Privatization" Law*, FIN. E. EUR., March 20, 1991.
276. *Stock Exchange Act*, *supra* note 234, § 1(1).
277. *Id.* § 1(2).
278. *Id.* § 3. The contents of the application are specified in § 3(1).
279. *Id.* § 3(5).
280. *Id.* § 1(5).
281. *Id.* § 4(1).
282. *Id.* § 4(3).

> stock exchange's shares, the total nominal value of which shall not exceed one third of the basic assets.[283]

Thus, foreign exchange ownership is permitted, but only to the extent such ownership does not exceed "one third of the basic assets;" presumably, legal entities with less than fifty percent foreign ownership are not counted against the one-third limitation. It is unclear exactly what is meant by basic assets in this context; presumably, the reference is to capital of the exchange (which must be formed as a joint stock company).[284] In order to become a shareholder of the exchange, a foreign national must be a resident of Czechoslovakia. A subsidiary of Credit Suisse First Boston based in Prague is one of twenty owners of the Prague Stock Exchange[285] and several other applications from foreigners are pending.[286] As indicated below, no owner of the exchange may vote more than twenty percent of the shares of the exchange.[287]

[3] *Governance*

Three internal bodies are involved in the governance of stock exchanges operating under the Stock Exchange Law: the General Assembly, the Chamber of the Stock Exchange ("Chamber") and the Supervisory Board.[288] The General Assembly comprises all of the shareholders of the exchange, each of whom votes according to the "nominal value" of his shares subject to the caveat that no one shareholder may vote more than twenty percent of the shares of the exchange.[289] The General Assembly, among other things, elects the members of the Chamber and the Supervisory Board, approves stock exchange rules (subject to further approval by the Chamber) and approves fees and commissions to be charged for the services offered by the exchange.[290] The Chamber acts as the exchange's chief administrative body with responsibility, *inter alia*, to supervise the exchange's compliance with applicable law; establish bookkeeping and computer systems; regulate exchange operations;[291] authorize transfers of exchange memberships; grant listing applications and trading licenses; and supervise stock brokers.[292] The Secretary-General of the stock ex-

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283. *Id.* § 4(3).

284. "The exchange is a joint stock company, regulated by provisions of the Code of Commercial Law [Zakon c. 513/1991 Sb.] with the exceptions specified in this Act." *Id.* § 1(3).

285. *Foreign Investors' Access to Stock Markets Could Be Limited*, *supra* note 239.

286. *Id.*

287. *Stock Exchange Act*, *supra* note 234, § 6(4). *Cf. supra* text accompanying n. 40 (describing the one vote per stock exchange member rule in Hungary).

288. *Id.* § 5.

289. *Id.* § 6(4). This provision does not prevent a shareholder from owning more than twenty percent of the shares of the exchange, but rather prevents the shareholder from voting more than such percentage.

290. *Id.* § 6.

291. The Stock Exchange Chamber "makes changes in the exchange's working days, interrupts, holds up, partially or entirely, the stock exchange operations." *Id.* § 8(f).

292. *Id.* The Stock Exchange Chamber "performs other functions of a Board of Direc-

change represents the Chamber. The BSE Trading Rules, discussed further below, denominate different exchange authorities that will be involved in supervising floor trading: the Commission for Trading, Commissioner, and Speaker.

§3.05 Listing Securities on the Stock Exchange

[1] *Stock Exchange Act*

In many countries, provisions concerning listing of securities on a stock exchange must generally be construed with regulations governing public offerings of securities because the two processes are inextricably linked. For example, "[i]f a company is able to meet the admission requirements of The Stock Exchange and a member firm is prepared to act as a sponsor and underwriter, the process of going public (or going to market) in the United Kingdom and the process of listing on the Exchange are intertwined and basically the same."[293] Czechoslovakia's Stock Exchange Act and the BSE Rules imply that Czechoslovakia will follow the European model whereby stock exchange listing is an integral part of the public offering process,[294] but this conclusion remains tentative in the absence of a statute regulating public offerings.

The Chamber or an authorized committee of an exchange make decisions on listing applications.[295] As is typical with most modern exchanges, the issuer must meet standards relating to operating history, assets, number of shareholders and float but the details of these matters are left to the rules of the exchange.[296] It is contemplated that the exchanges will have more than one market, as the Act vests the exchanges with the authority to decide whether the subject securities will trade "on primary or secondary securities market."[297] The Act provides as follows concerning the listing of foreign securities:

> Foreign securities are allowed for trading on the stock exchange, provided, they were issued in conformity with the legal regulations, valid in the state of the issuer and were accepted/listed, for trading on the

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tors of a joint stock company." *Id.* § 8(q).

293. HAROLD BLOOMENTHAL AND SAMUEL WOLFF, EMERGING TRENDS IN SECURITIES LAW 10-23 (1991). Although in the United States issuers often list on an exchange concurrently with offering their securities to the public, in many cases they instead arrange to have their securities quoted on non-exchange markets (e.g., NASDAQ) and even when their securities are listed the exchanges do not play as significant a role in the disclosure and review process as they do in many European countries.

294. *See, e.g., Stock Exchange Act, supra* note 234, § 22(3) (listing application must disclose "way of emission and place of sale of the securities"); TBSE Listing Rules, *supra* note 259, III § 10 (use of proceeds from issuing new securities, volume of securities to be offered to the public, plan of distribution).

295. *Stock Exchange Act, supra* note 234, § 21(1).

296. *Id.* § 21(3). Government bonds are listed on the stock exchange without an application and prospectus.

297. *Id.* § 21(4).

stock exchange, by the stock exchange chamber.[298]

In typical reciprocity provisions[299] the condition of listing in one state is listing in another. The provision of the Stock Exchange Act quoted above requires valid issuance in the home state and acceptance for listing in Czechoslovakia, as opposed to listing in the home state.[300] However, under the Stock Exchange Act even if the securities have been validly issued in the home country, they still must be accepted for trading by the Chamber.[301] Thus the Stock Exchange Act does not contain a true reciprocity provision. In any event, it is unlikely that large numbers of foreign issuers, at least U.S. issuers, will seek a listing on Czechoslovakian exchanges in the near future.

The listing process is commenced by the issuer filing a listing application with the exchange. "In the listing requirements the exchange chamber determines, when a prospectus, verified by a bank, is to be, necessarily attached to the application."[302] The disclosure requirements established by the Act are minimal, but are supplemented by stock exchange rules.[303] Under the Act, the disclosure document must contain data on the issuer's activities and on the issue of securities, specifically: a) the type of securities; b) the issuer's business prospects; c) the total volume of the issue and its "diversification by denominations;" and d) the "way of emission and place of sale of the securities."[304] When the disclosure document used in connection with a listing, which the EEC refers to as "listing particulars," the U.S. refers to as a "listing application" and Czechoslovakia refers to as a "prospectus," is required, it must be published in accordance with stock exchange rules.[305]

[2] *BSE Listing Rules*

Securities subject to preemptive rights or rights of first refusal may not be listed on the BSE.[306] The provision in the BSE Listing Rules applicable to foreign listings differs from that contained in the Stock Exchange Act: "[s]ecurities listed previously on another Stock Exchange shall be listed on the BSE as follows:" (1) a BSE member must certify that the security is listed on another exchange and provide a copy of the

298. *Id.* § 21(5).

299. Council Directive 87/345, 1987 O.J. (L 185) 81 (providing that when applications are made to list securities on two or more exchanges located in the EC, listing particulars prepared and approved in accordance with home state rules must be recognized by other member states without additional information or approval requirements).

300. *Cf. infra* note 104 and accompanying text.

301. Under EEC directives, a listing in the home state in accordance with specified requirements generally entitles the issuer to reciprocal listing privileges within the EEC as a matter of right.

302. *Stock Exchange Act, supra* note 234, § 22(1).

303. *See id.* § 22(3).

304. *Id.*

305. *Id.* § 22(5).

306. TBSE Listing Rules, *supra* note 259, I. § 2.

prospectus; (2) BSE will categorize the security as falling within the 1st, 2nd or 3rd market (described below); (3) "while listing a security [BSE] shall respect at that time valid Czech-Slovak regulations regarding trading with securities issued abroad."[307] The provision implies that securities listed on another "Stock Exchange," an undefined term, may be listed on the BSE as a matter of right, subject to existing Czechoslovakian regulations concerning "trading with securities issued abroad." This is similar to the EEC reciprocity provision, but goes beyond it in its seeming application to issuers listed on any stock exchange in any country.[308] The undefined term "Stock Exchange" is confusing and arguably refers only to other stock exchanges in Czechoslovakia. The BSE has stated informally that at present, foreign securities are not being accepted for listing on the BSE.[309]

The BSE is divided into three separate markets. In order to qualify for listing on the first market, the issuer must have "volume of the joint stock company capital stock" of 500 million crowns.[310] At least ten percent of the issuer's capital stock must be held by the public, and the issuer must have a three-year operating history information as to which must be presented in the "prospectus."[311] The total "nominal" value of the securities "to be listed, issued for selling to public" must be at least ten million crowns.[312] Different requirements apply to issuers listed on the second and third markets.[313] The BSE listing rules specify the information that must be disclosed in the "prospectus" at the time of listing. The "prospectus" must include, *inter alia*, information concerning the issuer's operating history, capital stock, number of employees, senior officers, managers and directors, business, and property; data concerning use of proceeds, size of the proposed issuance of securities, yield, plan of distribution; and audited financial information.[314] The procedural requirements for obtaining a listing are contained in paragraphs VI of the BSE Listing Rules.

§ 3.06 Trading Securities On and Off the Stock Exchange

[1] *Stock Exchange Act*

The Stock Exchange Act provides as follows:

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307. *Id.* I. § 5.

308. The corresponding EEC directive allows countries that are members of the EEC to restrict application of the reciprocity provision to issuers having their registered office in another member state.

309. Letter from BSE to Holme Roberts & Owen (Sept. 18, 1992)("[l]isting of foreign securities on [the BSE] is not being envisaged").

310. TBSE Listing Rules, *supra* note 259, II. § 6. This requirement appears to refer to float although the language is ambiguous.

311. *Id.*

312. *Id.*

313. *Id.*

314. *Id.* III.

> (1) Securities may be bought and sold on the stock exchange only by persons, authorized (licensed) for trading in securities, according to the specific legal act[315] and only by those, who are: (a) the stock exchange's shareholders or (b) the persons who, upon their request, were granted, by the stock exchange chamber, permission (licence) to buy and sell securities on the stock exchange market and who have paid the admission fee. (2) the Czechoslovak State Bank is authorized to trade in securities.[316]

A trading license may not be granted to a legal entity whose property is subject to "special bankruptcy and compounding proceedings"[317] or to a natural ("physical") person with "insufficient integrity."[318] A natural person "legally sentenced for any criminal act of material (property) nature, or for any other purposesful criminal act, is not considered a person with full integrity."[319] The BSE has stated informally that "[o]nly firms resident in CSFR may apply for a [BSE] broker's license at present,"[320] and that trading on the BSE "is limited to [BSE] members."[321]

A legal entity licensed to trade on the exchange designates one, "eventually, more," natural persons actually to conduct trades.[322] The legislation refers to such authorized natural person as a "stock broker" and requires the broker to possess "the necessary professional skills and personal integrity."[323] Unless applicable stock exchange rules provide otherwise, only stock brokers are authorized to act as intermediaries "in buying and selling securities between persons, licensed to buy and sell securities."[324] A "stock broker" thus is a natural person who acts as intermediary between persons who are licensed to buy and sell securities.

The Stock Exchange Act briefly addresses the question of the method by which prices are set on the exchange. The Act provides that the "[r]ate of a security, which is its market rate on an appropriate stock exchange's working day, is set by a stock broker."[325] The Act provides

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315. "For instance, § 1, section 3, of the Legal Act No. 21/1992 Sb., on Banks" (footnote in original).

316. *Stock Exchange Act, supra* note 234, § 14. The legislation provides that a person not authorized to trade on the exchange may trade through qualifying exchange members or licensed traders and "eventually" through the Czechoslovak State Bank. The reason for the delay in trading through CSB is not clear.

317. *See id.* § 14(3).

318. *Id.* § 14(3).

319. *Id.*

320. Letter from BSE, *supra* note 309.

321. *Id.*

322. *Stock Exchange Act, supra* note 234, § 15(1). "The legal entity, licensed to buy and sell securities, designates one, eventually, more physical persons, to buy and sell securities on its behalf. . ." *Id.* Elsewhere, however, the Act indicates that stock brokers are appointed by the Chamber on the basis of a public tender. *Id.* § 28(2).

323. *Id.* § 15(2).

324. *Id.* § 17.

325. *Id.* § 25(1). The term "price" would seem to have been more appropriate in this context than the term "rate."

further that "[i]f only an automated trading system is used by the stock exchange, the rate is computed in the above mentioned way."[326] This formulation is confusing in that it suggests that if an automated trading system is used, the rate of a security is set by a stock broker. The Act continues, however, with the provision that the "[w]ay of setting rates of securities is determined by the rules and regulations of the stock exchange."[327] "Rates" of securities are quoted in the "seat" of the exchange headquarters and at the end of a working day are to be published in the stock exchanges "rates list."[328] A person may file a "protest" against the quoted rates with the Chamber within three days following the day the rates were quoted,[329] and the Chamber will rule on such protest within another three days. BSE Trading Rules provide that "[m]arket rate is [the] price of a security agreed in [a] transaction between agents on TBSE Floor."[330]

A stock broker is not an employee of the exchange, but is appointed by the Chamber "on the basis of a public tender."[331] It is unclear exactly how this provision relates to Section 15(1), which provides that a legal entity licensed to buy and sell securities designates a stock broker to buy and sell securities on its behalf; presumably, a licensee appoints a stock broker subject to the approval of the Chamber. The broker "mediates" trades of securities "allotted to him/her by the Chamber[,]"[332] and "sets rates of the allotted securities."[333] The stock broker must be present at the exchange when it is open, "through all the working hours and. . . participate personally, in the particular stock exchange trade[s]."[334] The stock broker keeps a book of individual stock exchange transactions apparently in a hard copy format, although the book "may be replaced by output reports from an automated system, if such a record is confirmed by a stock broker."[335] The broker issues a confirmation of the terms of a trade after it is concluded, at which time the broker may receive a commission. Thus, the stock broker (i) "mediates" trades of securities; (ii) is "allotted" securities by the Chamber; (iii) sets rates of allotted securities; (iv) participates personally in stock exchange trades; (v) keeps a record book of trades; and (vi) issues confirmations. These provisions seem to imply a role for the stock broker somewhat similar to that of a "specialist" on U.S. exchanges, except that the Czechoslovakian stock broker, with certain exceptions, is not allowed to trade for his own account.[336] It

326. *Id.*
327. *Id.* § 25(2).
328. *Id.* § 25(3).
329. *Id.* § 26(1).
330. TBSE Trading Rules, *supra* note 259, VII § 29.
331. *Stock Exchange Act, supra* note 234, § 28(2).
332. *Id.* § 28.
333. *Id.* § 28(3)(b).
334. *Id.* § 28(5).
335. *Id.* § 28(3)(c).
336. *Id.* § 28(3)(d). SECURITIES AND FEDERAL CORPORATE LAW, §12.02 (Harold S. Bloo-

remains to be seen how the stock broker function will be defined in practice on Czechoslovakian exchanges.[337]

The Stock Exchange Act establishes certain rights and responsibilities applicable to "participants in trades on the stock exchange."[338] Among other things, such "participants" must honor their commitments, accept the exchange's clearance and settlement system, submit annual audited financial statements and deposit "a bail (collateral) to ensure the liabilities and risks, resulting from the stock exchange trading and its clearing (settlement)."[339] "Participants in trades" include licensed traders, stock exchange shareholders, and stock brokers.[340]

The Act only briefly addresses the topic of clearance and settlement which has been a major and controversial issue in international securities markets.[341] Settlement of individual trades "in a form of clearing, safe-custody, delivery, eventually, overtaking the securities, is conducted by a bank or by another legal person on the basis of a contract conducted with the stock exchange chamber."[342]

Off-exchange trading of listed securities is also an extremely controversial issue worldwide.[343] The Stock Exchange Act provides as follows

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menthal, ed.) contains the following description of the specialist on U.S. exchanges:

> A specialist is an exchange member who has been designated to act in that capacity as to a particular security or securities listed on the exchange. A representative of the specialist stays continuously at one post and performs the function of storing and executing limited price orders and otherwise upon request executes orders for other members. . . . A specialist also performs a dealer function. . . .[I]t is his function to give the market liquidity and continuity by quoting on a narrower spread at which he is expected to buy or sell for his own account to the extent necessary in order to assure a fair and orderly market. . .

337. TBSE Rules do not expressly refer to "stock brokers" nor do they define a role that is coterminous with that of the stock broker under the Act, although the role given to the "Speaker" under TBSE rules overlaps to some degree. *See infra* note 323 and accompanying text.

338. *Id.* § 18.

339. *Id.*

340. *Id.* § 13(3).

341. Clearance and settlement issues are currently being addressed by the European Community, the International Organization of Securities Commissions and the Group of Thirty, among others. *See e.g.*, INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION § 1.10[2][b] (Harold S. Bloomenthal and Samuel Wolff eds.); *Clearing/Settlement Issues Get IOSCO Recommendations*, 2 Int'l Sec. Reg. Rep. (Buraff) 10 (Sept. 27, 1989).

342. *Stock Exchange Act, supra* note 234, § 27(1).

343. Off-exchange trading is one of several issues that delayed the EEC's adoption of the Investment Services Directive for over a year. Some European countries, such as France, desire to limit trading to recognized securities exchanges, whereas others such as the United Kingdom wish to preserve off-exchange markets, such as the Euromarket. *See* Samuel Wolff, *Securities Regulation in the European Community*, 20 DENV. J. OF INT'L L. & POL. 126 (1991); *Finance Ministers Deadlocked on Off-Exchange Trading Regulations*, Int'l Sec. Reg. Rep. (Buraff) 6 (Dec. 1990). IOSCO has also hotly debated the topic of off-exchange trading. *See U.K. Will Ask Venice Meeting to Use British Rules as Model*, 2 Int'l Sec. Reg. Rep. (Buraff) 4 (Sept. 13, 1989).

with respect to this issue and the related issue of "transparency" (disclosure of trading information):

> Participants in a stock exchange transaction may conclude over-the-counter contracts on listed securities, however, only within the range, allowed by the stock exchange chamber and they are obliged to inform the stock exchange about it.[344]

The limitation of off-exchange trading to transactions "within the range" allowed by the exchange is not entirely clear. It is not apparent whether this limitation applies to volume, price or both, nor is it clear how the measure would be enforced.

[2] *Bratislava Stock Exchange*

The BSE Trading Rules supplement the trading provisions of the Stock Exchange Act. A BSE transaction is defined as one carried out by a BSE member in listed securities on the floor of the exchange during working hours.[345] The BSE member must be represented by an agent in all floor operations.[346] Only agents properly authorised by exchange members are allowed to operate on the floor.[347] The Rules indicate that a BSE member must accept any orders for listed securities "and can carry out such orders only on [BSE] Floor; or can have the orders carried out by other Member[s] of [BSE]."[348] Thus, the BSE Trading Rules prohibit off-exchange trading of listed securities by BSE members. As explained above, the Stock Exchange Act permits off-exchange trading "only within the range, allowed for the stock exchange chamber" and the BSE exercised its apparent discretion under this provision to prohibit off-exchange trading altogether. The BSE Trading Rules at this time also prohibit transactions in options and futures.[349]

A critical role in the functioning of the BSE is played by the "Speaker." Offers are made by BSE agents and are "repeated" by the Speaker who also receives confirmations that a sales contract has been made. "It is an obligation of the Speaker to repeat orally the offers and to make sure that the data shall be registered by computer and records shall be kept."[350] Generally, the Speaker's obligation is to follow the process of trading; monitor compliance with BSE Rules by agents; conduct the course of trading and "carry out decisions necessary for trading."[351] The

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344. *Stock Exchange Act*, *supra* note 234, § 19. *Cf.* TBSE Trading Rules, *supra* note 259, X § 7, discussed *infra* note 348 and accompanying text.

345. TBSE Trading Rules, *supra* note 259, II § 2.

346. *Id.* II § 3. "Agent is an authorised proxy of [TBSE] Member who acts in all transactions on behalf and responsibility of the Member." *Id.* X § 41.

347. *Id.* X § 42.

348. *Id.* X § 7.

349. *Id.* III § 8.

350. *Id.* XII § 51.

351. *Id.* XII § 51.

Speaker also must "settle any dispute related to trading on the spot."[352] It appears to be contemplated that there will be only one "Speaker," but presumably the "Speaker" will have a staff of his own.

[3] *Prague Stock Exchange*

As indicated above an English language translation of the rules of the Prague Stock Exchange is not yet available. It is reported, however, that the PSE will have both a trading floor and an electronic trading system,[353] and that the PSE and BSE may be linked by computers but this " 'will depend on the political situation.' "[354] The PSE will probably have two, possibly three tiers, and it has been estimated that when the exchange begins operating about fifty listed companies will trade on the first tier and 300-400 unlisted companies on the second tier,[355] although this estimate may be overly optimistic. The third market may be established for thinly traded securities and may be limited to institutional traders.[356] Prague is reported to favor a modified version of the French market based upon fixed price sessions,[357] while Bratislava is inclined toward an open outcry system similar to that of Switzerland's with "face-to-face dealing between principals."[358] In April 1992, the Prague Stock Exchange Association signed a protocol with the Paris Stock Exchange pursuant to which the latter will provide equipment and support.[359]

§3.07 Insider Trading

The Stock Exchange Act has several provisions intended to regulate insider trading and abusive trading practices generally, the most important of which is contained in Section 20 of the Act, which provides:

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352. *Id.* XII § 55.

353. CZECHOSLOVAKIA INVESTMENT GUIDE, *supra* note 4. *Cf. Czechoslovakia: Securities Market to Become Independent Company*, HOPODARSKE NOVINY, (Czechoslavakia), July 15, 1992 ("[i]ssues that remain unresolved include whether or not trading will be carried out on a material or purely electronic basis").

354. *Prague to Set Up New Stock Exchange*, PRIVATISATION INT'L, April 1992 (quoting Jan Erben of the Prague Stock Exchange Association); *CSFR Plans Stock Exchanges*, PRIVATISATION INT'L, May 1992.

355. *Prague Plods On Towards a Regulated Stock Market*, FINANCIAL TIMES, (London), May 15, 1992, *Cf. supra* text accompanying note 49, at 5 (the Budapest Stock Exchange had twenty-five securities trading of which six were listed at the end of 1991).

356. *Czechoslovakia: Securities Market to Become Independent Company*, *supra* note 353.

357. *Frances Societe des Bourses Francaises Wins Contract for Stock Exchanges*, EBRD WATCH, (Czech.), May 11, 1992. "The exchange is patterned on other European bourses, based on advice from the European Community." *See also Czechoslovakia: Stock Exchange to be Opened in Prague*, BRIT. BROADCASTING CORPORATION, SUMMARY OF WORLD BROADCASTS, July 16, 1992; *Czechoslovakia: Securities Market to Become Independent Company*, *supra* note 353 ("[t]he market will operate according to the French system, and the decision has been taken to import French software. . .").

358. *British Advice on Strategies*, E. EUR. MARKETS, March 20, 1992.

359. *Prague Stock Exchange with French Know How*, TYDENIK OBCHODU A PODNIKANI, (Czech.), April 29, 1992, at 3.

> The persons possessing, due to the current, or previous job, any information about the facts, which may have an impact on rates of some securities, and which are not possessed by other participants, are not allowed to conclude trades in those securities, or to use such information in favour of other persons until such information becomes known to the general public.[360]

This provision may be under-inclusive in that the proscription only applies to persons possessing inside information "due to the current, or previous job. . ."[361] However, the Chamber may determine by rule the "persons (insiders), who due to their working positions, are not entitled to conduct trades on the stock exchange in certain securities."[362] In addition, the Act provides that participants in Chamber meetings, stock brokers, exchange employees and "legal persons" conducting settlement of trades, must "keep secret" information acquired from insiders, "i.e., information that is important for the development of the financial market, or that touches the interests of individual participants."[363] The Stock Exchange Act provides that for purposes of a civil or criminal action, the foregoing persons may be granted an exemption from this obligation. The exemption is granted by chairman of the stock exchange chamber.[364]

§3.08 Periodic Reporting

In accordance with stock exchange rules, a listed issuer must publicly disclose "during the year" information concerning its business results, annual statements of accounts "verified by the auditor and comments on the financial status."[365] A listed issuer must also, "without any delay," notify the exchange (and the public, if required by the exchange) of "changes in the financial position or other facts, that may result in a change of a security rate, or in worsening of the issuer's ability to comply with the obligations due to the issue of the security."[366] These provisions do not apply "to the problems, related to government bonds, since they are accepted for trading (listed) on the stock exchange without an application and prospectus."[367]

BSE Listing Rules require quarterly reporting for first tier companies, semi-annual reporting for second tier companies and annual reporting for third tier companies.[368] Issuers must periodically submit to the BSE an "activity report" presenting certain information, including financial information, for the relevant period.[369] Further, listed companies

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360. Legal Act of April 21, 1992 on Securities Stock Exchange § 20(3).
361. *Id.*
362. *Id.* § 20(4).
363. *Id.* § 20(5).
364. *Id.*
365. *Id.* § 23(1).
366. *Id.* § 23(2).
367. *Id.* § 24.
368. TBSE Listing Rules, *supra* note 259, II § 8.
369. *Id.* IV § 15.

must within two days disclose to the exchange information on changes in the issuer's "economy influencing directly or indirectly the value or yields of securities. . ." resulting from specified events.[370] The activity reports and material event disclosure must be made available to exchange members on the trading floor, and summaries of such information must be published in two newspapers by the issuer.

§3.09 Violations, Sanctions and Dispute Resolution

[1] *Sanctions*

The Chamber may sanction participants to an exchange transaction and listed issuers who violate the Act; do not satisfy obligations established by the stock exchange; or "purposefully, with the intention to cause damage to the participants in the financial markets, disseminate false or misleading information that had, or might have had, an impact on rates of securities."[371] For these transgressions, the Chamber may issue a public or private reprimand, levy a fine, revoke trading licenses, "recall" stockbrokers or require delisting.[372]

The Ministry of Finance, in supervising the stock exchanges, acts through a "Stock Exchange Commissioner," who is authorized, *inter alia*, to control trading and stock broker activities and countermand decisions of the Chamber. In fact, the Minister of Finance is authorized to withdraw the powers of the Chamber under certain conditions,[373] in which case the Ministry would appoint an authorized representative to act on behalf of the exchange until a new Chamber is elected by the General Assembly.[374] The "Minister of Finance of the Czech Republic or the Minister of Finance of the Slovak Republic have the power to suspend, temporarily, a stock exchange trade, or trades, provided, there is no other way of prevention of extensive economic damages."[375] The exchange has some recourse against the power of the Ministry, however; it may lodge an appeal against it in the Supreme Court of the Czech Republic, or the Slovak Republic, as the case may be. BSE Trading Rules empower exchange officials to order trading breaks, halts and suspensions.[376]

[2] *Dispute Resolution*

Disputes involving stock exchange transactions are resolved in the courts unless the parties agree by written contract to arbitrate disputes in the "stock exchange arbitrary court."[377] The "arbitrary court" (possibly

370. *Id.* § 16.
371. *Stock Exchange Act, supra* note 234, § 31(1)(c).
372. *Id.* § 31(2).
373. *Id.* § 33(1).
374. *Id.*
375. *Id.* § 33(3).
376. TBSE Trading Rules, *supra* note 259, XIV, XV.
377. *Stock Exchange Act, supra* note 234, § 29(1). "In the disputes, arising from trad-

an unfortunate choice of words) is established by the Chamber. By agreeing to arbitrate the parties forego a right to resolve their disputes in court.[378] "The very cause itself is arbitrated by the stock exchange court by means of arbitrary findings, which are final and enforceable."[379]

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ing on the stock exchange, whatever objection, explaining that a mere bet or game is involved, is inadmissible." *Id.* § 2. In the United States, arbitration is now a widely used method of resolving disputes between broker-dealers and their customers. *See* U.S. Federal Arbitration Act, 9 U.S.C.A. § 1 (1970 & Supp. 1992).

378. *Stock Exchange Act, supra* note 234, § 30(2).

379. *Id.* § 30(4).