The International Capital Markets Review

Second Edition

Editor

Jeffrey Golden

Law Business Research

The International Capital Markets Review

SECOND EDITION

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EDITOR'S PREFACE TO THE SECOND EDITION

It was my thought that we should also include in this second edition of *The International Capital Markets Review* my preface to the first edition. Written less than a year ago, it captures relevant background and sets out the rationale for this volume in the series. The contemporary importance of the global capital marketplace (and indeed you must again admire its resilience), the staggering volume of trading and the complexity of the products offered in it, and the increased scrutiny being given to such activity by the courts all continue. And, of course, so does the role of the individual – the difference that an informed practitioner can make in the mix, and the risk that follows from not staying up to date.

However, I was delighted, following the interest generated by our first edition, by the publisher's decision to bring out a second edition so quickly and to expand it. There were several reasons for this. The picture on the regulatory front is much clearer for practitioners than it was a year ago – but no less daunting. According to one recent commentary, in the United States alone, rule-making under the Dodd-Frank report has seen 848 pages of statutory text (which we had before us when the first edition appeared) expand to 8,843 pages of regulation, with only 30 per cent of the required regulation thus far achieved. Incomplete though the picture may look, the timing seems right to take a gulp of what we have got rather than wait for what may be a very long time and perhaps then only to choke on what may be more than any one person can swallow in one go! Regulatory debate and reform in Europe and affecting other key financial centers has been similarly dramatic. Moreover, these are no longer matters of interest to local law practitioners only. Indeed, the extraterritorial reach of the new financial rules in the United States has risen to a global level of attention and has been the stuff of newspaper headlines at the time of writing.

There are also signs that any 'big freeze' on post-crisis capital markets transactional work may be thawing. In the debt markets, the search for yield continues. Equities are seen as a potential form of protection in the face of growing concerns about inflation. Participants are coming off the sidelines. Parties can be found to be taking risks. They are not oblivious to risk. They are taking risks grudgingly. But they are taking them. And derivatives (also covered in this volume) are seen as a relevant tool for managing that risk.

Most importantly, it is a big world, and international capital markets work hugs a bigger chunk of it than do most practice areas. By expanding our coverage in this second edition to include six new jurisdictions, we also, by virtue of three of them, complete our coverage of the important BRIC countries with the addition of reporting from Brazil, Russia and China. Three other important pieces to the international capital markets puzzle – Belgium, the Czech Republic and New Zealand – also fall into place.

The picture now on offer in these pages is therefore more complete. None of the 24 jurisdictions now surveyed has a monopoly on market innovation, the risks associated with it or the attempts to regulate it. In light of this, international practitioners benefit from this access to a comparative view of relevant law and practice. Providing that benefit – offering sophisticated business-focused analysis of key legal issues in the most significant jurisdictions – remains the inspiration for this volume.

As part of the wider regulatory debate, there have been calls to curtail risk-taking and even innovation itself. This wishful thinking seems to miss the point that, if they are not human rights, risk-taking and innovation are hardwired into human nature. More logical would be to keep up, think laterally from the collective experience of others, learn from the attention given to key issues by the courts (and from our mistakes) and 'cherry-pick' best practices wherever these can be identified and demonstrated to be effective.

Once again, I want to thank sincerely and congratulate our authors. They have been selected to contribute to this work based on their professional standing and peer approvals. Their willingness to share with us the benefits of their knowledge and experience is a true professional courtesy. Of course, it is an honour and a privilege to continue to serve as their editor in compiling this edition.

Jeffrey Golden
London School of Economics and Political Science
London
November 2012

EDITOR'S PREFACE TO THE FIRST EDITION

Since the recent financial markets crisis (or crises, depending on your point of view), international capital markets ('ICM') law and practice are no longer the esoteric topics that arguably they once were.

It used to be that there was no greater 'show-stopper' to a cocktail party or dinner conversation than to announce oneself to be an ICM lawyer. Nowadays, however, it is not unusual for such conversations to focus – at the initiation of others and in an animated way – on matters such as derivatives or sovereign debt. Indeed, even taxi drivers seem to have a strong view on the way the global capital markets function (or at least on the compensation of investment bankers). ICM lawyers, as a result, can stand tall in more social settings. Their views are thought to be particularly relevant, and so we should not be surprised if they are suddenly seen as the centre of attention – 'holding court', so to speak. This edition is designed to help ICM lawyers speak authoritatively on such occasions.

In part, the interest in what ICM lawyers have to say stems from the fact that the amounts represented by current ICM activities are staggering. The volume of outstanding over-the-counter derivatives contracts alone was last reported by the Bank for International Settlements ('BIS') as exceeding $700 trillion. Add to this the fact that the BIS reported combined notional outstandings of more than $180 trillion for derivative financial instruments (futures and options) traded on organised exchanges. Crisis or crises notwithstanding, ICM transactions continue apace: one has to admire the resilience. At the time of writing, it is reported that the 'IPO machine is set to roar back into life', with 11 flotations due in the United States in the space of a single week. As Gandhi said: 'Capital in some form or another will always be needed.'

The current interest in the subject also stems from the fact that our newspapers are full of the stuff too. No longer confined to the back pages of pink-sheet issues, stories from the ICM vie for our attention on the front pages of our most widely read editions. Much attention of late has been given to regulation, and much of the coverage in the pages of this book will also report on relevant regulation and regulatory developments; but regulation is merely 'preventive medicine'. To continue the analogy, the courts are our 'hospitals'. Accordingly, we have also asked our contributors to comment on any lessons to be learned from the courts in their home jurisdictions. Have the judges got it right? Judges

who understand finance can, by fleshing out laws and regulations and applying them to facts perhaps unforeseen, help in the battle to mitigate systemic risk. Judges who do not understand finance – given the increase in financial regulation, the amounts involved, and the considerable reliance on standard contracts and terms (and the need therefore for a uniform reading of these) – may themselves be a source of systemic risk.

ICM lawyers are receiving greater attention because there is no denying that many capital market products that are being offered are complex, and some would argue that the trend is towards increasing complexity. These changing financing practices, combined with technological, regulatory and political changes, account for the considerable challenge that the ICM lawyer faces.

ICM activity by definition shows little respect for national or jurisdictional boundaries. The complete ICM lawyer needs familiarity with comparative law and practice. It would not be surprising if many ICM practitioners felt a measure of insecurity given the pace of change; things are complex and the rules of the game are changing fast – and the transactions can be highly technical. This volume aims to assuage that concern by gathering in one place the insights of leading practitioners on relevant capital market developments in the jurisdictions in which they practise.

The book's scope on capital markets takes in debt and equity, derivatives, high-yield products, structured finance, repackaging and securitisation. There is a particular focus on international capital markets, with coverage of topics of particular relevance to those carrying out cross-border transactions and practising in global financial markets.

Of course, ICM transactions, technical though they may be, do not take place in a purely mechanical fashion – a human element is involved: someone makes the decision to structure and market the product and someone makes the decision to invest. The thought leadership and experience of individuals makes a difference; this is why we selected the leading practitioners from the jurisdictions surveyed in this volume and gave them this platform to share their insights. The collective experience and reputation of our authors is the hallmark of this work.

The International Capital Markets Review is a guide to current practice in the international capital markets in the most significant jurisdictions worldwide, and it attempts to put relevant law and practice into context. It is designed to help practitioners navigate the complexities of foreign or transnational capital markets matters. With all the pressure – both professional and social – to be up to date and knowledgeable about context and to get things right, we think that there is a space to be filled for an analytical review of the key issues faced by ICM lawyers in each of the important capital market jurisdictions, capturing recent developments but putting them in the context of the jurisdiction's legal and regulatory structure and selecting the most important matters for comment. This volume, to which leading capital markets practitioners around the world have made valuable contributions, seeks to fill that space.

We hope that lawyers in private practice, in-house counsel and academics will all find it helpful, and I would be remiss if I did not sincerely thank our talented group of authors for their dedicated efforts and excellent work in compiling this edition.

Jeffrey Golden
London School of Economics and Political Science
London
November 2011

Chapter 5

CZECH REPUBLIC

Tomáš Sedláček and Zdeněk Husták[1]

I INTRODUCTION

i Sources of law

Conduct on the capital market is governed by the following laws and regulations:

a Act No. 256/2004 Coll. the Capital Market Undertakings Act, as amended;
b Act No. 15/1998 Coll. Act on Supervision in the Capital Market Area, as amended;
c Act No. 6/1993 Coll. on the Czech National Bank, as amended;
d Act No. 229/2002 Coll. on the Financial Arbiter, as amended;
e Act No. 189/2004 Coll. the Collective Investment Act, as amended;
f Act No. 426/2011 Coll. on Retirement Savings;
g Act No. 427/2011 Coll. on Supplementary Pension Savings,
h Act No. 90/2004 Coll. Act on Bonds, as amended;
i Act No. 591/1992 Coll. on Securities, as amended;
j Act No. 104/2008 Coll. on Takeover Bids, as amended;
k Act No. 408/2010 Coll. on Financial Collaterals; and
l Act No. 513/1991 Coll. the Commercial Code.

ii Courts

The judicial structure in the Czech Republic consists of district courts, regional courts, and two high courts, the Supreme Court, the Supreme Administrative Court and the Constitutional Court. Disputes arising regarding capital markets, securities and negotiable instruments tradable on the capital market, trades on the commodity market, as well as most disputes between entrepreneurs in the course of their business, are tried in the first instance before Regional Courts. The High Court has jurisdiction to hear appeals of regional court decisions. Access to the review of the decision of a court of

1 Tomáš Sedláček is a partner and Zdeněk Husták is of counsel at BBH, advokatni kancelar, v.o.s.

appeal before the Supreme Court or the Constitutional Court may be restricted on the basis of statutory limitations.

Disputes may also be resolved by arbitration. Act No. 216/1994 Coll., on Arbitration Proceedings, sets out two types of arbitration proceeding: (1) arbitration administered by a professional arbitration court, including the Court of Arbitration of the Prague Stock Exchange or the Arbitration Court of the Economic Chamber of the Czech Republic and Agricultural Chamber of the Czech Republic; and (2) *ad hoc* arbitration, whereby arbitrators are appointed by the parties or by an appointing authority chosen by the parties.

iii Czech National Bank

The Czech National Bank ('the CNB') is an administrative authority supervising the financial markets in the Czech Republic. The structure, relation to other administrative bodies and competence of the CNB is stipulated in the Act on the Czech National Bank. The CNB issues decrees implementing acts governing capital markets. It may also issue guidance and official communications, which do not represent binding sources of law, but they are generally respected due to the supervisory authority of the CNB.

iv The Financial Arbiter

Disputes between consumers and financial institutions may be resolved in proceedings before the Financial Arbiter, which is an independent authority empowered to resolve disputes out-of-court arising out of the provision of payment services, consumer loans and electronic money and disputes between investment funds or investment management companies and consumers investing in standard UCITS funds or public special investment funds.

v Professional and non-governmental organisations

The Czech Capital Market Association

The Czech Capital Market Association ('AKAT') is a non-governmental association that aims to contribute to the transparency of the capital markets, investor's protection and members' business activities support in the Czech Republic. Activities include issuance of self-regulatory rules, such as the Code of Ethics, setting a standard for the professional and diligent conduct of its members, participating in legislative procedures in relation to acts regulating collective investment, and informing and educating the investing public. AKAT cooperates with EFAMA[2] and with other national associations in the field of collective investment, both in EU states and other countries.

The Czech Banking Association

The Czech Banking Association ('the CBA') is a voluntary association of legal persons in the banking and closely associated fields. Its members represent 99 per cent of the banking sector in the Czech Republic. The CBA is a full member of the European Banking Federation (EBF) and European Payments Council (EPC).

2 European Funds and Asset Management Association

The Association of Financial Intermediaries and Financial Advisers and the Union of Financial Intermediaries and Financial Advisers

The Association of Financial Intermediaries and Financial Advisers ('AFIZ') and the Union of Financial Intermediaries and Financial Advisers ('USF') are voluntary professional associations of financial intermediaries and financial advisers. The association's objectives are to promote best practice in the financial services areas and increase customer protection. In doing so, AFIZ and USF cooperate with administrative bodies, particularly the Ministry of Finance and the CNB. Members providing financial services are bound by the internal rules of these professional bodies such as ethical codes, and any failure to follow these may result in disciplinary action.

II THE YEAR IN REVIEW

i Developments affecting debt and equity offerings

Amendment to the Acts on Bonds

The main objective of this amendment, which came into force on 1 August 2012, is the reduction of administrative burdens connected with the issuance of bonds. There is no longer the need for the submission of applications on the issuance terms of individual bonds for approval to the CNB. The CNB does not supervise the private placement of bonds where the issuer has no obligation to publish a prospectus.

De novo natural persons are now entitled to issue bonds under conditions analogous to legal persons. Bondholders meetings may also now be held by means of electronic communication.

Czech Treasury Bonds for retail investors

The Czech Republic has launched a new programme of Treasury bond issuance for retail investors. There have so far been two issues: on 11 November 2011 and 10 May 2012. Bonds with maturity ranging from one to seven years can be offered to retail investors, municipalities and other public institutions. The distribution is arranged by banks

Interestingly, the yield offered to retail investors investing in these Treasury bonds is much lower than the rate of government debt financing on the wholesale market.

ii Developments affecting derivatives, securitisations and other structured products

Collective investment

The regulation governing collective investment encompasses the rules on the activities of investment companies, Czech and foreign collective investment funds and banks providing depository services to funds.

The Czech Ministry of Finance, in cooperation with the CNB, has proposed a draft of the New Collective Investment Act implementing recently issued European

legislation, including the UCITS IV Directive[3] and AIFMD Directive.[4] The New Collective Investment Act is expected to bring numerous changes to the classification of funds, introduce new legal forms of investment funds (e.g., special forms of joint-stock SICAV companies, which allow for the creation of sub-funds under one umbrella corporate body and special forms of limited liability partnerships, which may issue shares representing participation in the partnership) and impose duties on subjects participating in fund business, such as administrators or prime brokers. The aim of the New Collective Investment Act is to establish a flexible modern environment for fund businesses to attract foreign investors.

The value of assets under management of collective investment funds offered to the public in the Czech Republic exceeded 224 billion korunas by end of 2011. The main trends in the fund business in the Czech Republic are (1) increasing interest in individual asset management; (2) growth of the funds of qualified investors; and (3) raising the interest of investors to become more involved in fund management.

Pension reform

The Act on Retirement Savings and the Act on Supplementary Pension Savings were enacted in 2011 and will come into force in 2013. The pension system is based on three pillars: public pensions, supplementary pensions and personal savings.

The Act on Retirement Savings governs the second pillar, under which the contributions are invested in retirement funds adhering to similar regimes as standard UCITS unit funds. Unlike a unit fund, retirement funds do not issue shares but rather 'retirement units'. Companies managing retirement funds must establish four mandatory retirement funds, each having a statutory prescribed structure of assets, investment limits and investment regimes. These are state bond retirement funds, conservative retirement funds, balanced retirement funds and dynamic retirement funds. These companies must obtain a licence and fulfil statutory requirements. The process for the establishment of funds requires the permission of CNB.

The Act on Supplementary Pension Savings sets out a voluntary system under which the contributions of participants are invested in a variety of types of pension fund structures similar to the standard UCITS unit funds investing on the financial markets. The contributions paid by participants are boosted by additional state contributions, and employers may also pay contributions on behalf of their employees.

Companies managing retirement finds are obliged to establish at least one pension fund: a mandatory conservative fund with a statutorily prescribed investment strategy. They may also establish other pension funds with asset structures and investment limits

3 Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions related to undertakings for collective investment in transferable securities (UCITS).

4 Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010.

determined by law, but where the particular investment strategy remains at their own discretion.

The Act on Supplementary Pension Savings also regulates the transformation of current pension funds to special transformed funds under which the assets of shareholders and participants are segregated. Upon the application of an individual participant, his or her share in the transformation fund may be subsequently transferred to a new retirement fund. The Act provides for the establishment of pension companies managing such transformed funds. Current pension fund operators have to apply to the CNB for new licence to operate such pension company and to manage pension funds and retirement funds.

iii Cases and dispute settlement

Disputes concerning capital market transaction are rarely settled by the public courts. They are more often settled out-of-court or by professional arbitration courts or *ad hoc* arbitrators. This leaves only a limited number of cases to be decided by the courts, so there is little publicity regarding decisions in cases in this field.

iv Relevant tax and insolvency law

Tax law

An Amendment to Act No. 586/1992 Coll., on Income tax, which will likely come into force on 1 January 2015, brings major changes to the taxation of retail investors. Currently, private investor holding securities over six months are not subject to security income tax. The amendment changes this period by increasing it up to three years. The taxation will also increase from 15 per cent to 19 per cent.

Income tax on the dividends paid by joint-stock companies (15 per cent) will not be subject to these changes. This exception does not apply to dividends on unit trusts and investment funds.

Connected to the draft amendment of the Collective Investment Act, it is considered that the taxation of unit trusts and investment funds, now subject to 5 per cent corporate income tax, will be modified – regulated investment funds and unit trusts will remain subject to 5 per cent tax, but non-regulated funds will be subject to standard corporation tax (19 per cent).

It is also important to mention that dividends from subsidiary companies paid to parent companies are now exempt from taxation. The conditions are that at least a 10 per cent business share in the subsidiary company has been held for at least 12 months. The 12-month period can be fulfilled subsequently.

Insolvency law

The Ministry of Justice published a draft amendment to the Act on Insolvency. The changes aim to protect debtors against groundless insolvency proceedings. The Insolvency Act does not provide specific protection against obstruction of insolvency proceedings and the only remedy available is to subsequently claim damages before the court. According to the current regulation, insolvency proceedings are commenced two hours after the creditor delivers their draft to start proceedings to the relevant court, and the proceedings are immediately announced in the Insolvency Register; only after these

steps can the court verify its legitimacy. The amendment changes the procedure and allows the court to dismiss creditors' drafts that are obviously groundless. With regard to such dismissal, the court can penalise the creditor by imposing a fine. The Insolvency Court will also have the authority to demand that the creditor deposit a certain sum for potential damages caused by a groundless insolvency draft.

v Role of exchanges, central counterparties (CCPs) and rating agencies

Exchanges

There are two regulated markets operating in the Czech Republic: the Prague Stock Exchange ('the PSE') and the RM-SYSTEM Czech Stock Exchange ('the RM-S'). Both systems provide trading on the regulated market and a multilateral trading facility.

The PSE, together with the Stock Exchanges in Budapest, Ljubljana and Vienna, belongs under the CEE Stock Exchange Group. The most important PSE market is the SPAD system, whereby the most liquid securities are traded. Moreover, the PSE offers trading on the KOBOS market focused on small and medium investors. The RM-S is a local entity, owned and operated by FIO Banka, facilitating trades for small and medium investors.

The most significant commodity exchange is the Power Exchange Central Europe ('the PXE'), trading electricity. The PXE is a subsidiary of the PSE.

There are also four local commodities exchanges focusing on agricultural commodities in the Czech Republic.

The Central Securities Depository Prague

The activities of the Central Depository encompass the operation of a central register of dematerialised securities issued in the Czech Republic, the operation of a settlement system for the settlement of exchanges, and OTC transactions, including investment instruments, the lending of securities, administration and management of guarantee instruments, custody, the administration of investment instruments maintained in a separate register and other activities.

Rating agencies

Of the 'big three', there is only one affiliate of Moody's rating agency permanently present in the Czech Republic. Moody's activities include providing credit ratings, research, tools and analysis that contribute to transparent and integrated financial markets. Czech legislation governing the activities of rating agencies is fully in line with Regulation No. 1060/2009 on credit rating agencies,[5] which governs the activities of credit rating agencies in the European Union.

5 Regulation (EC) No. 1060/2009 of the European Parliament and of the Council of 16 September 2009, on credit rating agencies

III OUTLOOK AND CONCLUSIONS

Despite the existing euro debt crisis spreading from Greece to Spain and Italy, the financial sector in Czech Republic remains stable. Czech economics have been influenced only to a limited extent by the slowdown of economic activities in the EU, but developments in the eurozone may still bring many risks for the future financial stability of the Czech Republic.

The main threat for the Czech economy remains the decline in the economic activities of its neighbour states. This threat arises from the connection of the financial sector, public finances and real economics.

One step in the right direction in the field of public finances will be the reform of deficits in the actual pension system facilitated by the new three-pillar pension reform coming into force in 2013.

Czech regulations concerning the capital markets are derived from the European Union *acquis communautaire*, which, in relation to the financial debt crisis, is expected to bring more restrictive and detailed rules and regulations of the capital markets in the coming years.

Appendix 1

ABOUT THE AUTHORS

TOMÁŠ SEDLÁČEK

BBH, advokátní kancelář, v.o.s.

Tomáš Sedláček is a partner at BBH focusing on banking and finance, structured finance (including aircraft finance), capital markets and commercial law (including M&A and corporate law). Mr Sedláček provides professional counsel related to securities and financial and commodity derivatives, as well as preparing and negotiating the associated legal documentation. In this connection, Mr Sedláček became a member of the ISDA Central and Eastern Europe Committee. The drafting and negotiating of the standard loan facility (bilateral and syndicated) and alternative financing, and debt instrument documentation (such as credit-linked notes, asset-linked notes, leverage financing, asset-backed financing, etc.) constitutes a significant part of his work. He lectures at the Law Faculty of Charles University and has written a number of articles relating to the areas of law in which he specialises.

During his career, Mr Sedláček has acted as legal counsel on a wide number of projects and transactions, including loan facilities, structured-finance transactions, debt and share issues, and the purchase and subsequent financing of a number of aircraft. The most significant transactions that he advised on include the first-ever rated securitisation in central and eastern Europe, the largest private bond offering listed on the Prague Stock Exchange and advising clients on the development and practical implementation of a new structured financial product line at a Czech bank.

ZDENĚK HUSTÁK

BBH, advokátní kancelář, v.o.s.

Zdeněk Husták is of counsel at BBH and focuses on financial markets, banking and insurance and he advises banks, investment firms and asset managers on various topics including new product design and regulatory and corporate governance issues.

Mr Husták has extensive experience in the oversight of the financial markets. Between 2003 and 2006, he was a member of the Presidium of the Czech Securities Commission

responsible for supervising and regulating investment services, the settlement system, the regulated markets and clearing houses. He advised the Ministry of Finance of the Czech Republic and led the project of the transposition of MiFID into Czech law. During the Czech Presidency of the Council of the European Union, Mr Husták led a working group of the EU Council Regulation on rating agencies and also participated in the Alternative Investment Funds Managers Directive (AIFMD) negotiations. He is the chairman of the Ethics Committee of the Czech Capital Market Association and is a member of the board of the Institute for Financial Markets at Masaryk University, Brno; he often publishes on the topic of capital and finance markets, about which he frequently lectures at domestic and foreign conferences and seminars and the University of Economics in Prague.

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