Securities Market Integration in Asia: What Would Be the Theoretical Approach?

Md Anowar Zahid & Hasani Mohd Ali[1]

I. INTRODUCTION

Today, securities offerings and trading have become, to a remarkable extent, global in the same vein as other economic and business activities. The globalization is taking place mainly through integration of national securities markets. The principal examples of such integrated markets are the European Union (EU) and the Multijurisdictional Disclosure System (MJDS) between Canada and the United States. Recently, the Association of Southeast Asian Nations (ASEAN) initiated an attempt to integrate securities markets in Asia. This paper will go over the integration efforts of these three regions to see what theoretical approaches they have taken towards their goal.

Integration between different nations is not an easy task because they are politically, economically, and legally divided and diverse. A look into the theoretical perspective will describe how integration has been achieved despite these diversities. As integration has already successfully taken place in Europe and North America, their approaches will be examined first. After that, this paper will evaluate the ASEAN approach to determine if it is following the same line of theoretical construction to achieve its goal.[2]

II. INTEGRATION IN EUROPE

A. Background

The EU of today is a supranational organization that has integrated the economic, political, security, domestic, and justice regimes of twenty-five European states.[3] Its origin lies in three organizations: the European Coal and Steel Community (ECSC), the European Atomic Energy Community

1. Senior Lecturer and Associate Professor, respectively, Faculty of Law, *Universiti Kebangsaan Malaysia* (National University of Malaysia), Bangi 43600, Selangor, Malaysia. The authors may be contacted at dr.anowar.zahid@gmail.com and hmohdali@ukm.my.

2. In this paper, ASEAN is taken as representative for the purpose of Asian integration.

3. A supranational organization may be defined as an independent entity composed of a number of states to which powers have been transferred from the national level. *See* STEPHEN WEATHERILL, LAW AND INTEGRATION IN THE EUROPEAN UNION 10 (1995).

(Euratom), and the European Economic Community (EEC). The ECSC was formed by treaty in 1951 to integrate the coal and steel market in Europe and brought together six states including France and Germany, the two bitter enemies of the Second World War. With this act, Europe started its journey as a community, "basically as an economic organisation, although the final objectives were clearly political."[4] The other two organizations, Euratom and the EEC, followed in 1957 under two different treaties.[5]

Of the above institutions, the EEC (hereinafter EC) was the leading one.[6] Its goal was economic integration and political cohesion.[7] The economic development "was always planned with grander aspirations,"[8] because, for some theorists, economic integration "inevitably begets political integration too, even without any explicit initiatives directed at the political sector."[9]

The promoters of the EC envisioned a twofold means of achieving these goals: establishment of a common market and progressive harmonization of economic policies among the member states. Indeed, economic success as a goal and a common market as a means to reach that goal received prominence in EC propaganda and activities.[10] The common market, in this context, promoted four unfettered freedoms[11]: namely the free movement of goods,[12]

4. Loukas Tsoukalis, *Looking into the Crystal Ball*, 21 J. COMMON MKT. STUD. 229, 229 (1982); *see also Opinion of the Committee of the Regions of 13 April 2000 on the 'Expiry of the ECSC Treaty,'* ¶ 1.2, 2000 O.J. (C 226/14) [hereinafter *Opinion of the Committee*]. "The European Coal and Steel Community has . . . made a key contribution to bringing about and consolidating peace in Europe and promoting political and economic integration, thereby laying the foundations for further progress towards European unification." *Opinion of the Committee*, *supra*, ¶ 1.2.

5. Treaty Establishing the European Atomic Energy Community, Mar. 25, 1957, 298 U.N.T.S. 167 [hereinafter Euratom Treaty]; Treaty Establishing the European Economic Community, Mar. 25, 1957, 298 U.N.T.S. 11 [hereinafter EEC Treaty].

6. The ECSC expired automatically on July 23, 2002, fifty years after it entered into force. *See Treaty Establishing the European Coal and Steel Community, ECSC Treaty*, EUROPA, http://europa.eu/legislation_summaries/institutional_affairs/treaties/treaties_ecsc_en.htm (last updated Oct. 15, 2010). By that time, virtually all the ECSC's functions had been incorporated into the EU. *See id.* Meanwhile, the Euratom Treaty "has an essentially modest record of achievement. Control of and responsibility for policy and decision-making at virtually every stage of the nuclear fuel cycle remain firmly in the hands of the Member States." John Woodliffe, *Making Sense of Article 37 of the Euratom Treaty*, 14 EUR. L. REV. 101, 101 (1989). On the other hand, the EEC Treaty was negotiated to establish broader economic cooperation among member states through the formation of the EEC. *See* LAW OF THE EUROPEAN UNION 3 (Robert M. Maclean, Sydney William Templeman & Baron Templeman eds., 2d ed. 1999). It "involved the transfer of a considerable degree of national sovereignty to create a supranational body capable of regulating its economic affairs." *Id.* Subsequently, the treaty was amended several times and extended beyond economic fields, ultimately becoming the foundation for the EU. *Id.*

7. The EEC was formed "to promote throughout the Community a harmonious *development of economic activities*, a continuous and balanced expansion, an increased stability, an accelerated raising of the standard of living and *closer relations between its Member States*." EEC Treaty, *supra* note 5, art. 2 (emphasis added).

8. *See* WEATHERILL, *supra* note 3, at 6.

9. *Id.* at 8.

10. *Id.* at 6.

11. *See* EEC Treaty, *supra* note 5, art. 3(a), (c).

12. *See id.* arts. 9-37.

persons,[13] services,[14] and capital[15] under equal conditions of competition.[16] To facilitate their movement, the EC adopted a combined approach—harmonization of some rules and standards and mutual recognition of member states' domestic regimes. The reason behind this approach was that harmonization alone would not be an effective method of integration because detailing technical specifications would be time-consuming, "over-regulatory,"[17] and probably impossible given the diversity of the legal, administrative, and regulatory systems of the member states.[18] Conversely, resorting to mutual recognition alone would not be sufficient, either, because of the increasing size of the competitive market of Europe.

However, it is not easy to achieve the combined approach in practice. Member states, with a variety of diversities, have different legal and administrative requirements.[19] For example, they have varying standards for products, qualifications for professionals, and regulations for services. These differing requirements stand in the way of the four freedoms. Therefore, to forge harmonization, essential requirements—instead of detailed ones—are established so that member states can incorporate them in domestic laws or amend necessary legal provisions.

Article 100[20] of the EEC Treaty provides for harmonization mainly through EC directives issued by the European Council. Member states are supposed to adopt means to comply with the directives. States may adopt different means, but the ends must be the same.[21] In this system, so far as the securities market is concerned, "issuers can be certain of the results in each participating country, but may still have to comply with various sets of rules."[22] Derogation from the harmonization provision may be available to a member state on certain

13. *See id.* arts. 48-51.

14. *See id.* arts. 59-66.

15. *See* EEC Treaty, *supra* note 5, arts. 67-73.

16. *See id.* art. 3(f); *see also* Case C-300/89, Comm'n v. Council (*Titanium Dioxide*), 1991 E.C.R. I-2867, I-2899 (reaffirming this point).

17. *Completing the Internal Market, White Paper from the Commission to the European Council*, ¶ 64, COM (1985) 310 final (June 28-29, 1985) [hereinafter *Completing the Internal Market*].

18. *See id.* ¶¶ 64-65.

19. EC member states have a variety of diversities, including language, legal systems, economic strength, and geographical size and position. In spite of this, they sought cohesion based on common economic and political goals. This is unique of the integration process of Europe. "In reality, the entire European integration process is marked by a dialectic relationship between the necessary cohesion of the Union and the equally necessary diversity of the parts." PHILIPPE DE SCHOUTHEETE, THE CASE FOR EUROPE: UNITY, DIVERSITY, AND DEMOCRACY IN THE EUROPEAN UNION 64 (1997). Both cohesion and diversity are "necessary," and neither can be undermined at the cost of the other without prompting "a contrary reaction." *Id.* In the integration process, diversities and cohesion go hand in hand.

20. Presently article 94.

21. *See* DAVID L. JOHNSTON & KATHLEEN DOYLE ROCKWELL, CANADIAN SECURITIES REGULATION 314 (2d ed. 1998).

22. *Id.*

grounds, such as health, safety, or environmental protection.[23] Member states are allowed to legislate in such cases with varying standards or regulations.[24]

In the areas where harmonization of technical standards or regulations is not essential or possible on these grounds, the law requires each member to recognize other members' regulations as valid and as effective as its own for the purpose of market integration.[25] This is known as the principle of mutual recognition, which the European Court of Justice (ECJ) first established in the famous case of *Cassis de Dijon*.[26] The basic purpose of mutual recognition in securities law is "to keep the amount of supplemental information as small as possible."[27] If issuers' home country administration reviews the necessary documents, that should be sufficient so that issuers need not experience regulatory hassles in other jurisdictions.[28]

The method of mutual recognition operates in a dual fashion: removing barriers to the intra-Community market and setting common standards.[29] For example, in the financial services area,[30] each member state has to allow the financial services providers based in other member states free entry to its market, subject to the condition that a minimum degree of protection for investors or creditors is offered under the regulatory regime of the host

23. *See* EEC Treaty, *supra* note 5, arts. 13, 36, 48(3), 56, 135.

24. *See id.* Member states may mutually recognize these varying standards. This has encouraged innovation at the national level and at the same time integration at the community level. *See* Stephen Weatherill, *Beyond Preemption? Shared Competence and Constitutional Change in the European Community*, *in* LEGAL ISSUES OF THE MAASTRICHT TREATY 13, 13-33 (David O'Keeffe & Patrick M. Twomey eds., 1994).

25. *See* JOHNSTON & ROCKWELL, *supra* note 21, at 316.

26. *See* Case 120/78, Rewe-Zentral AG v. Bundesmonopolverwaltung für Branntwein (*Cassis de Dijon*), 1979 E.C.R. 649. In *Cassis de Dijon*, a concerned German authority barred the plaintiff from importing French wine with an alcohol content of fifteen to twenty percent, on the grounds that it had to contain a minimum alcohol content of twenty-five percent as provided under German law. The importer argued that in the absence of common rules, the German prohibition amounted to a quantitative restriction on the free movement of goods within the Community in violation of EEC Treaty article 30 (presently article 28). The ECJ agreed, ruling that the German law could have been accepted if it were necessary "to satisfy mandatory requirements relating in particular to the effectiveness of fiscal supervision, the protection of public health, the fairness of commercial transactions and the defence of the consumer." *Id.* ¶ 8. In other words, the ECJ for the first time established that, in the absence of harmonized EC law, goods produced and marketed legally in one member state must be recognized in other member states unless it contravenes mandatory rules. *See id.* The *Cassis de Dijon* formula is an invention of the ECJ with a view to promoting the objective of a common market as enshrined in the EC Treaty. The formula, however, is not found there. The ECJ just filled the gap. *See* WEATHERILL, *supra* note 3, at 236. Of course, the "seeds" of the *Cassis de Dijon* formula were sown five years earlier in the *Dassonville* case. *See* Case 8/74, Procureur du Roi v. Dassonville, 1974 E.C.R. 837; *see also* René Barents, *New Developments in Measures Having Equivalent Effect*, 18 COMMON MKT. L. REV. 271, 296 (1981).

27. Manuel Lorenz, *EEC Law and Other Problems in Applying the SEC Proposal on Multinational Offerings to the UK*, 21 INT'L LAW. 795, 819 (1987).

28. *See* JOHNSTON & ROCKWELL, *supra* note 21, at 316 n.79.

29. *See* Gérard Hertig, *Regulatory Competition for EU Financial Services*, 3 J. INT'L ECON. L. 349, 352 (2000).

30. For difficulties associated with harmonization policy, and the merits of mutual recognition and minimum harmonization in the field of financial services law, see Wulf-Henning Roth, *The European Economic Community's Law on Services: Harmonisation*, 25 COMMON MKT. L. REV. 35, 84-94 (1988).

country.[31] Additionally, the EC issues directives and regulations setting common minimum standards,[32] which will be mutually recognized by all states.[33] In the absence of such EC legislation, the national laws of each member state apply. This means that the application of the mutual-recognition principle is not automatic; rather, it requires EC legislative measures.[34]

The above approach to integration is based on economist Tibor Scitovsky's theory of European economic integration.[35] According to Scitovsky, European economic integration can take place through "the abolition of restrictions on the movement of products and . . . on the movement of labour and capital."[36] This will generate competition among the national economies of the member states under equal conditions. Such competition may produce "unfavourable effects" on any particular sector of any national economy. For example, small business firms that a particular member state has been fostering with subsidies, even to the disadvantage of larger firms, may not survive the competition.[37] In such a situation, Scitovsky suggests adopting measures to remove the "unfavourable effects" or to convert them into "favourable ones" and thereby bolster the integrated market.[38] Along the same line of thought, the EC Commission has maintained that:

> The benefits to an integrated Community economy of the large, expanding and flexible market are so great that they should not be denied to its citizens because of difficulties faced by individual Member States. These difficulties must be recognised, to some degree they must be accommodated, but they should not be allowed permanently to frustrate the achievement of the greater progress, the greater prosperity and the higher level of employment that economic integration can bring to the Community.[39]

31. *See* Hertig, *supra* note 29, at 353.

32. *Id.*

33. *See* Written Question No. 1104/95 by José Valverde López to the Commission: Problems in Applying the Principle of Mutual Recognition, 1995 O.J. (C 222) 41.

34. *See* Case 104/91, Colegio Oficial de Agentes de la Propiedad Inmobiliaria v. Aguirre Borrell, 1992 E.C.R. I-3003, I-3007.

35. *See* Geoffrey Fitchew, *Political Choices*, *in* EUROPEAN BUSINESS LAW: LEGAL AND ECONOMIC ANALYSES ON INTEGRATION AND HARMONIZATION 1, 4 (Richard M. Buxbaum et al. eds., 1991). For economic integration theory in general and without particular reference to Europe, see generally BELA BALASSA, THE THEORY OF ECONOMIC INTEGRATION (3d ed. 1969), and Bela Balassa, *The Theory of Economic Integration: An Introduction*, *in* THE EUROPEAN UNION: READINGS ON THE THEORY AND PRACTICE OF EUROPEAN INTEGRATION 125 (Brent F. Nelsen & Alexander C-G. Stubb eds., 1994). For two important critiques of the economic integration theory and their refutation, see Fitchew, *supra*, at 4-6.

36. TIBOR SCITOVSKY, ECONOMIC THEORY AND WESTERN EUROPEAN INTEGRATION 16 (1958).

37. *Id.* at 134.

38. *Id.* at 16.

39. *See Completing the Internal Market*, *supra* note 17, at 7.

B. Integration of Securities Markets

1. Prelude

The EC initially adopted directives liberalizing capital movement as a means of establishing a common market in financial services.[40] Those directives enabled individuals and firms to invest capital across national frontiers.[41] Although investors, taking advantage of this freedom, could invest in foreign securities, securities issuers could not establish business and solicit capitalization in foreign jurisdictions within the EC.[42] Therefore, the EC underscored the need for "a level playing field" for both securities issuers and investors.[43] This led to the adoption of a number of directives facilitating harmonization and mutual recognition of rules and requirements relating to the offering and trading of securities within the EC. Those directives include, in the first category,[44] the Listing Particulars Directive (LPD),[45] the Interim Reports Directive,[46] and the Major Shareholding Directive.[47] Later, the Admission and Information Directive (AID) replaced the four earlier directives, keeping their contents unchanged.[48] In the second category, the Public Offer Prospectus Directive (POPD) defines information to be published when securities, not previously listed, are offered to the public for the first time. Subsequently, the Annual Accounting Directive[49] and Consolidated Accounting Directive[50] were adopted, setting forth how financial statements—an important

40. *See, e.g.*, Council Directive 60/921, 1960 J.O. (L 43/921) (EC); Council Directive 63/21, 1963 O.J. (L 9/62) (EC).

41. Roberta S. Karmel, *Securities Law in the European Community: Harmony or Cacophony?*, 1 TUL. J. INT'L & COMP. L. 3, 6 (1993).

42. *Id.*

43. *Id.*

44. Council Directive 79/279, Coordinating the Conditions for the Admission of Securities to Official Stock Exchange Listing, 1979 O.J. (L 66/21) (EC).

45. Council Directive 80/390, Coordinating the Requirements for the Drawing Up, Scrutiny and Distribution of the Listing Particulars to be Published for the Admission of Securities to Official Stock Exchange Listing, 1980 O.J. (L 100/1) (EC).

46. Council Directive 82/121, On Information to be Published on a Regular Basis by Companies the Shares of Which Have Been Admitted to Official Stock-Exchange Listing, 1982 O.J. (L 48/26) (EC).

47. Council Directive 88/627, On the Information to be Published When a Major Holding in a Listed Company is Acquired or Disposed of, 1988 O.J. (L 348/62) (EC).

48. Directive 2001/34, of the European Parliament and of the Council of 28 May 2001 on the Admission of Securities to Official Stock Exchange Listing and on Information to be Published on Those Securities, 2001 O.J. (L 184/1) (EC); *see also Explanatory Memorandum, Proposal for the Admission and Information Directive*, ¶ 1, COM (2000) 126 final (July 20, 2000).

49. Council Directive 78/660, On the Annual Accounts of Certain Types of Companies, 1978 O.J. (L 222/11) (EC) [hereinafter Annual Accounting Directive]. This directive was last amended by Council Directive 1999/60, 1999 O.J. (L 162) (EC).

50. Council Directive 83/349, 1983 O.J. (L 193/1) (EC) [hereinafter Consolidated Accounting Directive] (based on article 54(3)(g) of EEC Treaty on consolidated accounts). This directive has been amended by Council Directive 90/605, 1990 O.J. (L 317) (EC).

component of listing particulars and public offer prospectuses—were to be prepared. In addition to the Interim Reports Directive mentioned above, the EC adopted post-listing directives including, among others, the Insider Dealing Directive,[51] which the Market Abuse Directive (MAD) later repealed.[52]

In 1993, the EC also adopted the Investment Services Directive (ISD).[53] It is the first "passport" directive in securities, enabling firms providing investment services to freely carry out business within the EC. Then, in 2003, the EC adopted the "passport" Prospectus Directive (PPD),[54] replacing the listing particulars provisions of the AID and the POPD, which had introduced "a partial and complex mutual recognition mechanism"[55] in the EC. Based on disclosure standards established by the International Organization of Securities Commissions (IOSCO), the PPD has harmonized "requirements for the drawing up, approval and distribution of the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market situated or operating within a Member State."[56]

The following sections summarize the EC efforts towards harmonization and mutual recognition in the area of prospectus disclosure, which is also applicable to listing particulars, in order to show how integration has taken place in securities law in this region.

2. Harmonization

a. Disclosure of Nonfinancial Information

Article 5(1) of the PPD requires that a prospectus contain—depending on the nature of the issuer and the securities offered to the public or admitted to trading on a regulated market—all information necessary to investors "in an easily analysable and comprehensible form." The purpose of the disclosure is to enable investors to "make an informed assessment of the assets and liabilities, financial position, profit and losses, and prospects of the issuer and of any guarantor, and of the rights attaching to such securities." Without prejudicing this general requirement, the PPD specifies the minimal contents of a prospectus in Annex I, based on the IOSCO disclosure standards. These contents include the details of the persons, such as directors, involved in the company's offer or admission to trading of its securities and also of those who

51. Council Directive 89/592, Coordinating Regulations on Insider Dealing, 1989 O.J. (L 334/30) (EC).

52. Directive 2003/6, of the European Parliament and of the Council of 28 January 2003 on Insider Dealing and Market Manipulation (Market Abuse), 2003 O.J. (L 96/16) (EC).

53. Council Directive 93/22, On Investment Services in the Securities Field, 1993 O.J. (L 141/27) (EC).

54. Directive 2003/71, of the European Parliament and of the Council of 4 November 2003 on the Prospectus to be Published When Securities are Offered to the Public or Admitted to Trading and Amending Directive 2001/34/EC, 2003 O.J. (L 345/64) (EC) [hereafter Passport Prospectus Directive].

55. *Id.* pmbl. ¶ 1.

56. *Id.* art. 1.

certify its veracity and fairness, such as auditors.[57] The company must disclose the method of the offering—equity, for example—expected amount of the offering and expected issue price, the period of time for which the offer will be open, and the method of payment for the securities.[58] The disclosure must list key information about the company's financial condition and capitalization, and the risk factors involved in the securities offered.[59]

The disclosure must also provide insight into the firm's structure by listing information about the issuer and its activities, such as its name; registered office; date of incorporation, merger or consolidation; any takeover offer for its shares; and its products, services, geographic markets, and material contracts.[60] Management must explain the company's financial condition and results of operations for the time for which the financial statements were prepared.[61] The statement must include names, addresses, and functions of members of the administrative, management, and supervisory bodies of the issuer, along with remuneration paid, benefits granted to, and shares held by, those groups.[62] The disclosure must also include major shareholders having control over the issuer and the issuer's transactions with persons affiliated with the company.[63] Logically, the disclosure will include information about the shares: their numbers, price and value, attached rights, and also the time when admission to official listing and stock exchange trading will be sought.[64] Finally, the disclosure includes miscellaneous information, such as the issuer's share capital, material contracts, exchange controls, taxation to which shareholders are subject, and other similar matters.

b. Disclosure of Financial Information

Item IX of the PPD requires a prospectus, with respect to consolidated accounts, to contain principally the balance sheets and income statement (profit and loss accounts), together with notes, cashflow statements, and statement of changes in equity (statement of profit/loss), for the last three financial years. The accounts are to be prepared according to International Accounting Standards (now called International Financial Reporting Standards or IFRS) under the International Accounting Standards (IAS) Regulation.[65] Member states may, at their option, permit or require the application of IAS in the

57. *Id.* annex I, ¶ II.

58. Passport Prospectus Directive, *supra* note 54, annex I, ¶ III.

59. *Id.* annex I, ¶ IV.

60. *Id.* annex I, ¶ V.

61. *Id.* annex I, ¶ VI.

62. Passport Prospectus Directive, *supra* note 54, annex I, ¶ VII.

63. *Id.* annex I, ¶ VIII.

64. *Id.* annex I, ¶ X.

65. Regulation 1606/2002, of the European Parliament and of the Council of 19 July 2002 on the Application of International Accounting Standards, 2002 O.J. (L 243/1) (EC).

preparation of annual accounts of such companies.[66] They may also apply this provision equally to nonpublicly traded companies for drawing up their annual and/or consolidated accounts.[67] The accounts, whether annual or consolidated, must provide a "true and fair view" (TFV) of the company's financial standing.[68]

c. Mutual Recognition

After a prospectus has been prepared in conformity with the PPD, it is to be filed with the competent authority, such as the Securities Exchange Commission, for approval. When a multi-jurisdictional listing is sought and the prospectus is approved in the home member state, the competent authority of the home member state shall, at the request of the issuer, provide a certificate of approval confirming that the prospectus has been drawn up in compliance with the PPD and attach a copy of the prospectus with that certificate. The host member state's competent authority shall accept the prospectus without further administrative procedure.[69]

3. Summary

It has been noted that the integration of the EC securities markets is based on Scitovsky's theory, which suggested removal of barriers to economic integration resulting from the diverse legal, administrative, and regulatory systems of the European states. The EC has adopted a combined approach—harmonization and mutual recognition—to remove those barriers by necessary directives, of which the PPD, the IAS Regulation, and the Annual Accounting and Consolidated Accounting Directives are worth mentioning. This approach has made the EC "the major force for global regulatory harmony."[70]

66. *Id.* art. 5.

67. *Id.*

68. Annual Accounting Directive, *supra* note 49, arts. 2(2), (3); Consolidated Accounting Directive, *supra* note 50, art. 16(3). The principle of TFV requires that "financial statements show distortion-free actual financial standing of a company." Md Anowar Zahid, *International Securities Offerings: A Quest for a Transatlantic "Passport" Prospectus*, 5 INT'L & COMP. CORP. L.J. 75, 108 (2006). This requirement may be fulfilled primarily by preparing financial statements according to IAS or domestic accounting standards. If compliance with IAS or domestic accounting standards does not provide a TFV, both may be departed from and the financial statements may be prepared according to any other standards as may be deemed suitable. For a discussion of this principle from a comparative perspective (European versus North American), see generally Md Anowar Zahid, *"True and Fair View" Versus "Fair Presentation" Accountings: Are They Legally Similar or Different?*, 19 EUR. BUS. L. REV. 677 (2008).

69. Passport Prospectus Directive, *supra* note 54, art. 18.

70. Manning Gilbert Warren III, *Regulatory Harmony in the European Communities: The Common Market Prospectus*, 16 BROOK. J. INT'L L. 19, 53 (1990).

III. INTEGRATION OF SECURITIES MARKETS OF NORTH AMERICA

A. Background

During the early to mid-1980s, there were many large-scale multi-jurisdictional equity offerings, like, for example, the British Telecom offering of 1984 in Canada, the United Kingdom, and the United States.[71] This new phenomenon carried some legal and regulatory complications, such as determining under which country's laws the securities-offering documents should be prepared, which regulatory authority should review the prospectus, and which law should apply in the event of a breach of any legal or regulatory requirements. These complications were likely to increase in the future. To tackle them, the regulatory authorities of Canada and the United States felt a need to establish a multi-jurisdictional offerings system. To this end, they found that the two jurisdictions had "similarity in substantive disclosure requirements, in the process and approach to prospectus review, as well as in the procedures and established history of regulation of capital markets."[72] In order to further facilitate the achievement of the goal, the Canadian authorities amended their securities laws to harmonize them with their U.S. counterparts in areas including continuous disclosure liability, shelf registration, and management's discussion and analysis disclosure.[73] The United States, however, was "unwilling to alter its standards significantly."[74] Thus, Canadian and U.S. securities laws were harmonized "with stricter, more detailed, U.S. norms being adopted" in Canada.[75] In addition, both Canada and the U.S. agreed to mutually accept each other's securities offering prospectuses. Ultimately, they entered into an agreement to establish an integrated system called the "Multi-jurisdictional Disclosure System" (MJDS) based on harmonization and mutual recognition, which took effect in 1991. Though initially a partnership between Canada and the United States, this is a "test-model" of integration designed to encourage other countries to join it.[76]

71. David Drinkwater, *Deferral to the Rules of Another Country: The MJDS Example*, *in* GLOBAL OFFERINGS OF SECURITIES: ACCESS TO WORLD EQUITY CAPITAL MARKETS 183, 183-84 (Meredith M. Brown & Alan Paley, eds., 1994).

72. *Id.* at 184.

73. *See* JOHNSTON & ROCKWELL, *supra* note 21, at 320 n.100; *see also* 13 O.S.C. Bull. 2560 (Can. Ont. Sec. Com. 1990); 12 O.S.C. Bull. 4275 (Can. Ont. Sec. Com. 1989).

74. *See* JOHNSTON & ROCKWELL, *supra* note 21, at 320.

75. Cally Jordan, *The Thrills and Spills of Free-Riding: International Issues Before the Ontario Securities Commission*, 23 CAN. BUS. L.J. 379, 381 (1994).

76. *SEC Adopts a Multijurisdictional Disclosure System with Canada*, FIN. REG. REP., June 1, 1991.

B. Harmonization

1. Disclosure of Nonfinancial Information

The Canadian securities administrators adopted National Instrument 71-101[77] to implement the MJDS throughout the country. The U.S. Securities and Exchange Commission (SEC) adopted necessary rules, forms, and schedules to the same end.[78] As a result, both laws are very similar in many respects. For example, both laws require the following nonfinancial information to be disclosed in a public offering prospectus: (1) details of the securities offered, the plan of distribution, and underwriting;[79] (2) net proceeds likely to be received from the sale of the securities and the purposes to which those proceeds will be applied;[80] (3) factors likely to make the offering speculative or risky;[81] (4) incorporation details of the issuer, intercorporate relationships, the issuer's business and property with history, earnings coverage, the promoters and their remuneration, legal proceedings to which the issuer is a party or to which its property is subject, and material contracts;[82] (5) details, such as addresses and backgrounds of the directors and officers, executive compensation and indebtedness, interests of the company's management and others in any material transactions to which the issuer was or will be a party;[83] (6) consolidated financial data derived from the financial statements incorporated in the prospectus for the last three completed financial years and for any period after the most recent completed financial year, and a management discussion on the current financial results, position, and future prospects based on the financial statements;[84] and (7) other material information to make the registration statement not misleading in light of the given circumstances.[85]

77. National Instrument 71-101: The Multijurisdictional Disclosure System (1998), 21 O.S.C. Bull. 6919 (Can. Ont. Sec. Com.) [hereinafter National Instrument 71-101] (replacing National Policy Statement No. 45).

78. For implementation at the state level in the United States, where blue sky laws apply, the North American Securities Administrators Association (NASAA) has adopted model rules. *See* N. AM. SEC. ADM'RS ASS'N, MODEL RULES FOR STATE IMPLEMENTATION OF THE MULTI-JURISDICTIONAL DISCLOSURE SYSTEM (1990).

79. *See* Regulation S-K, 17 C.F.R. §§ 229.201-.202, .501, .508 (2011); ONT. SECURITIES COMM'N, FORM 41-501F1 items 1.4, 1.7, 10, 12-15, 19, 24 [hereinafter FORM 41-501F1], *available at* http://www.gov.ns.ca/nssc/docs/o41501f1.pdf

80. *See* 17 C.F.R. § 229.504; FORM 41-501F1, *supra* note 79, item 7.

81. *See* 17 C.F.R. § 229.503; FORM 41-501F1, *supra* note 79, item 20.

82. *See* Schedule A, 15 U.S.C. §§ 77aa(20), (24) (2006); SEC, FORM S-1, item 11 (2008), *available at* http://www.sec.gov/about/forms/forms-1.pdf; FORM 41-501F1, *supra* note 79, items 4, 6, 9, 21-22.

83. *See* 17 C.F.R. §§ 229.401-.402; FORM 41-501F1, *supra* note 79, items 16-18, 23.

84. *See* 17 C.F.R. § 229.303; FORM 41-501F1, *supra* note 79, item 8.

85. *See* Regulation C, 17 C.F.R. § 230.408 (2011); FORM 41-501F1, *supra* note 79, item 29.

2. Financial Information

A Canadian prospectus must include statements of income, retained earnings, and cash flows, and a balance sheet[86] prepared according to Canadian Generally Accepted Accounting Principles (GAAP).[87] U.S. law is similar.[88] U.S. financial statements are to be prepared according to U.S. GAAP.[89] Qualified and independent auditors must audit both Canadian and U.S. statements. Additionally, the auditor's reports must be prepared in compliance with each country's Generally Accepted Auditing Standards (GAAS).[90]

3. Mutual Recognition

An eligible issuer can normally make a MJDS offering by publication of a prospectus prepared according to its home country disclosure requirements.[91] However, with respect to investment-grade debt or preferred shares, financial statements must, of course, be reconciled with the host country's GAAP.[92] Issuers of both countries are required to add legends or particular forms to their

86. *See* FORM 41-501F1, *supra* note 79, item 4.1.

87. *Id.* item 9.1; O.S.A.R. § 2(1); *see also* National Policy Statement No. 27: Canadian Generally Accepted Accounting Principles For Investment Funds, pts. 3.1-.2 (2004), 27 O.S.C. Bull. 786, 786-87 (Can. Ont. Sec. Com.) (defining Canadian GAAP by reference to CANADIAN INST. OF CHARTERED ACCOUNTANTS, CICA HANDBOOK – ACCOUNTING (2011)).

88. *See* Regulation S-X, 17 C.F.R. §§ 210.3-01 to -04 (2011).

89. 17 C.F.R. § 210.4-01.

90. *See* 17 C.F.R. §§ 210.1-02(d), .2-01; Ont. Sec. Comm'n. Rule 41-501 § 9.3(1); O.S.A.R. § 2(5).

91. Under the MJDS, certain eligible issuers in the United States and Canada are allowed to make offerings of different securities and tender offers both at home and in the other jurisdiction, or only in the other jurisdiction, in compliance with the home country disclosure and other regulatory requirements. Offerings, as provided for in the Canadian National Instrument 71-101 (Instrument) and the United States Securities Act of 1933 Forms (Forms), include rights offerings, exchange offers and business combinations, investment grade debt or preferred securities offerings, and equity offerings. *See* National Instrument 71-101, *supra* note 77, §§ 3.1(a)-(c), 12.1, 13.1; SEC, FORM F-7 (2007), *available at* http://www.sec.gov/about/forms/formf-7.pdf; SEC, FORM F-8 (2007), *available at* http://www.sec.gov/about/forms/formf-8.pdf; SEC, FORM F-9 (2009), *available at* http://www.sec.gov/about/forms/formf-9.pdf; SEC, FORM F-10 (2009), *available at* http://www.sec.gov/about/forms/formf-10.pdf. For each type of offering, both the Instrument and the Forms set forth certain eligibility requirements for the issuers. For example, with regard to an equity offering, section 3.1(c), read together with section 3.1(a)(iii) of the Instrument and Form F-10, requires that the issuer must have a twelve-month reporting history and also a public float (securities held by persons other than affiliates of the issuer) of at least $75 million U.S. dollars—called the substantiality requirement. The purpose of this requirement is "to single out issuers whose size is such that there is a large market following for them and the marketplace can be expected to have set a price for their securities based on all publicly available information." Multijurisdictional Disclosure and Modifications to the Current Registration and Reporting System for Canadian Issuers, Securities Act Release 6902, Exchange Act Release 29,354, Trust Indenture Act Release 2267, Investment Company Act Release 18,210, 1991 WL 285685, *7 (June 21, 1991). The SEC and the Ontario Securities Commission (OSC) later agreed to increase the amount of market capitalization to $250 million. As such, start-up and small to medium-sized companies are precluded from taking advantage of the MJDS. Only world-class issuers will qualify to make MJDS offerings. In the case of an exchange offer and business combination, the offering documents are takeover bid circular/issuer bid circular and information circular, respectively. These securities are to be offered by prospectus, however, when they are offered under section 3.1(c) of the Instrument or Form F-10 as "other securities." Drinkwater, *supra* note 71, at 185.

92. Drinkwater, *supra* note 71, at 186.

prospectuses. However, "these are routine and do not go to the substance of the document or disclosure."[93] A Canadian issuer must file the prospectus with a provincial securities commission and at the same time file a copy with the SEC. A U.S. issuer acts in the opposite order.[94] After filing, usually only the home securities regulator reviews the prospectus.[95] The securities regulator of the foreign jurisdiction may review the prospectus in an "unusual case." Such a case may arise where the concerned authority acts for the protection of public interest. For example, if a company seeks funds from the public to invest in purchasing securities of speculative mining companies, but its directors do not have experience in the proposed business, the reviewing authority of the host country may refuse to accept the prospectus. In this case, the directors may be considered an asset or liability of the company because "[u]pon their ability to assess the merits of the securities they propose to purchase will depend the success or failure of the company."[96] When the review process is over, the latter authority is notified, and the prospectus comes into effect in the foreign jurisdiction.[97] After securities have been offered, the issuer is required to file continuous disclosure documents with the securities regulators of both jurisdictions.[98]

4. Summary

Both Canada and the U.S. have harmonized their laws to establish an across-the-border market in securities. Under this system, a Canadian issuer may offer securities by prospectus prepared according to Canadian law and reviewed by the concerned Canadian securities authority. Similarly, a U.S. issuer may offer securities in Canada by prospectus drawn up under U.S. law and, in general, reviewed by the U.S. federal securities authority, the SEC. In other words, MJDS prospectuses are prepared and normally reviewed in compliance with the law of the home country of the issuer, which is accepted in the host country without further scrutiny.

IV. INTEGRATION OF SECURITIES MARKETS IN ASIA: ATTEMPTS BY ASEAN

The Association of Southeast Asian Nations (ASEAN) was established in 1967 in Bangkok, Thailand, with the signing of the ASEAN Declaration (Bangkok Declaration). The founders of ASEAN were Indonesia, Malaysia, the Philippines, Singapore, and Thailand. Subsequently, the member states of ASEAN came to include Brunei Darussalam (1984), Viet Nam (1995), Lao

93. *Id.* at 185.
94. *Id.*
95. *See id.*
96. Rivalda Investment Corp. (1965), O.S.C. Bull. 2, 3 (Can. Ont. Sec. Com.).
97. Drinkwater, *supra* note 71, at 185.
98. *Id.* at 186.

People's Democratic Republic (1997), Myanmar (1997), and Cambodia (1999). ASEAN aims, among other things, to develop friendly relations and mutually beneficial dialogue, cooperation, and partnerships with countries and sub-regional, regional, and international organizations and institutions. ASEAN has established relations with almost all major economies in Asia including those of Japan, China, South Korea, and India.[99]

In 2007, ASEAN adopted a Declaration on the Economic Community Blueprint (Blueprint). The member states are committed to abide by and implement the Blueprint by 2015.[100] The Blueprint seeks to transform ASEAN into a single market and production base, a highly competitive economic region, a region of equitable economic development, and a region fully integrated into the global economy by, among other things, establishing an integrated securities market.[101] With regard to its securities market integration, the Blueprint proposed actions that include: (1) achieving greater harmonization in capital market standards in the areas of offering rules for debt securities, disclosure requirements, and distribution rules; (2) mutual recognition arrangements or agreements for the cross-recognition of the qualifications, education, and experience of market professionals; and (3) greater flexibility in language and governing law requirements for securities issuance and withholding tax structure, where possible, to promote the broadening of the investor base in ASEAN debt issuance.

ASEAN requested technical assistance from the Asian Development Bank (ADB) for the development and integration of regional capital markets.[102] Recognizing the individual circumstances of each member country, the ADB report suggested that the regulators of capital markets, specifically the ASEAN Capital Markets Forum (ACMF), take measured steps toward harmonized capital-markets standards, achieving mutual recognition frameworks, and developing exchange alliances. In other words, the ADB proposed adopting a mutual recognition framework in conformity with global standards, such as those of IOSCO, and harmonization of national legal and regulatory

99. *See generally* ASS'N OF SE. ASIAN NATIONS, http://www.asean.org (last visited Aug. 10, 2011) (setting forth information on history, goals, and other aspects of ASEAN).

100. ASEAN desires to integrate its capital markets because the number of and openness to cross-border listings within ASEAN countries is low, despite the rapid increase in the share of foreign investors in the national equity markets of each member state. *See* ASS'N OF SE. ASIAN NATIONS, ASEAN ECONOMIC COMMUNITY BLUEPRINT, JAKARTA: ASEAN SECRETARIAT (2008). Southeast Asian markets generally lag behind more developed regions in terms of depth and quality. They remain relatively illiquid and have high trading costs because of their subscale trading volumes. All these scenarios, coupled with stiffer competition among world stock exchanges, the emergence of alternative trading networks, and rapid growth in trading volumes internationally, have led Southeast Asian countries to agree that regional integration is needed to expand their market capacity and scale so that they can compete globally.

101. *See generally id.*

102. ASIAN DEV. BANK, PROJECT NO. 42132, REGIONAL TECHNICAL ASSISTANCE REPORT: STRENGTHENING SOUTHEAST ASIAN FINANCIAL MARKETS (2008), *available at* http://www.adb.org/Documents/TARs/REG/42132-REG-TAR.pdf.

frameworks. This would eliminate legal and regulatory impediments and establish a "single passport" regime within the region. As to how the "single passport" system would work, the ADB made three important suggestions. First, once an issuer meets prospectus requirements in one country, the sale of the securities should be allowed across the region. Second, securities-market intermediaries should be able to provide their services throughout the region if they are incorporated and authorized to do so in one member state, and they should not be required to have separate authorization by the other countries in which they conduct their businesses. Lastly, investors should be allowed easy access to regional capital markets.

V. CONCLUSION: EVALUATION OF ASEAN'S APPROACH AND ITS RELEVANCE TO THE INTEGRATION OF PAN-ASIAN SECURITIES MARKETS

As noted earlier, economic integration theory posits that barriers impeding the "free" movement of products, labor, services, and capital should be removed so that the economies of the integrating region may compete with each other under equal legal, administrative, and regulatory conditions. Of these barriers, the most formidable ones are the technical barriers, which include divergent legal requirements and standards among states. Removal of these barriers in accordance with integration theory first requires harmonization of legal and other technical requirements and standards to as great a degree as possible. Equally important is mutual recognition of the integrating partner states' requirements, both harmonized and unharmonized. This theory, as discussed above, has worked well in Europe and North America. Both the EU and the MJDS have adopted harmonization and mutual recognition as the methods of integration. ASEAN has taken a great step in the same direction.

As the ADB suggested, a "single passport" is a must for ASEAN integration in securities. This, however, will not take place over night. It must start with baby steps. ASEAN may start with minimum harmonization of securities law of the member states. To this end, following disclosure standards formulated by IOSCO would be ideal. The EC started with minimum harmonization of listing and prospectus disclosure rules by adopting the LPD and the POPD. Minimum harmonization was in place for about forty years. Only then did the EC move towards massive harmonization patterned on IOSCO standards. In the same way, the U.S. and Canada took almost a decade to establish the MJDS. Both countries made changes to their domestic laws to create a harmonized securities regime. But total harmonization has not taken place in North America, just as it has not in Europe. It is not possible to harmonize everything. Therefore, mutual recognition is also a must for economic integration. This method has facilitated integration both in North America and Europe. With respect to its importance in the EU, one author has said that mutual recognition "has played a leading role in the process of European

integration, in particular, promoting the free movement of goods, services and persons."[103] The principle has also become popular in other regions and at the international level.[104] Wide acceptance of the principle of mutual recognition can be attributed to the following reasons:

> Mutual recognition is perceived as a simple, low-cost and low-maintenance mechanism for overcoming regulatory impediments to trade. It also represents a cost-effective alternative to harmonisation of regulations and standards. While harmonisation requires costly and time-consuming negotiation among nations to achieve a consensus on mutually acceptable standards, mutual recognition achieves a similar effect more rapidly and without the associated costs.[105]

In sum, ASEAN has taken the right theoretical approach to its prospective integration of securities markets. Now, it needs the sincere efforts and cooperation of its partners. This requires them to do their homework, which is to strengthen and liberalize domestic capital markets in order to build up capacity for domestic players to compete effectively, and to manage risks before they enter into the proposed integrated ASEAN market.[106] Once ASEAN has successfully integrated its securities markets, the rest of Asia may also be integrated within the same theoretical framework.

103. Der-Chin Horng, *The Principle of Mutual Recognition: The EU's Practice and Development*, 22 WORLD COMPETITION 135, 153 (1999).

104. *See* John Clarke, *Mutual Recognition Agreements*, 2 J. INT'L TRADE L. 31, 35 (1996).

105. Quentin Hay et al., *Trans-Tasman Mutual Recognition: A New Dimension in Australia-New Zealand Legal Relations*, 3 INT'L TRADE L. & REG. 6, 6 (1997).

106. *See generally* S.M. Solaiman, *Disclosure Philosophy for Investor Protection in Securities Markets: Does One Size Fit All?*, 28 COMPANY LAW. 135 (2007). The author emphasized market readiness before introducing disclosure-based regulation. He maintained that it was unwise for Bangladesh to adopt disclosure philosophy in 1999 without a study of market readiness because this was not a perfect philosophy even for a developed market, let alone a frontier market.