

ICMA's Legal and Regulatory Status and Relationship with Regulators and Organisations

1. LEGAL STATUS IN SWITZERLAND

1.1 Association under Swiss law

ICMA was established in 1969 as an association ("Verein") founded under the laws of Switzerland with independent legal capacity. It is registered in the Commercial Register of the Canton of Zurich.

1.2 Institution similar to an exchange

Until October 1998 ICMA was not subject to supervision in Switzerland. The Federal Act on Stock Exchanges and Securities Trading (**SESTA**) which came into force in February 1997/January 1998 introduced the concept of an institution similar to an exchange ("*börsenähnliche Einrichtung*"). In its decision of October 28, 1998 (the **Decision**), the Swiss Federal Banking Commission (the **SFBC**) ruled that ICMA is such an institution and therefore submitted ICMA in part under SESTA and in this capacity and to this extent under its supervision.

Pursuant to the Decision the SFBC granted ICMA a licence to operate as an institution similar to an exchange and approved ICMA's statutes and by-laws. The Decision also sets out a number of requirements with which ICMA must comply in order to maintain its authorisation. These requirements are outlined in the bullet points below.

- Pursuant to the Decision ICMA had to institute an internal supervisory body responsible for the supervision of transactions reported to ICMA's transaction matching, confirmation and reporting system (**TRAX**) comprising the Chief Executive and two other board members. The regulations of this body (the **TRAX Supervisory Committee**) were submitted to, and approved by, the SFBC on March 25, 1999. The composition of the TRAX Supervisory Committee is subject to approval by the SFBC.
- ICMA must inform the SFBC if it receives indications of or suspects any violations of law or other gross improprieties, such as violations of ICMA's statutes, by-laws or rules and recommendations committed by a member.
- ICMA must provide for the keeping of international securities transaction records as a membership requirement where no

corresponding obligation exists in the member's place of business.

- Pursuant to the Decision any amendments made to ICMA's statutes and by-laws and any changes to its organisation, management and board after October 28, 1998 must be reported to the SFBC. Any amendments made to by-laws 501 to 560 concerning disciplinary proceedings are subject to the SFBC's prior approval.
- Quarterly reports must be submitted to the SFBC on newly admitted members (including their competent supervisory authority) and on newly admitted TRAX subscribers (including their competent supervisory authority).
- ICMA must provide the SFBC with bi-annual updated lists of members and TRAX subscribers.
- ICMA must inform the SFBC of any proceedings against members before the agencies of the Association and of expulsions and rejections of applications for membership.
- ICMA must provide the SFBC with quarterly statistical evaluations on the transactions reported to TRAX.
- In addition, ICMA's auditors must report annually in writing to the SFBC with their views on the activity of ICMA and on ICMA's compliance with the SFBC requirements detailed in the Decision. The report must be filed on March 31. Subsequent to the Decision, the SFBC confirmed to ICMA's auditors that based on justifiable grounds this deadline could be extended to expire no later than June 30 of each year.

On July 1, 2005, the International Primary Market Association (IPMA) transferred its assets, liabilities and activities to ISMA and ISMA changed its name to International Capital Market Association (ICMA). The SFBC confirmed that this merger does not affect ICMA's status under SESTA.

2. LEGAL STATUS IN THE UK

2.1 THE FINANCIAL SERVICES AND MARKETS ACT 2000

2.1.1 Introduction

The Financial Services and Markets Act 2000 (the **FSMA**) and secondary legislation made under it provide the basis for the regulation of the banking, insurance and investment services

industries in the UK¹. Under the FSMA a statutory single regulatory authority, the Financial Services Authority (the **FSA**), is responsible for the supervision of these industries. The FSA has published a Handbook of Rules and Guidance under its rule-making powers in the FSMA. The rules provide a detailed set of provisions applying to authorised persons, such as prudential requirements and conduct of business rules.

Under the FSMA regime, investments include stocks and shares, debentures, government and other public securities, warrants to subscribe for shares or bonds, futures, contracts for differences, options to acquire or dispose of any such securities and depositary receipts. The activities which are regulated under the FSMA include dealing in investments, managing investments, advising on investments and establishing collective investment schemes such as UCITS² and OEICs³. They also include making "arrangements with a view to another person buying, selling, subscribing for or underwriting a particular investment" (Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (the **RAO**), Article 25). This covers the activities of an investment exchange.

Section 19 of the FSMA prohibits any person from carrying on a regulated activity in the UK unless he is either an authorised person or an exempted person. This is known as the general prohibition. ICMA's operation of the TRAX trade matching and confirmation system (through the agency of International Capital Market Association Limited (**ICMA Limited**) pursuant to the terms of a Service Agreement dated July 17, 1992) amounts to the carrying on of a regulated activity for the purposes of the FSMA because it serves to facilitate deals in investments and is therefore arranging for the purposes of Article 25 of the RAO. Accordingly, ICMA and ICMA Limited need to have a status in the UK which enable them to carry on regulated activities without being authorised under the FSMA.

2.1.2 Recognised Investment Exchange

Section 285(2) of the FSMA provides that a Recognised Investment Exchange (**RIE**) is exempt from the general prohibition if it carries on a regulated activity as part of its business as an investment exchange, or it is carried on for the purposes of, or in connection

¹ The FSMA, which came into force at midnight on November 30, 2001 (known as N2), replaced the Financial Services Act 1986. The FSMA established the FSA which has taken over the functions of the self-regulating organisations such as The Securities and Futures Authority (SFA), which have ceased to exist.

² Undertaking for Collective Investment in Transferable Securities

³ Open Ended Investment Company

with, the provision of clearing services by the exchange (Section 285(2)).

The objective of recognising investment exchanges is to ensure that they are exempted persons for the purposes of carrying on regulated activities and to encourage transactions in investments to take place on an exchange rather than "off-exchange".

The Treasury have set down in the Financial Services and Markets Act 2000 (Recognition Requirements for Investment Exchanges and Clearing Houses) Regulations 2001 recognition requirements which must be satisfied on a continuous basis if an entity is to be recognised, and continue to be recognised, as an investment exchange. These requirements are wide in scope and include matters such as adequate financial resources, suitability, systems and controls, safeguards for investors, discipline and default. The FSA has the power to revoke the recognition of an exchange if it fails to comply with the recognition requirements. A list of the existing RIEs is attached to this note (attachment 1).

2.1.3 Recognised Overseas Investment Exchange

The FSMA also contains a regime for exchanges which have their head offices outside the UK but which carry on regulated activities in the UK. Such exchanges are known as Recognised Overseas Investment Exchanges (**ROIEs**) which must obtain recognition from the FSA under section 292 of the FSMA. In order for a body to be eligible for recognition as an ROIE, it must be able to demonstrate that (i) it is, in the country in which its head office is situated, subject to supervision which, together with the rules and practices of that body, is such that investors in the UK are afforded protection at least equivalent to that provided by the provisions of the FSMA in relation to RIEs; (ii) that there are adequate procedures for dealing with a person who is unable, or likely to become unable, to meet his obligations in respect of one or more market contracts connected with the investment exchange; (iii) that it is able and willing to co-operate with the FSA; and (iv) that adequate arrangements exist for co-operation between the home supervisors of that body and the FSA.

ICMA is not currently eligible to qualify as an ROIE because it does not satisfy condition (i) referred to above. Although ICMA is subject to partial supervision in Switzerland, this, together with ICMA's rules, is not such that investors in the UK are afforded protection at least equivalent to that provided by the provisions of the FSMA in relation to RIEs. However, if ICMA were to become subject to a higher degree of supervision in Switzerland in the future it might then satisfy this condition.

ICMA's rules do not contain provisions relating to the default of a member, and so the second condition is not satisfied.

There has been some concern that direct disclosure of information by ICMA to foreign regulators without the consent of the person involved is severely curtailed by the Swiss secrecy laws to which it is subject and therefore condition (iii) might not be satisfied. However, there exists a Memorandum of Understanding between the UK and Switzerland dated October 30, 1991 (which is supplemented by an exchange of correspondence between the FSA and the SFBC in 1999) providing for the exchange of information between the respective regulatory authorities. Information which may be required to be divulged to Swiss regulators may then be passed on by those authorities to foreign regulators without infringement of the secrecy laws by ICMA. The third condition referred to above therefore appears to be satisfied. The existence of the Memorandum of Understanding also means that the fourth condition referred to above is satisfied.

A list of the existing ROIEs is attached to this note (attachment 2).

2.1.4 International Securities Self-Regulating Organisation

ICMA is approved as an "international securities self-regulating organisation" (*ISSRO*) for the purposes of Article 35 of the RAO⁴. This designation was specially created for ICMA which, as explained above, could not satisfy the conditions for eligibility as an ROIE. ICMA's approval as an ISSRO is dependent on it remaining ineligible to qualify as an ROIE by reason of it not being able to satisfy either or both of conditions (i) or (ii) referred to above (see Article 35(3)(b) of the RAO); should ICMA at any stage be able to satisfy both these conditions then ISSRO status would no longer be available to it. However, the Treasury, which are now responsible for approval of ICMA as an ISSRO, have indicated that regulation in Switzerland would not necessarily mean that ICMA would have to relinquish its ISSRO status.

As an ISSRO, ICMA's and ICMA Limited's activities of arranging deals in investments (whether through the activities of TRAX or otherwise) are excluded from the regulated activity of arranging for the purposes of the FSMA. The understanding on which ICMA's original approval as an ISSRO was granted was that the reporting of equity trades through TRAX would remain "de minimis and peripheral" to its overall use as a system for the reporting of international securities by its members (see letter from the DTI to ICMA dated April 7, 1988).

⁴ ICMA was originally approved by the Department of Trade and Industry under paragraph 25B of Schedule 1 to the Financial Services Act 1986.

ICMA is the only body to be accorded ISSRO status.

ICMA's regulatory obligations as an ISSRO are relatively light and essentially involve its having to provide the Treasury with monthly information concerning details of trades involving international securities entered into by members who are UK authorised persons. The information provided does not include information about counterparties or any other information that could identify counterparties.

As an ISSRO, ICMA may only have a membership composed of persons who are either authorised or exempted persons for the purposes of the FSMA or otherwise whose head office is located outside the UK and whose ordinary business involves them in engaging in activities which are activities of a kind specified by the RAO.

HM Treasury confirmed that the merger between ISMA and IPMA which took effect on July 1, 2005 does not affect ICMA's status as an ISSRO.

2.1.5 Designated Investment Exchange

The FSA, for the purposes of its Conduct of Business Rules (and also its regulatory capital rules), created a special category of exchange known as a Designated Investment Exchange (**DIE**). ICMA has been designated as a DIE. Designation by the FSA means that transactions on the relevant exchanges are more favourably treated for the purposes of the relevant FSA rules; for example, instruments traded on DIEs benefit from a more favourable capital adequacy treatment than instruments traded off-exchange. A list of the existing DIEs designated by the FSA is attached to this note (attachment 3).

While an RIE is an exempted person for the purposes of the FSMA by reason of its designation, a DIE is accorded its status by virtue of the particular application of the rules of the FSA and it is only through the detailed application of those rules that the consequences of having DIE status can be ascertained.

The FSA confirmed that the merger between ISMA and IPMA which took effect on July 1, 2005 does not affect ICMA's status as a DIE.

2.1.6 Status of TRAX: approved reporting system

The rules of the FSA contain provisions requiring the reporting of transactions for audit trail purposes. The FSA requires that

transaction reporting be made through one of the reporting systems listed in its Supervision Manual⁵ (SUP 17.7.8R).

Under ICMA Rule 202.1, members who carry on investment business in the UK and who are subject to a requirement to report transactions in international securities [under the rules of a self-regulatory organisation recognised under the Financial Services Act 1986 or any act which replaces that act] are obliged to report to ICMA every transaction in international securities whether or not entered into with another ICMA member. TRAX is one of the systems approved under SUP17.7.8R for the purposes of the FSA's rules. Accordingly, by reporting through TRAX, UK-based members of ICMA are able to satisfy their transaction reporting obligation to FSA. In October 1994, ICMA entered into a Memorandum of Understanding with SFA under which it agreed to supply SFA with daily details of all transactions reported to it by its members.

Under SUP17.6.2(3)R and SUP17 Ann 2R regulated firms are required to identify the relevant counterparty by reference to an identifying code, as well as provide various other pieces of information relating to the transaction. Although the TRAX General Terms and Conditions impose upon ICMA a duty of confidentiality in respect of information reported through TRAX, there is an exemption for information which is required to be disclosed under any applicable law or regulation and in the performance of the transaction reporting function of TRAX⁶. There is a similar exemption for information which is required to be disclosed under the regulations of any relevant stock exchange. Accordingly, ICMA is not in breach of the duty of confidentiality by including the identity of the counterparty in the information passed to the FSA or a relevant stock exchange.

2.1.7 Price Stabilisation

The FSA's price stabilisation rules provide a safe harbour, for stabilising activities carried out in accordance with those rules, from the offences of insider dealing under the Criminal Justice Act 1993, making misleading statements under Section 397 of the FSMA and the civil offences under the FSMA's market abuse regime. The price stabilisation rules will apply to securities which are, or may be, traded under ICMA's rules (MAR 2.2.1(2)(c)R).

⁵ The Supervision Manual forms part of the FSA's Handbook of Rules and Guidance.

⁶ TRAX General Terms and Conditions, Condition 8.1 and 8.3.1.

3. RELATIONSHIP WITH OTHER REGULATORS AND ORGANISATIONS

3.1 European Commission

ICMA applied to the European Commission in March 1990 for negative clearance of, and notified for exemption, its statutes, by-laws, rules and recommendations. By a letter dated December 16, 1992, the EC Commission indicated that their examination of ICMA's Rule Book did not reveal the existence of any grounds under Article 85(1) of the Treaty of Rome for further action on the part of the Commission. This "comfort letter" from the Commission is confirmation by the Commission that the present ICMA Rule Book is compatible with Community Competition Law. Pursuant to an agreement reached with the Commission at that time, ICMA has notified the Commission of subsequent changes to its Rule Book and has obtained confirmation (in letters dated September 3, 1997 and November 18, 1997) that changes to the definition of "reporting dealer" and to the by-laws on suspension of membership and disciplinary proceedings did not seem to comprise an appreciable restriction of competition.

In a letter dated January 31, 2002, the Commission confirmed that ICMA no longer needs to consult informally with the Commission in relation to envisaged changes to its Rule Book which it considers might raise competition concerns for the Commission, but that ICMA is free to notify the Commission of proposed amendments if it considers it necessary to do so. As from February 1, 2002, any amendment proposed to ICMA's Rule Book (including the amendment to incorporate IPMA's Handbook) is forwarded to Freshfields Bruckhaus Deringer for advice on whether such amendments need to be notified to the Commission.

3.2 Office of Fair Trading

Under the Restrictive Trade Practices Act 1976 (the **RTPA**) ICMA filed with the OFT its statutes, by-laws, rules and recommendations and, as a matter of course and on a fail-safe basis, delivered to it any amendments of the Rule Book for clearance. On March 1, 2000 the RTPA was replaced by the Competition Act 1998 (the **Competition Act**) and there is no longer any provision for furnishing amendments to agreements registered under the RTPA. The historic exemption for ICMA's Rule Book will however continue in the absence of material amendments to it. From the coming into force of the Competition Act, any amendments proposed to ICMA's Rule Book (including the amendment to incorporate IPMA's Handbook) are forwarded to Freshfields Bruckhaus Deringer for advice on whether the materiality test is likely to be met and whether

such amendments should be forwarded to the OFT for guidance or a decision on whether it infringes the Competition Act.

3.3 IOSCO

ICMA is an affiliate member of International Organisation of Securities Commissions (IOSCO) and in consequence a member of the IOSCO SRO Consultative Committee. In connection with its membership of the SRO Consultative Committee, ICMA has given an undertaking to provide assistance on a reciprocal basis, to the extent permitted by law, towards self-regulatory organisations, that are also members of the SRO Consultative Committee and who have signed a similar undertaking. This undertaking has been given by ICMA in the light of a resolution by the members of the SRO Consultative Committee on information sharing between the SROs that are included in its membership.

3.4 ICSA

ICMA is a member of the International Council of Securities Associations, comprising a number of important trade associations and non-governmental regulatory organisations.

July 12, 2005/TH/ch

Attachments

RECOGNISED INVESTMENT EXCHANGES

EDX London Ltd
131 Finsbury Pavement
London EC2A 1NT

The International Petroleum Exchange of London Limited
International House
1 St. Katharine's Way
London E1W 1UY

London Stock Exchange plc
10 Paternoster Square
London EC4M 7LS

LIFFE Administration and Management
Cannon Bridge House
1 Cousin Lane
London EC4R 3XX

The London Metal Exchange Limited
56 Leadenhall Street
London EC3A 2BJ

virt-x Exchange Limited
One Canada Square
34th Floor
Canary Wharf
London E14 5AA

RECOGNISED OVERSEAS INVESTMENT EXCHANGES

National Association of Securities Dealers Automated Quotations
(NASDAQ)

Sydney Futures Exchange Limited

The Chicago Mercantile Exchange (CME)

Chicago Board of Trade (CBOT)

New York Mercantile Exchange Inc. (NYMEX Inc.)

The Swiss Stock Exchange (SWX)

Cantor Financial Futures Exchange (CFEE)

EUREX (Zurich)

Wareterminbourse Hannover

NQLX LLC

US Futures Exchange LLC

DESIGNATED INVESTMENT EXCHANGES

American Stock Exchange
Australian Stock Exchange

Bermuda Stock Exchange
Bolsa Mexicana de Valores
Bourse de Montreal Inc.

Channel Islands Stock Exchange
Chicago Board of Trade
Chicago Board Options Exchange
Chicago Stock Exchange
Coffee, Sugar and Cocoa Exchange, Inc.

Euronext Amsterdam Commodities Market

Hong Kong Exchanges and Clearing Limited

International Capital Market Association

Johannesburg Stock Exchange

Kansas City Board of Trade
Korea Stock Exchange

MidAmerica Commodity Exchange
Minneapolis Grain Exchange

New York Cotton Exchange
New York Futures Exchange
New York Stock Exchange
New Zealand Stock Exchange

Osaka Securities Exchange

Pacific Exchange
Philadelphia Stock Exchange

Singapore Exchange
South African Futures Exchange

Tokyo International Financial Futures Exchange
Tokyo Stock Exchange
Toronto Stock Exchange