SHEARMAN & STERLING LLP

OCTOBER 2015

A QUARTERLY NEWSLETTER FOR COMPANIES AND FINANCIAL INSTITUTIONS

Governance & Securities Law Focus: Latin America Edition

This newsletter provides a snapshot of the principal US and selected global governance and securities law developments during the third quarter of 2015 that may be of interest to Latin American corporations and financial institutions.

The previous quarter's Governance & Securities Law Focus newsletter is available here.

Financial regulation developments are available here.

Our just-published 13th annual survey of corporate governance and executive compensation at the 100 largest US public companies is available here.

In this issue (please click on any title to go directly to the corresponding discussion):

US Developments

SEC and NYSE/Nasdaq Developments

SEC Clarifies Definition of "Whistleblower" under Dodd-Frank Anti-Retaliation Provision

Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which amended the Securities Exchange Act of 1934 (the "Exchange Act") to add Section 21F, established a series of new incentives and protections for individuals to report possible violations of the federal securities laws. Generally speaking, these incentives and protections take three forms: monetary awards for providing information, heightened confidentiality assurances and enhanced employment retaliation protections.

In response to a disagreement among courts as to the scope of the whistleblower anti-retaliation protections, in August 2015, the US Securities and Exchange Commission ("SEC") issued an interpretation clarifying that an individual's status as a whistleblower for purposes of the anti-retaliation protections does not depend on whether the individual has reported the alleged misconduct to the SEC.

The interpretive release reasons that this definition of "whistleblower" best comports with the SEC's overall goals in implementing the whistleblower program under Section 922 of the Dodd-Frank Act. Specifically, by providing employment retaliation protections for individuals who report internally first to a supervisor, compliance official or other person working for the company that has authority to investigate, discover or terminate misconduct, the SEC's interpretation avoids a two-tiered structure of employment retaliation protection that might discourage some individuals from first reporting internally in appropriate circumstances and, thus, jeopardise the investor-protection and law-enforcement benefits that can result from internal reporting.

The SEC's interpretive release is available at:

http://www.sec.gov/rules/interp/2015/34-75592.pdf

SEC Decreases Filing Fees

The SEC announced that, effective 1 October 2015, the fees that public companies and other issuers pay to register their securities with the SEC will be set at $100.70 per million dollars of securities registered. This is a decrease from the current filing fee of $116.20 per million dollars.

SEC Sets Expedited Schedule to Adopt "Publish What You Pay" Rule for Resource Extraction Issuers by Late June 2016

Section 1504 of the Dodd-Frank Act, which was signed into law in 2010, directed the SEC to issue rules requiring resource extraction issuers to report annually on payments made to governments. In August 2012, the SEC adopted a final rule implementing Section 1504 of the Dodd-Frank Act, but in July 2013 the SEC rule was vacated by US federal courts. The SEC has yet to propose a new rule implementing "publish what you pay" reporting under Section 1504 of the Dodd-Frank Act.

On 2 September 2015, in an action brought by Oxfam America, Inc. to compel the SEC to issue a final resource extraction issuer disclosure rule, the US District Court for the District of Massachusetts ordered the SEC to an expedited schedule for promulgating a final rule. In its ruling, the court stated that it would retain jurisdiction over the rulemaking process so as to ensure compliance with its order.

On 2 October 2015, the SEC filed with the court a notice of its proposed expedited rulemaking schedule, in which it has endeavoured to adopt a final rule by 27 June 2016. The SEC plans to hold a vote on a proposed rule before the end of this year, following which members of the public will have a period of at least 45 days to submit comments. The SEC cautioned that this 270 day schedule is aggressive and that there are many reasons why the rulemaking may be further delayed.

The District Court's order is available at:

http://www.gpo.gov/fdsys/pkg/USCOURTS-mad-1_14-cv-13648/pdf/USCOURTS-mad-1_14-cv-13648-0.pdf

Our recent client publication, which provides an overview of the status of "publish what you pay" regulation in the United States, the European Union, Canada and Australia, is available at:

http://www.shearman.com/en/newsinsights/publications/2015/05/shining-a-light-on-payments-to-governments

New York Stock Exchange ("NYSE") Proposes Changes to Rules on Notifications of Material News and Trading Halts

The NYSE recently amended its rules relating to notifications of material news and trading halts. The rule changes, which are effective from 28 September 2015, amend Section 202.06 of the NYSE Listed Company Manual, which contains the rules applicable to issuers listed on the NYSE.

The rule changes expand the pre-market hours during which listed companies are required to notify the NYSE prior to disseminating material news, to 7:00 a.m. (US Eastern Time). Currently, listed companies are required to comply with this requirement during the NYSE trading session, so the effect of the amended rule is to extend this requirement to the period between 7:00 a.m. and the commencement of trading on the NYSE at 9:30 a.m.

The amended rules also provide the NYSE with authority to halt trading:

- during pre-market hours at the request of a listed company;
- when the NYSE believes it is necessary to request certain information from listed companies; and
- in an American Depositary Receipt ("ADR") or other listed security, when the NYSE-listed security (or the security underlying the ADR) is listed on or registered with another national or foreign securities exchange and such other exchange (or regulatory authority overseeing such exchange) halts trading in such security for regulatory reasons.

The NYSE also has provided new guidance related to the release of material news after the close of trading. Section 202.06(C) of the NYSE Listed Company Manual requires companies to release material news by the fastest available means. Listed companies can disclose such material news via any Regulation FD compliant method, including by filing a Form 8-K with the SEC. The NYSE's new guidance states that listed companies releasing material news should either (i) include the news in a Form 8-K or other SEC filing, or (ii) issue the news in a press release to the major news wire services, including, at a minimum, Dow Jones & Company, Inc., Reuters Economic Services and Bloomberg Business News. The NYSE believes that distribution by either of these methods is consistent with current disclosure practices and ensures adequate dissemination.

The amended rule also includes advisory language that listed companies intending to release material news after the close of trading on the NYSE should wait until the earlier of the publication of their security's official closing price on the NYSE or 15 minutes after the scheduled closing time on the NYSE.

The NYSE memorandum summarising the rule changes is available at:

https://www.nyse.com/publicdocs/nyse/regulation/nyse/timelyalertmemo_amendment.pdf

SEC Issues Concept Release Seeking Comments on Enhanced Disclosures for Audit Committees

On 1 July 2015, the SEC published a "concept" release to solicit input on possible revisions to audit committee reporting requirements, with a focus on the audit committee's reporting of its responsibilities with respect to its oversight of the independent auditor. Some have expressed a view that the SEC's disclosure rules for this area may not result in disclosures about audit committees and their activities that are sufficient to help investors understand and evaluate audit committee performance, which may in turn inform those investors' investment or voting decisions.

The majority of the SEC's current disclosure requirements relating to audit committees, which are found principally in Item 407 of Regulation S-K, were adopted in 1999. Since then, there have been significant changes in the role and responsibilities of audit committees arising out of, among other things, the Sarbanes-Oxley Act of 2002, enhanced listing requirements for audit committees, enhanced requirements for auditor communications with the audit committee arising out of the rules of the Public Company Accounting Oversight Board, and changes in practice, both domestically and internationally.

The SEC also invited public comment on other aspects of the audit committee's role beyond those involving the auditor, such as its oversight of financial reporting, internal controls and risk.

The period during which the public could submit comments on the concept release ended on 8 September 2015, and a significant volume of comment letters were submitted by reporting issuers, institutional shareholders, industry groups, law firms and other stakeholders. After considering the comments received, the SEC may proceed with a rulemaking proposal, on which there would be another round for public comment before a final rule is adopted.

The SEC's concept release is available at:

http://www.sec.gov/rules/concept/2015/33-9862.pdf

Comments on the concept release are available at:

http://www.sec.gov/comments/s7-13-15/s71315.shtml

Conflict Minerals Rule Developments

On 18 August 2015, a divided panel of the US Court of Appeals for the District of Columbia Circuit, in *National Association of Manufacturers v. SEC* ("NAM"), upheld its earlier ruling that requiring companies to describe their products as having "not been found to be 'Democratic Republic of the Congo ("DRC") conflict free'" is unconstitutional, thereby invalidating a part of the SEC's conflict minerals rule.

This most recent decision means nothing changes for SEC reporting companies that file conflict minerals disclosure on Form SD. Following the D.C. Circuit's initial decision in NAM, the SEC's Division of Corporation Finance had issued a statement that it expected reporting companies to continue to comply with the provisions of the conflict minerals rule that were upheld by the court. However, no company is required to describe its products as "DRC conflict free," having "not been found to be 'DRC conflict free,'" or "DRC conflict undeterminable." An independent private sector audit will not be required unless a company voluntarily elects to describe a product as "DRC conflict free" in its Conflict Minerals Report. This has been the status for the last two conflict minerals reporting periods (calendar years 2013 and 2014), and, unless the SEC changes the position it took following the D.C. Circuit's first decision, companies should expect to continue to prepare their conflict minerals disclosure as they have in the past.

Our related client publication is available at:

http://www.shearman.com/en/newsinsights/publications/2015/08/partial-invalidation-of-sec-conflict-minerals-rule

SEC Approves Changes to FINRA Research Rules

The Financial Industry Regulatory Authority ("FINRA"), the self-regulatory organization that regulates broker-dealers in the United States, has adopted new rules relating to equity and fixed income research.

The new rule relaxes the research black-out periods to 10 days following an initial public offering in which the firm publishing equity research has participated as an underwriter or dealer, and three days following a secondary offering in which the firm has participated as manager or co-manager. The new rule eliminates the black-out period upon expiration, waiver or termination of a lock-up agreement, which brings all offerings in line with the existing accommodation for "emerging growth companies." These changes to the quiet period rules came into effect on 25 September 2015.

The new rule also affects broker-dealers' conflicts of interest policies and rules relating to the separation of the equity research and investment banking functions within a firm, among other changes to broker-dealer regulation.

Our related client publications are available at:

http://www.shearman.com/en/newsinsights/publications/2015/10/new-fixed-income-research-rule-and-more; and

http://www.shearman.com/en/newsinsights/publications/2015/10/finra-publishes-faqs

Sanctions Developments

Looking Forward to Lifting of Sanctions Against Iran

After almost two years of negotiations, on 14 July 2015, the E3/EU+3 (China, France, Germany, Russia, the United Kingdom and the United States) and Iran reached an agreement regarding Iran's nuclear program. The Joint Comprehensive Plan of Action ("JCPOA") lays out a framework for Iran to dismantle much of its nuclear program in exchange for lifting certain United Nations ("UN"), European Union and US sanctions against Iran.

Financial and energy sanctions are lifted earlier—The agreement provides for financial and energy sector-related sanctions to be lifted before certain arms-related sanctions. The purpose of lifting these sanctions is to enable payment mechanisms for Iran to export petroleum-related products. A range of these sanctions can be lifted as early as 15 December 2015, when the International Atomic Energy Agency ("IAEA") is scheduled to verify that Iran has taken measures in accord with the JCPOA.

No sanctions are lifted today—The JCPOA provides for the gradual lifting of sanctions over the course of ten years provided that Iran continues to meet its commitments regarding its nuclear program.

Section 219 disclosure obligations remain—SEC disclosure obligations under the Iran Threat Reduction and Syria Human Rights Act with respect to transactions or dealings with Iran do not appear to have been changed by the JCPOA.

UN sanctions "snap back" provision—The deal lays out a framework for dispute resolution and a mechanism for the UN sanctions to be re-imposed in the event that Iran does not adhere to the terms of the deal. However, the sanctions would not apply retroactively to any business contracts signed with Iran while sanctions were lifted.

Our related client publications, which include a timetable for the implementation of the JCPOA, are available at:

http://www.shearman.com/en/newsinsights/publications/2015/07/lifting-of-sanctions-against-iran;

http://www.shearman.com/en/newsinsights/publications/2015/07/looking-ahead-to-lifting-sanctions-against-iran; and

http://www.shearman.com/en/newsinsights/publications/2015/09/iran-sanctions-relief-opportunities-and-challenges

Sanctions Round Up

On 3 August 2015, we published the second quarter 2015 issue of our quarterly Sanctions Round Up.

Included in this quarter's Sanctions Round Up is a discussion of:

- no immediate lifting of sanctions against Iran despite achievement of comprehensive nuclear agreement;
- Obama Administration continues effort to restore diplomatic and economic ties with Cuba;
- OFAC provides additional guidance on sanctions against Russia;
- US authorities continue to enforce sanctions through settlements, criminal charges;
- OFAC targets terrorists in Middle East, Somalia, and Greece; and
- OFAC uses sanctions to combat narcotics traffickers and organised crime.

Our Sanctions Round Up: Second Quarter 2015 is available at:

http://www.shearman.com/en/newsinsights/publications/2015/08/sanctions-round-up-second-quarter-2015

Noteworthy US Securities Law Litigation

In the Matter Montford and Company, Inc. v. SEC: 180-Day Time Limit for SEC to Bring Action Following a Wells Notice Does Not Preclude SEC from Bringing Actions After that Time

On 10 July 2015, the federal appellate court in Washington, D.C., held that the SEC can continue to bring actions for securities violations even after the 180-day time limit in the Exchange Act for bringing such actions has passed. After reaching this conclusion, the court also affirmed the disgorgement order and civil monetary penalty that the SEC imposed on Montford and Company ("Montford") and its founder for failing to disclose that the company received payments from an investment manager to which Montford recommended its clients even though Montford described itself as an independent and unbiased investment advisor.

Montford is a registered investment advisor to institutional investors that described itself as "independent" and as a firm that "did not accept any fees from investment managers" and that would disclose any information that might compromise its "ability to make unbiased and objective recommendations." Despite these disclosures, Montford received $210,000 from an investment manager at least in part in exchange for Montford's strongly recommending that its clients invest with that manager. In March 2011, the SEC sent a letter, known as a "Wells notice," advising Montford of an ongoing investigation and potential securities violations based on this arrangement. Then, 187 days later, in September 2011, the SEC commenced an administrative proceeding against Montford and its founder that resulted in industry bars, cease-and-desist orders, and a disgorgement order and civil penalties totalling $860,000.

The Montford parties argued that the SEC was not permitted to bring this action because the Exchange Act provides that the SEC "shall" file an action no later than 180 days after it issues a Wells notice. Based on a well-established rule that federal agencies are afforded deference in their reasonable interpretations of ambiguous statutes that they administer, the court held that the Exchange Act left open whether its 180-day time limit precludes the SEC from bringing actions after that period expires. The SEC's view "that the provision is intended to operate as an internal-timing directive, designed to compel our staff to complete investigations, examinations, and inspections in a timely manner and not as a statute of limitations," was a reasonable interpretation. This ruling was based in part on the "the strong presumption that, where Congress has not stated that an internal deadline shall act as a statute of limitations, courts will not infer such a result."

Having ruled that the SEC was permitted to bring its action against the Montford parties following the 180-day deadline, the court went on to affirm the SEC's imposition of a disgorgement order and civil monetary penalties. Noting that the SEC "has flexibility in ordering disgorgement" and that it is owed "great deference" in its choice of sanctions, the court held that the Montford parties' referral payments were sufficiently connected to their failure to disclose those payments and that the record supported the amount of civil penalties imposed.

The court in this case has established an important rule: namely, that the SEC can continue to bring enforcement proceedings even after its 180-day internal time limit has expired.

In the Matter Berman v. Neo@Ogilvy LLC: Federal Appellate Courts Split on Whether Internal Employee Reports are Protected by the Dodd-Frank Act's Whistleblower Anti-Retaliation Provision

On 10 September 2010, the federal appellate court based in New York held, contrary to the view of another federal appellate court, that an employee who reports suspected securities law violations to the employer is entitled to the protection of the whistleblower anti-retaliation provision in the Dodd-Frank Act even if the employee did not report those allegations to the SEC. This decision is contrary to a prior decision of the federal appellate court based in Louisiana, and thus creates a disagreement between the two federal appellate courts to have ruled on this issue.

In Berman, the former finance director of Neo@Ogilvy, a media agency, claimed under the Dodd-Frank Act's whistleblower anti-retaliation provision that he was fired in retaliation for his reporting suspected accounting fraud internally. The Dodd-Frank Act, which was enacted following the recent financial crisis, defines a "whistleblower" as someone who reports a possible federal securities law violation to the SEC. But the statute's anti retaliation provision includes a prohibition on retaliation against whistleblowers who make reports in accordance with the Sarbanes-Oxley Act of 2002, which, in turn, covers those who report only internally and not to the SEC. The court concluded that because the anti-retaliation provision covering those who report internally would have an "extremely limited scope ... if it were restricted by the [SEC] reporting requirement in the 'whistleblower' definition," and the legislative history did not clarify at all whether Congress intended for that provision to be so limited, it is at least ambiguous whether the Dodd-Frank Act's anti-retaliation provision requires a whistleblower to report to the SEC in order to qualify for its protection. Applying the principle of deferring to a federal agency in its reasonable interpretation of certain statutes, as described in the discussion of the Montford case above, the court here deferred to the SEC's interpretation that the anti-retaliation provision applies even to someone who reports suspected securities violations only to his or her employer and not to the SEC.

The court here was split internally, with a vociferous dissent arguing that the statute is not at all ambiguous in its definition of "whistleblower" and that "[t]he majority ignores the distinction Congress drew" between the anti-retaliation provision of the Dodd-Frank Act—which provides a broader set of remedies to a narrower category of whistleblowers—and the Sarbanes-Oxley Act, which provides narrower remedies to a wider group of complainants. On the other hand, the majority opinion explained that while it was deviating from the only other federal appellate court decision on this question, "a far larger number of district courts have deemed the statute ambiguous and deferred to the SEC's Rule." Unless this split in authority is resolved by the Supreme Court, whether an employee that reports suspected securities violations only internally is covered by the Dodd-Frank Act's whistleblower anti-retaliation provision will depend on the jurisdiction in which that claim is brought.

Recent SEC/DOJ Enforcement Matters

In the Matter of R.T. Jones Capital Equities Management, Inc., SEC Administrative Proceeding No. 3-16827: SEC Enforces "Safeguards Rule" Against Investment Adviser for Failure to Adopt Written Policies and Procedures to Protect Customer Information from Cybersecurity Attacks

On 22 September 2015, the SEC reached a settlement with R.T. Jones Capital Equities Management, Inc. ("R.T. Jones") over the company's failure to maintain proper policies and procedures to protect customer information from a cyber-security attack. The SEC pursued this action even though there had not been any evidence of a client actually having suffered any financial harm from the cyber-attack and despite the fact that R.T. Jones took prompt action to try and remediate the threat.

R.T. Jones is an investment adviser registered with the SEC that offers investment advice to retirement plan participants based on a program that applies various investment profiles. Potential clients would provide personal information to R.T. Jones, which would determine their eligibility by comparing that information to the personally identifiable information that the company received from plan sponsors. R.T. Jones stored this personal information on a "third party-hosted web server without adopting written policies and procedures regarding the security and confidentiality of that information."

In July 2013, R.T. Jones found a possible cyber-security breach on its third-party hosted web server. R.T. Jones was found to have willfully violated Rule 30(a) of Regulation S P, also known as the "Safeguards Rule," which the SEC explained "requires registered investment advisers to adopt written policies and procedures that are reasonably designed to safeguard customer records and information." The SEC noted in particular that R.T. Jones lacked policies and procedures for "conducting periodic risk assessments, employing a firewall to protect the web server containing client [personally identifiable information], encrypting [such information] stored on that server, or establishing procedures for responding to a cyber-security incident." While R.T. Jones neither admitted nor denied the SEC's findings, the SEC imposed several sanctions under the Investment Advisers Act, including a cease-and-desist order, censuring the company, and a civil penalty of $75,000.

Although there was no evidence of any clients suffering financial harm, and despite the fact that R.T. Jones took prompt remedial efforts and cooperated with the SEC, the SEC explained in its press release that "[a]s we see an increasing barrage of cyber-attacks on financial firms, it is important to enforce the safeguards rule even ... when there is no apparent financial harm to clients." The remediation efforts that R.T. Jones took following the breach, including the appointment of an information security manager, the implementation of a written information security policy that established a more secure data storage system, the retention of a cyber-security advisory firm, and free identity monitoring for individuals whose data was compromised, are useful examples of cyber-security measures that companies can take. This action was brought under the specific securities laws and regulations described above that apply to investment advisers, but all companies can take efforts to determine the particular cyber-security rules that apply based on the type of personal data they maintain and applicable rules and regulations.

In the Matter of Coinflip, Inc., CFTC Docket No. 15-29: Virtual Currencies are Considered Commodities by the CFTC

On 17 September 2015, the Commodity Futures Trading Commission (the "CFTC") reached a settlement with Coinflip, Inc. and its chief executive officer for violations of provisions of the Commodity Exchange Act and CFTC regulations arising out of their running a market for Bitcoin options and futures without registering with the CFTC.

Coinflip's online exchange allowed buyers and sellers to trade Bitcoin options and futures contracts. Payments on the exchange were made by using Bitcoins according to an independently determined spot exchange rate. The CFTC's theory of liability was premised in part on its characterization of Coinflip's exchange as a "swap execution facility or designated contract market" because "swaps" under the Commodity Exchange Act include option contracts. But even more fundamental to the CFTC's action was its determination that virtual currencies such as Bitcoin qualify as a "commodity" under the Commodity Exchange Act's broad definition that includes "all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in." The CFTC also defined a "virtual currency" such as Bitcoin "as a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value, but does not have legal tender status in any jurisdiction." This definition goes on to distinguish virtual currencies "from 'real' currencies ... that are designated as legal tender, circulate, and are customarily used and accepted as a medium of exchange in the country of issuance."

The parties reached a settlement whereby Coinflip and its chief executive officer did not admit or deny the CFTC's findings, the CFTC issued a cease-and-desist order against future violations of the provisions at issue, and the Coinflip parties would cooperate with the CFTC and related governmental enforcement activities and would not make public statements challenging the Order. This enforcement action highlights how the nascent technology of virtual currencies can potentially qualify under different regulatory definitions and schemes. The CFTC here has now characterised virtual currencies like Bitcoin as a commodity within its statutory authority. Even more broadly, this ruling shows that the law relating to virtual currencies is still developing. Parties that deal in them should take that into account.

Executive Compensation & Employee Benefits Developments

SEC Finalises Pay Ratio Disclosure Requirements

On 5 August 2015, in a 3-2 vote of commissioners cast along party lines, the SEC released final rules implementing the pay ratio disclosure requirements of Section 953(b) of the Dodd-Frank Act. The final rules are largely consistent with the proposed rules issued by the SEC in September 2013, and will be codified as paragraph (u) to Item 402 of Regulation S-K. Foreign private issuers are exempt from these rules.

- Summary of Proposed Pay Ratio Disclosure Requirements
  - The final rules establish a prescribed format for comparing the total compensation of the registrant's principal executive officer ("PEO") to the median compensation paid to the registrant's covered employees. New Item 402(u) of Regulation S K requires issuers to disclose:
    - the median of the annual total compensation of all employees of the registrant (except the registrant's PEO) (the "Median Compensation");
    - the annual total compensation of the registrant's PEO (the "PEO Compensation"); and
    - the ratio of the Median Compensation to the PEO Compensation (the "Ratio").
  - The SEC refers to the disclosure of the above three items as the "pay ratio" disclosure. The Ratio must be presented as either:
    - a ratio in which the Median Compensation equals one; or
    - a narrative in terms of the multiple that the PEO Compensation bears to the Median Compensation.
  - For example, if the Median Compensation is $100 and the PEO Compensation is $1,000, the Ratio can be presented as: (1) 10 to 1, (2) 10:1 or (3) "The PEO Compensation is ten times the Median Compensation."
- When and Where the Pay Ratio Disclosure is Required
  - The first reporting period is the first full fiscal year beginning on or after 1 January 2017.
  - The final rules require the pay ratio disclosure in any SEC filing that calls for executive compensation disclosure under Item 402 of Regulation S K. Therefore, for calendar year registrants, the first pay ratio disclosure will be made in early 2018, as part of the proxy statement or information statement for the 2018 annual meeting. For some fiscal year companies, the disclosure may not be made until 2019. For example, if a registrant's fiscal year starts on 1 November 2017 and ends on 31 October 2018, the first pay ratio disclosure will be made in the next proxy statement or information statement, which may not be distributed until January 2019.

- New Registrants
  - The first pay ratio disclosure for a new registrant will follow the first full fiscal year beginning after the registrant has (1) been subject to the requirements of Sections 13(a) or 15(d) of the Exchange Act for a period of at least 12 months beginning on or after 1 January 2017 and (2) filed at least one annual report pursuant to those same sections of the Exchange Act that does not contain the pay ratio disclosure.
  - By way of example, if a calendar year company completes its initial public offering on 1 March 2017; its pay ratio disclosure must be included in its proxy or information statement for its 2019 annual meeting of shareholders (but no later than 120 days following the end of the 2018 fiscal year).
  - No pay ratio disclosure is required on a registration statement on Form S 1 or Form S 11 for an initial public offering, or a registration statement on Form 10.
- Identifying the Median Employee
  - The final rules allow a registrant to identify its median employee once every three years, unless there has been a change in its employee population or compensation arrangements that it reasonably believes would result in a significant change in the pay ratio disclosure.
  - If there has been no change to a registrant's employee population or compensation arrangements, but the median employee is no longer employed with the registrant (or has had a change in circumstances), the registrant may use another employee whose compensation is substantially similar to the original median employee based on the compensation measure used to identify the original median employee.
  - Registrants may choose any date within the last three months of the relevant fiscal year to determine its median employee. Only employees that are employed on the chosen date will be taken into account for purposes of determining the median employee.
  - Each registrant is provided flexibility to choose a method to identify the median employee based on the registrant's facts and circumstances. The chosen methodology may use reasonable estimates. Further, because of the complexity of applying the Item 402(c)(2)(x) of Regulation S-K ("Item 402(c)(2)(x)") calculation to all employees of a registrant, the final rules permit registrants to use any other consistently applied compensation measure, such as information derived from tax and/or payroll records. If the measure used is recorded on a basis other than the registrant's fiscal year, such as might be the case with tax and/or payroll records, the registrant may use the same annual period used in those records.
  - Regardless of the measure used to determine the median employee, the total compensation for the identified median employee will need to be calculated using the Item 402(c)(2)(x) calculation for the completed fiscal year.
- Covered Employees
  - The final rules define "employee" as the US and non US employees of the registrant and any of its consolidated subsidiaries. This definition includes part time, seasonal and temporary employees. Only employees that are employed on the date chosen for the determination of the median employee are taken into account. A consolidated subsidiary of a registrant is a subsidiary with financial statements that are consolidated with those of the registrant. Although this will result in a smaller pool of employees than would be the case under the proposed rules (which required inclusion of all employees of the registrant's subsidiaries as such term is defined under Rules 405 of the Securities Act of 1933 and 12b 2 of the Exchange Act), the SEC does not believe it will undermine the usefulness of the pay ratio disclosure.

- Exemptions for Non-US Employees
  - Registrants are not required to include non US employees in the pay ratio disclosure if obtaining the information required to comply with the rules would cause a violation of a non US jurisdiction's data privacy laws. Before taking advantage of this exception, the registrant must make reasonable efforts to obtain the information, such as seeking an exemption or other relief. In addition, the registrant must obtain an opinion from legal counsel opining on the registrant's inability to comply with the pay ratio disclosure rules without violating the non US jurisdiction's data privacy laws.
  - If a registrant excludes any non US employee in a particular jurisdiction under this exemption, it must exclude all non US employees in that jurisdiction.
- There is Also a Tailored Exemption for De Minimis Non-US Employees:
  - *Registrants whose non US employees make up 5% or less of their total employees*. These registrants may exclude all of their non US employees when identifying the median employee. If the registrant chooses to exclude any of these employees, it must exclude all of them.
  - *Registrants whose non US employees make up more than 5% of their total employees*. These registrants may exclude non US employees up to the 5% threshold. However, if a registrant excludes any non US employees in a particular jurisdiction, it must exclude all employees in that jurisdiction, subject to compliance with the overall 5% limitation. For example, if employees in a single non US jurisdiction constitute 6% of the registrant's covered employees, none of the employees in that jurisdiction could be excluded, unless the data privacy exception applied.
- Non US employees that are excluded under the data privacy exemption will also be counted as excluded under the 5% de minimis exemption. As a practical matter, together, these exemptions allow registrants to exclude a number of non-US employees equal to the greater of 5% of total employees and the number of employees covered by the data privacy exemption.
- Defining Total Compensation
  - The final rules requires that "annual total compensation" for both the PEO and the median employee be determined using the Item 402(c)(2)(x) calculation. However, a registrant may use reasonable estimates for any of the elements of total compensation utilised in the Item 402(c)(2)(x) calculation with respect to its median employee, so long as the registrant has a reasonable basis to conclude that the estimates approximate the actual amount of compensation. For example, reasonable estimates can be used for determining an amount that reasonably approximates the aggregate change in actuarial present value of an employee's defined pension benefit and calculating the amount of personal benefits that may be excluded because the total value is less than $10,000.
  - Reasonable estimates may not be used for purposes of calculating the PEO's total compensation. The total compensation of the identified median employee must be recalculated each year.
- The Pay Ratio Disclosure is "Filed" with the SEC
  - The pay ratio disclosure required by the new rules is "filed" with the SEC. As a result, false or misleading statements can lead to liability under Section 18 of the Exchange Act. Similarly, regardless of whether the pay ratio disclosure is "furnished" or "filed," potential liability exists under Exchange Act Sections 13(a) and 15(d) if the registrant fails to comply with the rule. Finally, misleading statements in the pay ratio disclosure can be interpreted as a manipulative or deceptive device in connection with the purchase or sale of a security leading to potential liability under Section 10(b) of the Exchange Act and Rule 10b 5 promulgated thereunder.

Our related client publication discussing the final rules is available at:

http://www.shearman.com/en/newsinsights/publications/2015/08/sec-final-pay-ratio-rules-what-you-need-to-know

EU Developments

Transparency Directive: The European Securities and Markets Authority ("ESMA") Consultation on European Single Electronic Format

On 25 September 2015, ESMA published a consultation paper on draft Regulatory Technical Standards ("RTS") on the European Single Electronic Format, as required by the Transparency Directive.

ESMA considered that some sections of the Annual Financial Reports ("AFR") are not suitable because, in order to have effect and admissibility in court, the document should be in human-readable form. ESMA proposes that the AFR should consist of a dual data format including structured (machine-readable data with embedded coding) and non-structured (human-readable) electronic formats.

ESMA highlights that the adoption of a standardised taxonomy to classify financial information would be very hard to achieve due to the differences in accounting standards across the EU and the problems it creates for narrative reporting.

The consultation will be open until 24 December 2015 and ESMA must submit the draft RTS to the European Commission by 31 December 2016.

The full text paper is available here:

https://www.esma.europa.eu/content/ESMA-Consultation-Paper-ESEF

Transparency Directive: ESMA Final Report on European Electronic Access Point

On 28 September 2015, ESMA published its final report on draft RTS on a European Electronic Access Point ("EEAP") as required by the Transparency Directive.

ESMA will be in charge of administering EEAP, which will be a single point of access for regulated information in the EU. The EEAP will act in conjunction with other Officially Appointed Mechanisms ("OAM") in each Member State without replacing them. The proposed mechanism would be for the EEAP to work as a search engine that fetches OAM regulated information.

ESMA broadly adopted the feedback on the draft RTS received in a consultation from 19 December 2014 and incorporated its own improvements to the technical infrastructure. Given that issuers and OAMs will have to adapt to the requirements of the draft RTS, ESMA suggests that these should only apply to regulated information released after 1 January 2017 to OAMs and issuers.

The European Commission has received ESMA's final report and has three months to decide whether to endorse the draft RTS.

A copy of the report is available here:

https://www.esma.europa.eu/content/ESMA-Final-Report-DRAFT-RTS-EEAP

OECD Updates G20/OECD Principles of Corporate Governance

On 5 September 2015, the Organization for Economic Co-operation and Development ("OECD") published an updated version of the G20/OECD Principles of Corporate Governance ("Principles"). The Principles' objective is to improve the legal, regulatory and institutional framework for corporate governance. The update to the Principles includes the following additions:

- a new principle on the role of the stock market in supporting good corporate governance;
- new guidance on the board of directors' role in risk management, tax planning and internal audit, as well as a recommendation for establishing specialised board committees to oversee these areas; and
- new guidance on stakeholders' rights to access information and consequences for the violation of such rights.

This is the first update to the Principles since 2004 and will be presented to the G20 leaders before the November 2015 summit.

The full text of the Principles is available here:

http://www.oecd.org/g20/topics/financing-for-investment/Corporate-Governance-Principles-ENG.pdf

TheCityUK Report on European Capital Markets Union

On 16 July 2015, TheCityUK, a lobbying group representing UK-based financial and related professional services industry at a national and international level, published a report setting out its views on the European Commissions' proposal to create a Capital Markets Union ("CMU"). This proposal was covered in our April 2015 newsletter.

The report concludes that capital markets could play a much more significant role in financing growth, given that European businesses, particularly small and medium enterprises ("SMEs"), remain too reliant on banks. The objective of the report is to recommend ways to make capital markets more accessible and fundraising for SMEs quicker and cheaper in order to secure diversified sources of capital to support long-term growth.

The report's key recommendations include:

- creating national and central European registers of capital markets to raise awareness of capital markets options available to SMEs;
- minimising the regulatory complexity involved in raising capital and listing on a regulated market in order to help manage costs. In particular, the Prospectus Directive's definition of "offer to the public" should be amended so that its financial and other thresholds could provide greater flexibility;
- publishing the prospectus and other information sooner to investors in the context of an IPO;
- improving the quality of information available to investors by making the prospectus more focused and relevant;
- harmonising the approach of National Competent Authorities to prospectus review and approval in an effort to boost investor confidence in pan-European offerings; and
- reducing the prospectus disclosure requirements for secondary offerings.

Other recommendations focus on how the current regime could be improved to further the goals of the CMU.

The full text of the report is available here:

http://www.thecityuk.com/research/our-work/reports-list/capital-markets-for-growing-companies-a-review-of-the-european-listings-regime/

European Parliament Adopts Amendments to Proposed Shareholder Rights Directive

On 8 July 2015, the European Parliament resolved to adopt amendments to the European Commission's proposal to amend the Shareholder Rights Directive. The amendments introduce:

- an obligation for multinational companies to declare the taxes paid in each country in which they operate as a measure to tackle tax evasion and avoidance;
- a requirement for shareholders of listed companies to vote at least every three years on a company's remuneration policy for directors, and for companies to explain how the directors' remuneration policy advances the long-term interest of the company;
- an expansion and clarification regarding transparency for proxy advisors, including disclosure of their codes of conduct, policies and amount of research undertaken; and
- provisions in the Accounting Directive for large undertakings and public-interest entities and the Transparency Directive, requiring issuers to publicly disclose a range of information on a country by country basis.

The full text of the adopted amendments is available here:

http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+TA+P8-TA-2015-0257+0+DOC+PDF+V0//EN

Prospectus Directive: ESMA's Final Report on Regulatory Technical Standards under Omnibus II Directive

On 1 July 2015, ESMA submitted to the European Commission its final report on draft RTS on prospectus related issues under the Omnibus II Directive. The report is based on the submissions it received from the consultation paper and suggests changes to the draft RTS in the areas of prospectus approval, incorporation by reference, publication of the prospectus and advertisements.

The European Commission now has three months to decide whether to adopt ESMA's draft RTS.

The full text of the report is available here:

http://www.esma.europa.eu/content/Draft-RTS-prospectus-related-issues-under-Omnibus-II-Directive

Prospectus Directive: ESMA Update Opinion on Israeli Equivalence

On 1 July 2015, ESMA published an updated opinion on Israel's prospectus regime. This updated opinion uses Article 20 of the Prospectus Directive as a framework for assessing Israel's laws and regulations regarding prospectuses taking into account changes brought into effect in September 2012.

The opinion outlines the "wrapper" information that would be required to make Israeli prospectuses compliant with the Prospectus Directive, which would allow them to receive approval from the relevant Member State authority.

The full text of the report is available here:

https://www.esma.europa.eu/news/ESMA-issues-opinion-equivalence-Israeli-prospectus-regime

Market Abuse: ESMA Technical Standards on the Market Abuse Regulation

On September 2015, ESMA published its final technical standards report regarding the Market Abuse Regulation ("MAR") and feedback in response to its consultation published in July 2014.

The report makes important changes to the previous consultation draft published on 15 July 2014, notably in the area of disclosure of inside information and delays. The following changes have been made:

- to improve clarity, some direct references to the Transparency Directive have been replaced by a list of specific ways in which disclosure of inside information can be made;

- SME growth market issuers will no longer be required to publicly disclose inside information on the website of the relevant SME growth market operator's venue and maintain such information for at least five years;
- issuers will no longer be required to post on their websites insider information on a section exclusively reserved for such information and will now be able to disclose it anywhere on the website provided that the information is clearly and easily identifiable,; and
- a specific template for insider lists has been introduced for SME issuers and there is a slightly reduced content requirement for the insider lists of all other issuers.

Other changes include:

- changes to the notification requirements when an issuer delays the disclosure of inside information. In particular, ESMA has clarified that the relevant trigger point is when inside information first exists within the issuer; and
- clarification that both the financial adviser and the issuer must comply with the MAR and ESMA requirements when they conduct a market sounding.

The full text of the report is available here:

https://www.esma.europa.eu/content/Final-Report-MAR-TS

MiFID II: ESMA Final Draft RTS on Admission to Trading

On 28 September 2015, ESMA published its final report and draft RTS on the admission of financial instruments to trading on regulated markets under MiFID II.

The final draft RTS covers the following issues:

- the characteristics of financial instruments for admission to trading on a regulated market, in particular the criteria regulated markets should follow to decide whether a transferable security is freely negotiable and capable of being traded fairly and in an orderly and efficient manner;
- arrangements to help regulated markets ensure that issuers comply with initial, on-going and ad-hoc disclosure obligations; and
- provisions that regulated markets must establish to facilitate access to information made public under EU law.

The Commission has three months to approve the RTS after which, if endorsed, the European Parliament and the Council will have a period to object. The regulation is intended to apply from 3 January 2015.

The full text of the draft RTS is available here:

https://www.esma.europa.eu/content/2015-ESMA-1464-Annex-I-draft-RTS-and-ITS-MiFID-II-and-MiFIR

UK Developments

London Stock Exchange: Changes to the Alternative Investment Market ("AIM") Rules for Companies Arising from the Central Securities and Depositories Regulation

On 7 August 2015, the London Stock Exchange published AIM Notice 41 and its accompanying guidance on Regulation S, Category 3 Securities in Inside AIM as a result of the changes brought by the Central Securities and Depositories Regulation ("Regulation").

Rule 36 of the AIM Rules requires securities admitted to trading to be eligible for electronic settlement in CREST. However, derogations from this rule were given mainly to US securities, which were not eligible for electronic settlement, in order to facilitate their admission to the AIM. These securities were known as Regulation S, Category 3 securities.

Article 3(2) of the Regulation, which requires transactions in transferable securities that occur in trading venues (such as the AIM) to be settled electronically in a book entry form with a central securities depository, will make derogations from rule 36 unavailable for Regulation S, Category 3 securities. These changes are effective from 1 September 2015 and are already reflected in the AIM application form. However, they will be incorporated to the rules in its next update.

The AIM Notice 41 is available here:

http://www.londonstockexchange.com/companies-and-advisors/aim/advisers/aim-notices/aimnotice41.pdf

London Stock Exchange: Guidance on Disclosures Relating to Equity Financing Products for AIM

On 24 September 2015, AIM Regulation published an Inside AIM update to provide guidance on AIM company disclosures regarding equity financing products for AIM securities in which an AIM company or its directors are interested.

These equity financing products can include share sale and repurchase agreements, swap facilities, equity lines of credit among others. The guidance covers the following points:

- a recommendation for AIM companies to include more detail in the announcements of the transactions than they typically would for other common structures;
- a reminder that AIM companies must comply with the ongoing disclosure obligations and update announcements; and
- general advice on AIM companies to consult with their nomad companies about any arrangements in relation to these products.

The AIM guidance is available here:

http://www.londonstockexchange.com/companies-and-advisors/aim/advisers/inside-aim-newsletter/aim-company-disclosures.pdf

Takeover Code: Consultation on Additional Presumptions to Definition of Acting in Concert

On 14 July 2015, the Code Committee of the Takeover Panel published PCP 2015/3 outlining its proposals to add three new presumptions to the definition of "acting in concert" in the Takeover Code. These presumptions would be introduced to the already existing six categories of persons who will be presumed to be acting in concert with other persons in the same category. The proposed presumptions are for:

- a person, the person's close relatives, and the related trusts of any of them, all with each other;
- the close relatives of a founder of a company to which the Takeover Code applies, their close relatives, and the related trusts of any of them, all with each other; and
- shareholders of a private company who sell their shares in that company in consideration for the issue of new shares in a company to which the Takeover Code applies, or who, following the re-registration of that company as a public company in connection with an IPO or otherwise, become shareholders in a company to which the Takeover Code applies.

The addition of these presumptions serves to clarify what has already been common practice. While the panel expected practitioners to be aware that other categories of persons which were not expressly covered in the presumptions of the definition would fall within it, the panel has proposed to codify it.

The consultation paper is available here:

http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/PCP201503.pdf

Takeover Code: Consultation on Restriction and Suspension of Voting Rights

On 14 July 2015, the Code Committee of the Takeover Panel published PCP 2015/2 proposing a new definition of voting rights in the Takeover Code. The consultation paper also includes consequential amendments to the Note on Rule 9.7 and Rule 11 of the Takeover Code.

Under the new definition, voting rights will include all voting rights relating to the target's share capital which are currently exercisable at a general meeting. Additionally, shares subject to a restriction on the exercise of voting rights or a suspension of such rights will still be considered as having voting rights. Treasury shares are, however, expressly excluded from the new definition.

The Code Committee believes that this new definition brings important benefits, since in addition to codifying existing practice in relation to the treatment of shares subject to a restriction on voting rights, it will remove the possibility for a company to issue suspended voting shares as a way to avoid the application of Rule 9 of the Takeover Code.

Responses to the consultation were received until 11 September 2015.

The consultation paper is available here:

http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/PCP201502.pdf

Proxy Voting: the Shareholding Voting Working Group ("SVWG") Discussion Paper on Transparency

On 1 July 2015, SVWG published a discussion paper covering proxy voting and potential progress in transparency. The paper suggests improvements to address the lack of transparency and trust in relation to proxy voting within the current regime. A number of these suggestions include:

- making CREST voting available for shareholders of issuers with CREST;
- implementing a standard approach for registrars to deal with split overvoted accounts; and
- ensuring that investors publicly disclose their voting record on a regular basis.

The paper did not favour the introduction of a standalone electronic voting system, and it considered that its costs would be high and that the system would be out of date before it would be fully implemented.

The paper is available here:

http://uk.practicallaw.com/cs/Satellite?blobcol=urldata&blobheader=application%2Fpdf&blobkey=id&blobtable=MungoBlobs&blobwhere=1247755323916&ssbinary=true

Extension of Settlement Day for CREST and CHAPS

On 23 July 2015, Bank of England ("BoE") published a press release announcing that the settlement day for CREST (the UK's securities settlement system) and CHAPS (the UK's high-value payment system) will be extended until 6.00 pm for direct participants from summer 2016. This announcement follows previous proposals published by BoE and BoE jointly with Chaps Co and Euroclear UK.

This change is particularly beneficial as the settlement dates for CREST and CHAPS will be very similar to the typical business hours of many system users. BoE will also extend the operating hours of its Real-Time Gross Settlement infrastructure to reflect this change.

BoE, Euroclear UK & Ireland and CHAPS Co will work jointly to raise awareness about the upcoming change. In particular, financial institutions must be aware that this change will require modification of their staffing, budgets, IT systems and legal documentation.

BoE's press release is available here:

http://www.bankofengland.co.uk/publications/Documents/news/2015/059.pdf

Financial Reporting: Financial Reporting Lab Project on Business Model Reporting

On 24 July 2015, the Financial Reporting Council's Financial Reporting Lab Project ("FRL") announced that it will commence a study to analyse how quoted companies report their business models in their annual reports, as required by the UK Corporate Governance Code and the Companies Act. FRL is a project seeking to improve the effectiveness of corporate reporting with input from companies and investors.

In particular, FRL wants to help companies understand how investors use the companies' information when deciding to invest and how to present it clearly and effectively. The FRL's study will consider in particular:

- the definition of "business model" under the Companies Act and the UK Corporate Governance Code;
- preparation of business model disclosures;
- how investors use business model disclosures; and
- the characteristics of good business model reporting.

FRL aims to publish its reports in the first quarter of 2016.

A copy of the announcement is available here:

https://www.frc.org.uk/Our-Work/Publications.aspx?searchtext=financial+reporting+lab+call+for+participants+pro&searchmode=anyword&searchfilter=0&searchfilter1=0&searchfilter2=0&searchfilter3=0&frcdaterangesmartsearchfilter=190001010000;209912312359

Financial Reporting: Proposal to Revise and Remake Accounting Standards (Prescribed Bodies) (United States of America and Japan) Regulations 2012

On 20 July 2015, the Department for Business, Innovation and Skills ("BIS") published its post-implementation review of the Accounting Standards (Prescribed Bodies) (United States of America and Japan) Regulations 2012.

The review assesses the effectiveness of the regulations, which apply to companies relocating to the UK which have securities registered in the US or admitted to trading on Japanese stock exchanges in order to make the transition to UK GAAP or IAS. The regulations effectively provide a grace period of three years where the companies can continue using US or Japanese GAAP before adopting UK GAAP or IAS.

As the regulations are due to expire on 31 December 2015, BIS is currently considering the following options:

- allowing the regulations to expire and doing nothing;
- extending the regulations so that the financial reporting years after January 2015 are covered infinitely; and

- introduction of a rolling transitional period of a maximum of four years from incorporation in the UK for parent companies that relocate to the UK from the US or Japan to prepare their group accounts in line with UK GAAP or IAS.

BIS will further analyse each of these options and carry out comprehensive impact assessments before deciding which option to pursue, although BIS recommends the third option because the costs for eligible companies of settling in the UK would be lower.

The review is available here:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/446706/bis-15-443-accounting-standards-prescribed-bodies-usa-and-japan-regulations-2012-post-implementation-review.pdf

Limited Partnerships: Consultation on Amendments to Limited Partnership Act 1907 for Private Equity Investments

On 23 July 2015, HM Treasury published a consultation paper inviting comments on proposed amendments to the Limited Partnership Act 1907. The amendments focus on maintaining the use of UK LPs as the market standard structure for European private equity and venture capital funds. This paper addresses the government's commitment to revise the act with a view to eliminate redundant legal complexity and administrative burden.

HM Treasury has also published the Legislative Reform (Limited Partnerships) Order 2015 for consultation. This paper contains several amendments that will be applicable to a UK LP that is a collective investment scheme that is not regulated by the Financial Conduct Authority but falls under the definition of section 235 of the Financial Services and Markets Act 2000. The proposed amendments include:

- granting the Registrar of Companies power to strike off entries for inactive private fund LPs;
- removing the requirement for limited partners in private funds to make a capital contribution and removing the liability of limited partners in private funds for capital contributions that have been withdrawn;
- eliminating the requirement for a court order if partners in a private funds agree among themselves who should wind up the partnership; and
- eliminating the duties of limited partners in private funds to render accounts and information to other partners and to account for profits made in competing businesses.

While the government has affirmed that it will continue to explore the possibility of allowing funds to elect to have a separate legal personality, it will not be possible to do this in the legislative reform order.

Copies of the consultation papers are available here:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/447458/Proposal_on_using_LRO_for_LimPart_condoc.pdf; and

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/447428/Draft_LRO_Stat_Instr..pdf

SBEE Act: Updated Provisional Implementation Dates

Companies House has published provisional implementation dates for some of the company transparency and filings provisions set out in Parts 7 and 8 of the Small Business, Enterprise and Employment Act 2015. These dates have been confirmed by BIS as accurate. The dates have been confirmed for the following filings:

- PSC register — companies are expected to be required to keep the PSC register from April 2016 and have it ready to file at Companies House from 30 June 2016;

- confirmation statement — requirement to file at Companies House expected to come into force in June 2016;
- statement of capital — changes to the statement of capital will come into force in June 2016;
- company registers — the measures under which companies can decide to keep information in their registers on the public register at Companies House is expected to come into force in June 2016;
- Abolition of corporate directors — this will come into force in October 2016;
- director disqualification — amendments to come into force in June 2016; and
- filing optional information — companies will be able to supply additional voluntary information to Companies House from late 2016 to 2017.

The Companies House amended press release is available here:

https://www.gov.uk/government/news/the-small-business-enterprise-and-employment-bill-is-coming#history

Statutory Audit: Financial Reporting Council ("FRC") Consultation on Revisions to UK Corporate Governance Code, Auditing and Ethical Standards, and Guidance for Audit Committees

On 29 September 2015, FRC published a consultation paper seeking views on its proposed amendments to auditing standards, ethical standards for auditors, the UK Corporate Governance Code and its guidance for audit committees.

Minor changes have been proposed to the UK Corporate Governance Code as a result of the changes brought by the amendments to the Statutory Audit Directive, in particular, to Section C of the code which relates to accountability. C.3.1 would now require the audit committee as a whole to have competence in relation to the sector in which the company operates. Additionally, the audit committee members would be required to have auditing and accounting competence. Lastly, C.3.8 would require shareholders to be informed about future audit tendering plans.

The proposed changes are explored further in the FCA quarterly consultation extract below.

A copy of the consultation paper is available here:

https://www.frc.org.uk/Our-Work/Publications/FRC-Board/Consultation-Enhancing-Confidence-in-Audit-File.pdf

Financial Conduct Authority ("FCA"): Quarterly Consultation (No 10) (CP15/28)

On 4 September 2015, FCA published its tenth quarterly consultation paper. The paper invites comments on several proposals.

- Delisting Following a Takeover Offer

  Some modifications have been proposed for the application of the listing rules in relation to the cancellation of listed securities following a takeover. These changes aim to resolve disparity in terms of outcome with the procedures that apply in respect of a decision on cancellation by a premium listed issuer following a vote by shareholders. Under normal circumstances, there must be a minimum of 25% free float shareholding for a company to be listed. However, if a company had exceptionally been allowed to list with an 80% controlling shareholder and a 20% free float shareholding and a takeover offer were made on terms that did not require any acceptances, the controlling shareholder could subsequently try to delist the company. In this circumstance, the decisions made by some shareholders to accept the offer would not reflect whether the terms of the offer provided fair compensation for those independent shareholders that may not want to hold the shares once the company is unlisted.

To tackle this issue, the FCA considers that the best option would be to delete the 80% control provision. This would mean that for a cancellation request to be made, the controlling shareholder has to obtain acceptances of the offer from independent shareholders which represent a majority of voting rights held by independent shareholders.

- Audit Committees

  The FCA has also proposed some amendments and additions to the Disclosure and Transparency Rules ("DTR") to reflect the changes brought by the Statutory Audit Amending Directive. The effect of these proposals would be to extend the independence requirement from at least one member to a majority of the members of the relevant body in charge of the audit and require the members of that body as a whole to have competence relevant to the sector in which the issuer is operating. Furthermore, the chairman of that body should be independent and appointed by the members of that body or a supervisory body of the issuer company. Also the responsibilities of that body would be expanded to reflect wider scope of responsibilities in the directive. However, FCA has not amended the DTR in relation to the composition of the audit committee. The directive will now require the shareholders of a company to elect in general meeting the non-executive members of the audit committee. In particular, FCA noted that there is no evidence that not implementing these changes would create problems or disadvantages to issuers. Equally FCA proposes not to adopt the option to require the audit committee chairman to be elected by the shareholders in general meeting.

  The FCA is also consulting on making minor amendments to the prospectus rules which would reflect the changes introduced by the regulatory technical standards on the Prospectus Directive, as amended by the Omnibus II Directive.

A copy of the consultation paper is available here:

https://www.fca.org.uk/your-fca/documents/consultation-papers/cp15-28

Contacts

This newsletter is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

If you wish to receive more information on the topics covered in this publication, you may contact your usual Shearman & Sterling representative or any of the following:

ROBERT ELLISON
Avenida Brigadeiro Faria
Lima, 3400
São Paulo – SP 04538-132
robert.ellison@shearman.com
+55.11.3702.2220
Brazil

STUART K. FLEISCHMANN
599 Lexington Avenue
New York, New York 10022-6069
sfleischmann@shearman.com
+1.212.848.7527
United States

LAURA S. FRIEDRICH
599 Lexington Avenue
New York, New York 10022-6069
laura.friedrich@shearman.com
+1.212.848.7411
United States

HEATHER LAMBERG KAFELE
801 Pennsylvania Avenue, NW
Suite 900
Washington, DC 20004-2634
hkafele@shearman.com
+1.202.508.8097
United States

MANUEL A. ORILLAC
599 Lexington Avenue
New York, New York 10022-6069
morillac@shearman.com
+1.212.848.5351
United States

BRADLEY K. SABEL
599 Lexington Avenue
New York, New York 10022-6069
bsabel@shearman.com
+1.212.848.8410
United States

RUSSELL D. SACKS
599 Lexington Avenue
New York, New York 10022-6069
rsacks@shearman.com
+1.212.848.7585
United States

ANTONIA E. STOLPER
599 Lexington Avenue
New York, New York 10022-6069
astolper@shearman.com
+1.212.848.5009
United States

ROBERT C. TREUHOLD
599 Lexington Avenue
New York, New York 10022-6069
rtreuhold@shearman.com
+1.212.848.7895
United States