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Governance & Securities Law Focus: Latin American Edition

This newsletter provides a snapshot of the principal US and selected global governance and securities law developments during the fourth quarter of 2015 and the first quarter of 2016 that may be of interest to Latin American corporations and financial institutions.

Financial regulation developments are available here.

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

US DEVELOPMENTS

SEC and NYSE/Nasdaq Developments

FAST Act Amends JOBS Act and Creates New Exemption for Resales of Restricted Securities

On 4 December 2015, the Fixing America's Surface Transportation Act, or FAST Act, was signed into law. The FAST Act includes a number of provisions affecting US securities law, including changes to the Jumpstart Our Business Startups Act ("JOBS Act"), changes to US Securities and Exchange Commission ("SEC") disclosure requirements and a new statutory exemption for private resales of securities.

The FAST Act relaxes certain provisions of the JOBS Act to facilitate initial public offerings by emerging growth companies ("EGCs"). EGCs can now commence roadshows within 15 calendar days of publicly filing the registration statement with the SEC, as opposed to the previous 21-calendar day waiting period, and can rely on continued treatment as an EGC for certain purposes during a grace period if they lose EGC status during the SEC review process. Further, EGCs can start the SEC review process without having to include financial information for periods that will not be required to be included at the time the IPO is expected to go on the road.

- For example, an issuer that expects to market its IPO during 2016 on the basis of audited financial statements for 2015 could commence the SEC review process in 2015 or early 2016 without ever having to prepare audited financial statements for 2013. However, the SEC will still require interim financial information, even if the issuer reasonably expects such interim financial information to be superseded by annual or interim financial information that will be included in the registration statement at the time of the contemplated offering.
- In addition, the statutory change permitting the omission of financial information relating to periods that are not expected to be included at the time of the offering also applies to Regulation S-X Rule 3-05 financial statements of an acquired business. An EGC may omit such acquired business financial statements if the EGC reasonably believes those financial statements will not be required at the time of the contemplated offering. Specifically, such separate financial statements would not be required at the time of the offering if sufficient time has elapsed since the acquisition and such acquired business has been part of the issuer's financial statements for a sufficient amount of time.

The legislation further directs the SEC to simplify, for all filers, Regulation S-K and eliminate duplicative, overlapping or otherwise unnecessary disclosure requirements.

The FAST Act also amends the US Securities Act of 1933 (the "Securities Act") to add a new Section 4(a)(7) based on the so-called 4(a)(1½) exemption for resales of restricted securities by persons other than the issuer. The Section 4(a)(1½) exemption, which is based on case law and has been recognized by the SEC in no-action letters and interpretative releases, but which has not previously been formally adopted in statute, has been interpreted to permit, in certain circumstances, the resale of restricted securities in a private placement by persons other than the issuer.

- The exemption created by new Section 4(a)(7) requires that purchasers of the restricted securities must be "accredited investors" as defined in Rule 501(a) under the Securities Act. In addition, Section 4(a)(7) prohibits general solicitation and general advertising by the seller and any person acting on the seller's behalf. If the issuer is not subject to reporting requirements under the US Securities Exchange Act of 1934, as amended (the "Exchange Act"), nor exempt from reporting pursuant to Rule 12g3-2(b) under the Exchange Act, Section 4(a)(7) requires the seller to make available reasonably current information about the issuer, including the issuer's most recent balance sheet and income statement.
- The legislation expressly provides that Section 4(a)(7) is not the exclusive means for establishing an exemption from SEC registration. This should give market participants some comfort that the traditional Section 4(a)(1½) exemption continues to be available, and that it is not necessary to comply with all of the requirements of Section 4(a)(7) in every resale that relies on a private placement exemption.

Our related client publications are available at:

http://www.shearman.com/en/newsinsights/publications/2015/12/jobs-act-and-sec-disclosure-requirements; and
http://www.shearman.com/en/newsinsights/publications/2015/12/sec-staff-issues-guidance-on-jobs-act

SEC Proposes New "Publish What You Pay" Rule for Resource Extraction Issuers

Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (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.

On 11 December 2015, the SEC issued a new proposed rule to implement Section 1504 of the Dodd-Frank Act. In the newly proposed rule, the SEC addresses the findings of the court that vacated its prior rule. In addition, the SEC indicates that it is endeavoring to more closely align its reporting regime with developments in extractive industry transparency in the European Union and Canada since its original rulemaking, with a view to enhancing the consistency and comparability of the SEC rules with the disclosure requirements of these key jurisdictions.

Under the new proposed rule, SEC reporting issuers that are engaged in the commercial development (including exploration, extraction, processing, export and the acquisition of a license for any such activity) of oil, natural gas or minerals would be required to file annually on Form SD certain information regarding payments made to governments, including subnational governments and state-owned companies. Information regarding such payments would need to be reported at the level of each project and only payments above $100,000 would be required to be included. The SEC is proposing to recognize the equivalency of other jurisdictions' "publish what you pay" reporting regimes that the SEC determines are substantially similar to its rules—this could ultimately include the European Union and Canada.

The SEC will adopt a final rule implementing Section 1504 of the Dodd-Frank Act after considering comments received on the proposed rule. The SEC expects to adopt a final rule by June 2016. If it meets this timetable, the first government payments report would be for the first fiscal year ended on or after 30 June 2017. Until a new final SEC rule becomes effective, 20-F filers are not subject to "publish what you pay" reporting under Section 1504 of the Dodd-Frank Act and need only comply with any applicable home country reporting requirements.

Initial comments on the proposed rule were due on 25 January 2016. A second round of comments, responding to issues raised in the initial comment period, will be due on 16 February 2016.

Our related client publication is available at:

http://www.shearman.com/en/newsinsights/publications/2015/12/shining-a-light-on-payments-to-governments

Climate Change – The Peabody Settlement and Exxon Mobil Investigation

In 2007, the New York Attorney General served subpoenas on five companies (Peabody Energy, the world's largest private sector coal producer, and four coal-intensive power generating companies) requesting information on investigations those companies had conducted in the past and the conclusions those companies had made at the time regarding the effects of climate change on their businesses, in order to determine whether those companies' disclosures to investors about such effects were inadequate. The subpoenas were issued under state law at a time of increasing media and investor interest in climate change disclosure, but before the SEC published its climate change interpretive guidance in 2010. Since then, the SEC guidance has significantly increased climate change reporting by public energy companies in the United States.

In November 2015, Peabody Energy entered into a settlement agreement with the New York Attorney General, which focused on two allegations:

- Statements in Peabody's public disclosures that it could not reasonably predict the future impact of any climate change regulation were inconsistent with the fact that Peabody and its consultants had looked into this issue at some length and had projected material and severe impacts from certain potential regulations;
- The International Energy Agency ("IEA") projections included in Peabody's public disclosures showing the impact of climate change developments on the future of the coal market were "cherry picked." Peabody discussed demand under the IEA's "current policies scenario," which is the high case for coal usage, rather than its "new policies scenario," which assumes the implementation of announced government carbon commitments and policies and which the IEA considers its baseline scenario.

The New York Attorney General recently served a subpoena on Exxon Mobil, which similarly seeks information from as far back as 1977, in order to assess Exxon Mobil's climate change disclosures.

The Peabody settlement and the investigation of Exxon Mobil have recast a spotlight on the sufficiency of climate change disclosure by energy companies. In drafting, reviewing and updating their climate change disclosure, including risk factors, companies should take into consideration any investigations the company has made into the effects of climate change on the company's business, including on the markets for the company's products. To the extent a company's disclosure includes projections as to the market or demand for a product, companies should ensure that such disclosure is balanced and reflects a range of conventional scenarios on the impact of climate change regulation.

Our client publication surveying recent developments in corporate climate change reporting is available at:

http://www.shearman.com/en/newsinsights/publications/2015/12/corporate-climate-change-reporting

SEC Requests for Comment on Effectiveness of Regulation S-X Financial Disclosures About Entities Other than the Registrant

As part of its disclosure effectiveness initiative, in September 2015, the SEC issued a request for comment on the effectiveness of certain financial disclosure requirements in Regulation S-X for entities other than a registrant. The request for comment focuses on the requirements for the form and content of financial disclosures that companies must file with the SEC about acquired businesses, affiliated entities and guarantors and issuers of guaranteed securities.

The period during which the public could submit comments ended on 30 November 2015. After considering the comments received, the SEC may proceed with a rulemaking proposal to amend the existing disclosure requirements, on which there would be another round for public comment before a final rule is adopted.

The SEC's request for comment is available at:

http://www.sec.gov/rules/other/2015/33-9929.pdf

Comments submitted in response to the request can be viewed at:

http://www.sec.gov/comments/s7-20-15/s72015.shtml

New SEC Guidance on General Solicitation and General Advertising

In certain types of private placements of securities, a condition to complying with the relevant exemption from Securities Act registration is that the issuer, as well as those acting on its behalf, must not use "general solicitation" or "general advertising" to market the securities. In August 2015, the SEC issued a "no action" letter and released new interpretative guidance relating to what constitutes general solicitation or general advertising.

Among other things, the new guidance clarifies the SEC's position on the following:

- The use of an unrestricted, publicly available website to offer or sell securities constitutes a general solicitation;

- Factual business information that does not condition the public mind or arouse public interest in a securities offering is not an offer and may be disseminated widely without violating the prohibition on general solicitation. "Factual business information" typically is limited to information about the issuer, its business, financial condition, products, services or advertisement of such products or services, provided the information is not presented in such a manner as to constitute an offer of the issuer's securities. Factual business information generally does not include predictions, projections, forecasts or opinions with respect to valuation of a security;
- The existence of a pre-existing, substantive relationship is one means, but not the exclusive means, of demonstrating the absence of a general solicitation. Accordingly, an issuer (or a person acting on its behalf) may make offers of securities to persons with whom it has such a relationship without violating the prohibition on general solicitation. A "substantive" relationship is one in which the issuer (or a person acting on its behalf) has sufficient information to evaluate, and does, in fact, evaluate a prospective offeree's financial circumstances and sophistication in determining his or her status as an accredited or sophisticated investor.

The SEC's compliance and disclosure interpretations relating to general solicitation and general advertising are available at:

https://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm#256.23

NYSE Increases Annual Listing Fees

The New York Stock Exchange ("NYSE") has increased the annual fee for an issuer's shares listed on the NYSE to the greater of $52,500 or $0.001025 per share, from the current fee rate (the greater of $45,000 or $0.001 per share). The fee increase came into effect on 1 January 2016.

SEC Urged to Adopt Rules Requiring Reporting of Short-Sale Activities

In October 2015, the NYSE and the National Investor Relations Institute submitted a petition requesting the SEC to adopt new rules that would require the periodic public disclosure of short-sale activities by institutional investment managers, along the same lines as the reporting currently required for long positions.

The petition advocates the SEC to "bring light to a less transparent and increasingly consequential corner of the securities market." It does not call on the SEC to impose additional restrictions on the practice of short selling.

The petition letter is available at:

http://www.sec.gov/rules/petitions/2015/petn4-689.pdf

Nasdaq Solicits Comments on Potential Changes to Shareholder Approval Rules

In November 2015, The Nasdaq Stock Market ("Nasdaq") announced that it is seeking public comments on the rules for listed companies to obtain shareholder approval prior to issuing securities in connection with (i) acquisitions, (ii) equity-based compensation, (iii) a change of control and (iv) private placements amounting to 20% or more of the company's outstanding common stock or voting power. Under the existing rules, foreign private issuers may claim an exemption from the shareholder approval rule by following their home country practice, but are required to publicly disclose claiming the exemption and provide Nasdaq with a written statement from the company's counsel certifying that the company's practices are not prohibited by the home country's laws.

Specifically, in connection with the shareholder approval requirement for private placements involving the issuance of common stock or securities convertible into common stock equal to 20% or more of the common stock or voting power outstanding at a price less than the greater of book or market value of the stock, Nasdaq is seeking comments regarding the following, among others:

- the appropriate method of determining market value (currently, market value is measured by reference to the closing bid price);
- whether Nasdaq should eliminate the book value measurement prong of the rule;
- whether a higher percentage threshold should be adopted for smaller companies;
- whether a company should be permitted to obtain pre-approval to issue shares in capital raising or acquisition transactions on a periodic basis, and, if so, the terms that must be included in a pre-approval; and
- whether the percentage threshold requiring shareholder approval should be based on a sliding scale depending on the size of the discount to market price.

The comment period will run until 15 February 2016. The solicitation of comments notice is available at:

https://listingcenter.nasdaq.com/assets/Shareholder%20Approval%20Comment%20Solicitation.pdf

Recent Trends and Patterns in FCPA Enforcement

In January 2016, we published our bi-annual *Recent Trends and Patterns in FCPA Enforcement* report, part of our FCPA Digest, which together provide an insightful analysis of recent enforcement trends and patterns in the US, the UK and elsewhere, as well as helpful guidance on emerging best practices in FCPA and global anti-corruption compliance programs.

Following a busy 2014, the US Department of Justice ("DOJ") and the SEC took a step back in 2015 to refocus and reprioritize their efforts. While the SEC pursued ten low-value corporate enforcement actions, the DOJ took a back seat with only two—indicating a greater interest in pursuing individual enforcement actions and apparently conserving its resources to focus on a set of large ongoing investigations.

Among the highlights from 2015 were:

- 12 corporate enforcement actions with total sanctions of $143.1 million reflect a slowdown in enforcement activity by the DOJ and SEC;
- The 12 corporate enforcement actions have resulted in total average corporate penalties of $11.9 million—significantly lower than previous years;
- The DOJ's trial difficulties in the prosecution of former PetroTiger CEO Joseph Sigelman and the failed extradition of Dmytro Firtash reflect the government's ongoing obstacles to successfully prosecuting individuals;
- The DOJ's decision to publicly decline to prosecute PetroTiger for FCPA violations, while noteworthy, may be of limited significance for large companies;
- The SEC breaks new ground in its enforcement action against The Bank of New York Mellon, concluding that the provision of prestigious internships to the family members of foreign officials is sufficient to trigger FCPA liability;
- The announcement of the Yates Memo, although neither a substantive change to DOJ policy nor to the historical expectations of the DOJ Fraud Section and the SEC Division of Enforcement, nevertheless puts increasing pressure on prosecutors to demand information on culpable individuals and then to either bring a prosecution or justify not doing so;
- The UK Serious Fraud Office entered into its first ever deferred prosecution agreement with Standard Bank Plc over the bank's violations of section 7 of the UK Bribery Act;
- Personnel changes at the DOJ raise an interesting new dynamic, but the FCPA will continue to be a priority.

Our January 2016 report is available at:

http://www.shearman.com/en/newsinsights/publications/2016/01/fcpa-digest-2016

New NYSE Rule on Reporting Semi-Annual Financials for Foreign Private Issuers

On 19 February 2016, the US Securities and Exchange Commission ("SEC") approved a New York Stock Exchange ("NYSE") rule change to require foreign private issuers to file semi-annual financial statements on Form 6-K. This rule change is intended to align financial reporting practices of NYSE-listed foreign private issuers with NYSE-listed domestic issuers.

Prior to the change, foreign private issuers were not subject to any SEC rule that specifically requires the filing of interim financial information. However, as a matter of practice or home-country requirements, most foreign private issuers do already comply with semi-annual financial reporting.

The new Section 203.03 of the NYSE Listed Company Manual provides that each listed foreign private issuer must, at a minimum, submit to the SEC a Form 6-K that includes: (i) an interim balance sheet as of the end of its second fiscal quarter; and (ii) a semi-annual income statement that covers its first two fiscal quarters. These must be submitted no later than six months following the end of the company's second fiscal quarter. The new rules have been effective retroactively from 5 February 2016, and apply to companies with a fiscal year starting on or after 1 July 2015.

Nasdaq Proposes New Rule Requiring Disclosure of Third Party Compensation to Directors and Candidates

On 28 January 2016, Nasdaq filed an initial proposal with the SEC to mandate disclosure by listed companies where third parties (usually corporate activist shareholders) make payments to directors and director nominees. The proposed changes in Rule 5250 are intended to improve transparency to investors, shareholders and the public on directors and director nominees incentives.

In recent years, activist shareholders have tried to use monetary incentives to induce directors to push for at least short-term returns for the company, or to induce individuals to act as director nominees in a proxy contest. Such arrangements have raised concerns of conflicts of directors' fiduciary duty to the company and the promotion of certain shareholders' narrow interests.

The new rules will require listed companies: (i) to make reasonable enquiries as to such third-party compensation arrangements; and (ii) to promptly disclose all the salient terms of these arrangements and the names of the parties on the company website and proxy statement filings. The proposed rules are intended to be broadly interpreted, with the exception of payments made to director nominees as reimbursement of expenses and payments which existed before the nominee's candidacy and that are already publicly disclosed elsewhere (such as compensation relating to a pre-existing employment relationship but not in contemplation of the director candidacy).

If approved by the SEC, the new rules will take effect beginning on 30 June 2016. In order to meet the requirements, companies should revisit their director questionnaires and corporate governance policies on directors' disclosure of interests.

US House Of Representatives Passes Bill That Would Expand "Accredited Investor" Definition

On 1 February 2016, the House of Representatives passed HR 2187 "Fair Investment Opportunities for Professional Experts Act," which, if signed into law, would expand the definition of "accredited investor" under the US securities laws. The bill would amend Section 2(a)(15) of the Securities Act of 1933 (the "Securities Act") to include within the definition of "accredited investor": (i) persons in the securities industry licensed by the SEC or the Financial Industry Regulatory Authority ("FINRA") (such as a registered broker or investment adviser), or persons licensed with the securities division of a state or an equivalent state division; and (ii) persons whom the SEC determines by regulation to have demonstrable education or job experience to qualify such persons as having professional knowledge of a subject

related to a particular investment, and whose education or job experience is verified by FINRA or an equivalent self-regulatory authority.

The bill also seeks to codify in the definition of "accredited investor" in Section 2(a)(15) of the Securities Act the income and net worth thresholds currently specified in Regulation D and directs the SEC to adjust those financial thresholds for inflation every five years.

The bill would need to be passed by the Senate and signed into law by the President before taking effect.

SEC Financial Reporting Manual Update

On 17 March 2015, the SEC's Division of Corporation Finance revised its Financial Reporting Manual in three main aspects:

- First, the revised version includes updated guidance on testing significance of equity method investments.
- Second, topic 10 on "Emerging Growth Companies" ("EGCs") has been updated to reflect the requirements of the Fixing America's Surface Transportation Act (the "FAST Act"), including paragraphs on: (i) an EGC's ongoing treatment as an EGC even if such status is lost during the review of its registration statement; and (ii) financial reporting accommodations regarding (a) the omission of financial information for historical periods, (b) the number of periods covered in Management's Discussion and Analysis and (c) the permitted omission of financial statements required by either Rule 3-05 or Rule 3-09 of Regulation S-X if the issuer reasonably believes those financial statements will not be required at the time of the offering.
- Third, topic 11 on "Reporting Issues Related to Adoption of New Revenue Recognition Standard" has been revised to include a summary of the implementation guidance in Accounting Standards Update No. 2014-09 on *Revenue from Contracts with Customers*, as amended by Accounting Standards Update No. 2015-14, and IFRS 15 *Revenue from Contracts with Customers*. The revisions also add a Q&A section addressing the effects of implementation on (i) selected financial data, (ii) supplementary quarterly financial data for an EGC, (iii) the ratio of earnings to fixed charges and (iv) financial statements of other entities and significance.

The revised Financial Reporting Manual is available at:
https://www.sec.gov/divisions/corpfin/cffinancialreportingmanual.shtml

First Outsider to Receive Whistleblower Award from SEC

On 15 January 2016, the SEC announced a whistleblower award of more than $700,000 to an individual who did not work for the company in question, but, as an industry expert, produced a detailed analysis leading to a successful SEC enforcement action. This was the first ever whistleblower award to a company outsider since the beginning of the SEC whistleblower program in 2011.

The SEC has commended whistleblowers who voluntarily provide unique and useful information that leads to successful enforcement action, and incentivizes with awards between 10% and 30% of the money collected where the monetary sanctions exceed $1 million. This first outsider award may encourage further claims from potential outsider whistleblowers and may result in situations where the SEC is made aware of problems before the company itself.

SEC Forces Exxon Mobil to Include Climate Change Resolution Proposal in Proxy Upon Request of New York State Comptroller and Shareholders

On 22 March 2016, the SEC ruled that Exxon Mobil must allow its shareholders to vote on a proposal for annual reporting of how the company would be affected by climate change regulations. Nevertheless, it is open to Exxon Mobil to recommend against the proposal through its proxy document.

The ruling follows a request by the New York State Comptroller and four other shareholders who argued that investors need to know how the bottom line of Exxon Mobil will be affected by the global effort on reduction of greenhouse gas emissions and the company's plans in this regard. The SEC did not find the company's public disclosures up to the standards required by the proposal guidelines. Exxon Mobil declined to comment on the SEC ruling, but had earlier indicated that it intended to block a vote on the shareholder resolution, claiming it was vague and asking for metrics difficult to quantify.

Concurrently, Exxon Mobil is facing an inquiry by the New York Attorney General into Exxon Mobil's climate change disclosures (discussed in our client publication available at: http://www.shearman.com/en/newsinsights/publications/2015/12/corporate-climate-change-reporting).

Sanctions Developments

Navigating Iran Sanctions After Implementation Day

Although the United States, the European Union and the United Nations lifted a number of sanctions targeting Iran on 16 January 2016 ("Implementation Day") in accordance with the terms of the recent Iran nuclear deal, the immediate impact for financial institutions and companies considering doing business in Iran may be more limited than some of the news headlines may suggest. Our publication highlighting some of the main issues for financial institutions and companies is available at:

http://www.shearman.com/~/media/Files/NewsInsights/Publications/2016/01/Navigating-Iran-Sanctions-after-Implementation-Day-LT-012016.pdf

Noteworthy US Securities Law Litigation

In re Chinacast Education Corporation Securities Litigation: Court Finds Corporate Scienter Can Be Imputed In Certain Circumstances Even Though Employee's Actions Were Adverse to the Company's Interests

On 23 October 2015, in *In re Chinacast Education Corporation Securities Litigation*, the federal appellate court based in California addressed an issue of first impression within the jurisdiction of this court: whether an employee's intent to defraud may be imputed to the corporation as a basis for the company's liability for securities fraud under Section 10(b) of the Securities Exchange Act even where the employee acted for his or her own personal benefit and against the company's interests. The court held that, even though the intent of such an employee ordinarily may not be imputed to the company, imputation is permissible where the employee acts with apparent authority and an innocent third party relies on the employee's actions.

In *In re Chinacast*, the CEO and founder of a for-profit educational services provider defrauded the company of over $120 million and thus devastated its finances. There was no dispute that the CEO committed securities fraud. The only issue was whether his fraudulent intent could be imputed to the company. While the actions of corporate agents ordinarily are imputed to the company, an "adverse interest exception" protects the corporation from liability for the conduct of employees who act for their own personal benefit and against the company's interests. But the court held that when the employee acts under the cloak of apparent authority from the company and an innocent third party relies on the employee's actions, an "exception to the exception" allows the employee's adverse actions to be imputed to the corporation. This rule is meant to ensure the fair allocation of risk in protecting innocent parties who rely on an agent's apparent authority and to incentivize corporations to carefully choose and monitor high-ranking corporate officials (who are the most likely employees to have such authority). In this case, the securities fraud claims were based on disclosures that the CEO made with apparent authority concerning the company's finances and innocent investors relied on these statements.

Although this was an issue of first impression within the jurisdiction of this court, the court here noted that other courts around the country have adopted the same rule. The court found it particularly significant that the employee at issue was the company's CEO and founder and that the corporation's board failed to properly oversee him. In addition, the court explained that at the pleading stage of a securities class action, whenever an employee acts with fraudulent intent under his or her apparent authority from the company and a claim for securities fraud is brought by a legitimate investor, that intent will be imputed to the company at this initial stage because all investors are presumed at this early point to have relied on the alleged misrepresentations or omissions at issue.

United States v. Litvak: Trial Court's Refusal to Allow Expert Evidence on Materiality Leads to Reversal of Conviction on Appeal

On 8 December 2015, in *United States v. Litvak*, the federal appellate court based in New York reversed the conviction of Jesse Litvak, a bond trader at Jefferies & Company, because the trial court exceeded its authority when it excluded from trial evidence related to whether the information that the defendant allegedly misrepresented was material to a reasonable investor. The appellate court also held that the government did not need to prove that the defendant had an "intent to harm," but only a lower level of fraudulent intent, and that based on the evidence that was actually presented for most of the claims, a rational jury could have concluded that the defendant's misrepresentations were material. For a subset of claims related to statements made to the United States Department of the Treasury, however, the court held that the defendant's misstatements were not material in the context of those specific claims.

Litvak was convicted for fraudulently misrepresenting (i) to purchasers, the amount that Jefferies paid to acquire residential mortgage-backed securities ("RMBS"), (ii) to sellers, the price at which Jefferies agreed to resell RMBS and (iii) to purchasers, that Jefferies was acting as a middleman for another party trying to sell its RMBS even though Jefferies actually owned the securities already. After a fourteen-day trial in early 2014, Litvak was convicted on 15 counts of securities fraud for making these misrepresentations in numerous transactions with several counterparties. The appellate court held that based on the evidence that was presented at trial, including counterparties' testimony that the misrepresented facts were important to them, a rational jury could have concluded that Litvak's misrepresentations were material to the private parties that he transacted with. But the court went on to hold that the trial court improperly disallowed Litvak's presentation of expert testimony on what factors are relevant to the investment process of "reasonable" investors in the RMBS market. This excluded evidence was particularly relevant in light of the complex and subjective nature of the RMBS market. The court further held that the exclusion of this evidence was not "harmless," and therefore vacated Litvak's conviction and remanded the case for a new trial, because Litvak did not have other proof available to rebut the government's evidence of what information would be important to a reasonable RMBS investor.

After making this ruling, the court went on to issue several evidentiary rulings intended to provide guidance as to what other types of evidence are admissible on the issues of materiality and fraudulent intent. But the issue that led to the court's vacating Litvak's conviction was the exclusion of expert testimony about the investment decisions of investors in the opaque RMBS market. Parties facing charges of securities fraud should consider presenting expert testimony to show what information a reasonable investor in a particular market at issue would weigh in making investment decisions.

Tongue v. Sanofi: Supreme Court's Omnicare Decision Does Not Require the Disclosure of Every Fact Counter to an Honestly Held Belief

On 4 March 2016, in *Tongue v. Sanofi*, the federal appellate court based in New York affirmed the dismissal of securities claims arising out of statements of opinion concerning the likelihood that a drug would be approved by the Food and Drug Administration ("FDA"). This decision is an important application of the US Supreme Court's March 2015 decision in *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund*. As discussed in a prior edition of this publication, the Court in *Omnicare* held that a statement of opinion is misleading, even if honestly

held, if it omits information that is contrary to what a reasonable investor would assume was the basis for the stated opinion. The court in *Sanofi* held that *Omnicare* does not require a defendant to disclose every single piece of information that might go against its honestly held belief.

The plaintiffs in *Sanofi* held securities whose value depended on the achievement by the defendant biotechnology company of certain milestones, including FDA approval of its multiple sclerosis treatment. According to the plaintiffs, positive statements that the defendants made about the drug, including its high likelihood of receiving FDA approval, were misleading in light of their failure to disclose the FDA's skepticism about the company's use of a "single-blind," rather than "double-blind" test of the drug. The court held that the omission of the FDA's concerns did not render the defendants' statements misleading because "*Omnicare* does not impose liability merely because an issuer failed to disclose information that ran counter to an opinion expressed."

The court in *Sanofi* considered several factors in determining that the omitted information did not render the defendants' statements misleading. First, the FDA's concerns did not conflict with the defendants' statements because the FDA also told the defendants that the company could overcome the FDA's concerns if the drug exhibited an "extremely large effect" on patients. In addition, based on the instruction in *Omnicare* to view allegedly misleading opinions in context, the court here held that because the plaintiffs were sophisticated investors dealing in securities called contingent value rights, which would pay out preset amounts based on the company achieving certain milestones, including milestones established by the FDA, they should have known that it is common in the pharmaceutical industry for the FDA to engage in a dialogue with companies about the drugs for which they seek approval. As such, they should have known that there could initially be discrepancies between the company's views and those of the FDA. Similarly, the court viewed the plaintiffs as being on notice of the FDA's publicly expressed preference for double-blind trials. The court also noted the "numerous caveats" that the defendants made as to the reliability of their projections.

While *Omnicare* opened a new avenue of liability for expressions of opinion, the *Sanofi* court's application of *Omnicare* takes seriously the Supreme Court's admonition that meeting the Omnicare standard for omissions liability "is no small task for an investor." Another notable point is that, whereas Omnicare dealt with claims under the Securities Act of 1933 (the "Securities Act"), *Sanofi* applied the same standard to claims under the Securities Exchange Act of 1934 (the "Exchange Act") as well. *Sanofi*, however, addressed only whether the statements at issue were materially misleading, without considering what a plaintiff is required to plead in order to show fraudulent intent for statements of opinion under the Exchange Act. Ultimately, the court held that for an honestly held belief to be misleading, more is required than merely the omission of a fact that has the potential to undermine the opinion.

For more information on the *Sanofi* decision, our client note is available at:

http://www.shearman.com/en/newsinsights/publications/2016/03/second-circuits-first-published-opinion

Lloyd v. CVB Financial Corporation: Disclosure of a Government Investigation Can Support a Showing that the Defendant's Statements Caused the Plaintiff's Losses When Accompanied by a Subsequent Disclosure Connecting the Investigation to the Company's Alleged Misrepresentations

On 1 February 2016, in *Lloyd v. CVB Financial Corporation*, the federal appellate court based in California, reinstated part of an action for securities fraud against a financial institution for alleged misstatements concerning the ability of its creditors to repay their loans. The court held that its ruling in 2014 in *Loos v. Immersion Corporation* (discussed in a prior edition of this publication)—namely, that "the announcement of an investigation, standing alone, is insufficient to establish" that the defendant's statements or omissions caused the plaintiff's losses (i.e., "loss causation")—left open the question of whether the commencement of an investigation could support loss causation when the complaint also alleges a subsequent disclosure showing that the government investigation was focused on the defendant's alleged misstatements. In *Lloyd*, the court answered that question affirmatively, and held that a subsequent revelation of an

alleged misrepresentation can render the earlier announcement of a government investigation itself a basis for establishing loss causation.

In *Lloyd*, a lender, CVB Financial Corporation ("CVB"), was sued for securities fraud under Section 10(b) of the Exchange Act for saying that it was not aware of credit problems that would "cause serious doubts as to the ability of" borrowers to repay their loans. According to the complaint, however, this statement was false because CVB's biggest borrower had told CVB before CVB made this statement that the borrower could not meet its loan obligations and might file for bankruptcy. The court accordingly held that the plaintiffs—the investors that purchased CVB's stock—had adequately pleaded misstatement by the company.

At issue, however, was whether the plaintiffs had met the separate requirement under Section 10(b) of showing that the defendant's misstatement caused their losses. This element of securities fraud is typically established by showing a drop in share price immediately after the revelation of the misstatement. In this case, CVB's stock price dropped when it announced that the SEC was investigating its practices relating to loan underwriting, provisions for credit losses and other accounting practices. The defendants argued that, under the court's prior ruling in Loos, the plaintiffs' losses from the company's alleged misrepresentation about borrowers' ability to pay their loans could not be attributed to the drop in the company's stock price that followed the announcement of the SEC investigation, because that announcement did not reveal anything about the company's losses from its largest borrower. The court held, however, that CVB's disclosure of the SEC investigation into its lending and accounting practices, which preceded the only significant decline in CVB's share price, could satisfy the requirement that a plaintiff plead that the defendant's misstatement or omission caused the plaintiff's losses. This finding was supported by the fact that, one month after CVB's disclosure of the SEC investigation, the company announced that it *had* lost millions of dollars on the loans at issue. The court concluded that "any other rule would allow a defendant to escape liability by first announcing a government investigation and then waiting until the market reacted before revealing that prior representations under investigation were false." While the court here reversed the lower court's dismissal of the claims described above, the court affirmed the dismissal of claims concerning other statements by the company that the court agreed were not false.

In *Lloyd*, the court determined that the announcement of a government investigation could support a showing that the defendant's alleged misstatements caused the plaintiff's losses in light of other factors corroborating this theory. Based on public commentary concerning how market participants understood the disclosures at issue, the court reasoned that the fact that "the market hardly reacted at all to CVB's bombshell disclosure about its [losses from its] largest borrower, confirm[ed] that investors understood the" announcement of the SEC investigation as at least a partial disclosure of CVB's prior misstatements about its borrowers' ability to repay their loans. While this case provides an important qualification to the general rule, at least within the jurisdiction of this court, that the announcement of a government investigation cannot by itself support a showing that the defendant's misstatement caused the plaintiff's loss, it also reinforces the "context dependent" nature of this "loss causation" inquiry, which, even at the pleading stage, will often turn on the unique circumstances surrounding the disclosures at issue.

Tyson Foods, Inc. v. Bouaphakeo: Supreme Court Allows Use of Statistical Evidence to Establish Classwide Liability at the Class Certification Stage

On 22 March 2016, in *Tyson Foods, Inc. v. Bouaphakeo*, the US Supreme Court affirmed a lower court's decision to allow plaintiffs to use statistical evidence based on a representative sample of the plaintiffs' employment-related activities at issue in the case to show that liability presented a classwide issue that was appropriate for litigation in a class action context. The Court declined to declare a categorical rule permitting or disallowing the use of statistical sampling at the class certification stage, but held instead that "[i]ts permissibility turns not on the form a proceeding takes—be it a class or individual action—but on the degree to which the evidence is reliable in proving or disproving the elements of the relevant cause of action."

Tyson Foods dealt with a claim by workers in a meat processing plant that they were denied overtime pay under federal and state law for the time they spent putting on and taking off certain protective equipment. The workers used statistical evidence to estimate the amount of time these activities took. In ruling that this evidence was allowed, the Court explained that "where representative evidence is relevant in proving a plaintiff's individual claim, that evidence cannot be deemed improper merely because the claim is brought on behalf of a class." The Court was also persuaded by the fact that the evidence was used to "fill an evidentiary gap created by the employer's failure to keep adequate records" and was therefore the only practical way to present evidence as to the employer's liability. In addition, the Court distinguished *Wal-Mart Stores, Inc. v. Dukes*, a case from 2011 holding that a statistical sample could not be used to establish a class claiming gender discrimination. The Court in *Tyson Foods* explained that, in contrast to this case, the employees making up the putative class in *Wal-Mart* were not "similarly situated" and therefore could not have used the statistical evidence even if they had brought individual suits.

While *Tyson Foods* addressed an issue that does not arise in the typical securities class action (where investors that bought their shares during the class period are generally viewed as similarly situated for purposes of a class action), the Court explained more generally that "[t]he fairness and utility of statistical methods in contexts other than those presented here will depend on facts and circumstances particular to those cases." The factors discussed in Tyson Foods will therefore help guide future determinations in a broad range of cases as to whether the use of statistical evidence is appropriate. For example, statistical evidence is commonly used for purposes of determining whether a disclosure revealing the defendant's alleged misstatement caused the defendant company's stock price to drop, as well as in other ways related to the calculation of the plaintiffs' damages. Parties can now be guided in these areas by the Supreme Court's pronouncements in Tyson Foods as to the proper use of statistical evidence.

For more information on business cases currently before the Supreme Court, our client note is available at:

http://www.shearman.com/en/newsinsights/publications/2016/03/some-observations-on-the-impact-of-justice-scalias

In re Lions Gate Entertainment Corp. Securities Litigation

On 22 January 2016, in *In re Lions Gate Entertainment Corp. Securities Litigation*, the United States District Court for the Southern District of New York dismissed securities fraud claims alleging that the defendants did not sufficiently disclose SEC enforcement activities. The case was a putative securities fraud class action brought under Section 10(b) of the Exchange Act.

Lions Gate had been investigated by SEC and had received a "Wells Notice" (a letter from the SEC Enforcement Division staff informing the company that it has decided to recommend that the SEC bring an enforcement proceeding). In a similar case, *Richman v. Goldman Sachs Group, Inc.*, which was heard by the same court in 2012, the court held that Goldman Sachs was not liable for failing to publicly disclose the receipt of a Wells Notice. Expanding on its decision in *Richman*, the court in *In re Lions Gate* held that the defendant had no independent duty to disclose any of the enforcement developments and that they were not *per se* material to investors.

The plaintiffs alleged that Lions Gate should have disclosed publicly the pendency of an SEC investigation, the company's intention to settle with the SEC and Lions Gate's receipt of the Wells Notice. The judge dismissed the case in part because Lions Gate had made no statements about the SEC investigation and therefore did not make any materially incomplete or inaccurate statements, or, in the alternative, the SEC investigation and Wells Notice were not material because the penalty amounted to less than 1% of Lions Gate's consolidated revenues and because the mere possibility that a piece of information may be material to the company's financial condition is not necessarily sufficient to satisfy the plaintiff's burden to plead materiality. In its SEC filings, Lions Gate disclosed that "[f]rom time to time, the Company is involved in certain claims and legal proceedings arising in the normal course of business," and that "the Company does not believe, based on current knowledge, that the outcome of any currently pending claims or legal

proceedings in which the Company is currently involved will have a material adverse effect on the Company's financial statements." The court here ruled that Lions Gate's statements were not false or misleading because a Wells Notice may not necessarily culminate in litigation and therefore does not render the company's disclosure inadequate. Lastly, the court held that Lions Gate did not breach Regulation S-K Items 103, 303 and 503.

The case sheds further light on companies' duties of disclosure and confirms that courts will continue to be guided by established principles of quantitative and qualitative thresholds of materiality. The court thus held that the company was not required to disclose the SEC's ongoing investigation or the company's receipt of a Wells Notice, but left open the possibility that the principles described above might require the disclosure of these types of facts in a different set of circumstances.

Recent SEC/DOJ Enforcement Matters

In the Matter of Crédit Agricole Corporation and Investment Bank: Several Regulators Reach Settlements with Crédit Agricole Corporation and Investment Bank for a Total of $787 Million for Sanctions Violations

On 20 October 2015, Crédit Agricole Corporate and Investment Bank ("CA-CIB"), a subsidiary of the French bank Crédit Agricole S.A., reached settlements with several US federal and state regulators in which the company agreed to pay a total of $787,300,000, entered into deferred prosecution agreements with certain regulators, and agreed to certain other compliance conditions in order to resolve its potential liability for violations of US sanctions regulations and other federal and state laws prohibiting financial transactions with improper parties and the falsification of financial records. The conduct at issue related to thousands of transactions that CA-CIB processed using several methods designed to avoid detection by US financial institutions.

From 2003 to 2008, CA-CIB, through subsidiaries and predecessor entities primarily located in Switzerland, processed thousands of transactions, totaling at least hundreds of millions of dollars, that traveled through the US on behalf of parties subject to US sanctions mainly against parties located in Sudan, but also in Burma, Iran and Cuba. CA-CIB employees used several techniques that were approved by high-level officers to remove the names and locations of the sanctioned parties from transactions traveling through the US, including transactions sent to CA-CIB's New York branch. Communications uncovered during the investigations showed CA-CIB employees, including compliance personnel, taking positions that were clearly inconsistent with US law (such as the position that US regulations did not apply to activities conducted in Switzerland even if they involved transactions traveling through the US). This evidence also showed written policies directing employees to omit information from transactions that would identify parties as being from certain sanctioned countries in order to avoid detection by US financial institutions.

CA-CIB's activities were investigated by the US Attorney's Office for the District of Columbia (which is part of the DOJ), the Treasury Department's Office of Foreign Assets Control ("OFAC") and the Board of Governors of the Federal Reserve System at the federal level and by the New York County District Attorney's Office and the New York State Department of Financial Services at the state level. The approximately $787 million that CA-CIB agreed to pay was divided among these different regulators. In addition, CA-CIB entered into deferred prosecution agreements and agreed to compliance and remedial steps. While CA-CIB received some credit for, among other things, its cooperation with the investigation, its remedial actions, and the fact that the conduct at issue subsided recently, other factors, such as the egregiousness of the conduct, CA-CIB's status as a global financial institution and CA-CIB's lack of proper controls were deemed to aggravate the nature of its conduct. This matter serves as a reminder that foreign companies doing business in the US are not shielded from the laws and regulations of the United States just because the companies are located outside the US. Such companies should assess what US rules apply to their business and take the steps necessary to ensure compliance with those rules.

In the Matter of JPMorgan Chase Bank, N.A., et al., File No. 3-17008: JPMorgan Agrees to Pay $307 Million for Undisclosed Preferences for Investing Customer Funds in Proprietary Investment Vehicles

On 18 December 2015, JPMorgan Chase Bank, N.A. ("JPMCB") and J.P. Morgan Securities LLC ("JPMS") reached a civil settlement with the SEC resolving allegations that they failed to disclose certain conflicts of interest related to investment programs in which they and several other bank entities and affiliates (collectively, or as applicable, "JPMorgan") invested on behalf of high net worth customers. In addition to agreeing to pay a total of $267 million to the SEC, including disgorgement of profits, prejudgment interest and a civil monetary penalty, JPMCB and JPMS agreed to pay an additional $40 million to the Commodity Futures Trading Commission because some of the investments at issue involved commodities. As part of the settlement with the SEC, JPMCB and JPMS acknowledged that the conduct at issue violated the federal securities laws and agreed to the censure of JPMS.

JPMorgan offered high net worth clients investment programs that invested funds in various portfolios. For various periods from 2008 until early 2014, depending on the investment program at issue, JPMorgan did not disclose conflicts of interest arising from its preference for investing customers' funds in proprietary JPMorgan-managed mutual funds and hedge funds for which JPMorgan would earn management fees, as well as for investing in hedge funds managed by third parties that shared fees with JPMorgan. In addition, JPMorgan did not disclose that certain of its funds could have invested in products that would have charged lower fees than the investment types chosen. During the relevant periods, as much as 50% of customers' investments were invested in proprietary JPMorgan funds, though toward the end of the relevant period this proportion decreased to levels as low as approximately 30%. After the relevant periods, JPMorgan amended its disclosures for these investment programs to note its preference for investing in its own proprietary funds.

The settlement here provides that JPMorgan's failure to disclose the conflicts described above constituted willful civil violations by JPMS of provisions of the federal securities laws relating specifically to investment advisers and by JPMCB of provisions prohibiting misrepresentations or omissions in securities transactions more generally. The SEC considered favorably JPMorgan's cooperation with the SEC and remedial actions related to the implementation of policies concerning the disclosure of conflicts of interest. For certain of the investment programs at issue, JPMorgan did disclose that it had a conflict of interest when it invested client funds in its own proprietary funds because those investments increased the revenue that JPMorgan received, and it also disclosed how clients' assets were allocated between proprietary and third-party investment funds. But the SEC determined that those disclosures were not sufficient because they still did not disclose that JPMorgan preferred to invest its clients' assets in the company's proprietary funds. This settlement against JPMorgan demonstrates the heightened sensitivity of market regulators to any potential conflicts of interest; financial institutions and other companies should pay close attention.

In the Matter of Monsanto Company, et al., File No. 3-17107: SEC Settles Claims of Accounting Violations for $80 Million

On 9 February 2016, the SEC settled charges of securities violations against Monsanto Company ("Monsanto") and three of its employees relating to alleged accounting violations from 2009 to 2011 concerning sales of its flagship product, an herbicide called Roundup. Monsanto agreed to pay $80 million and engage in substantial remedial efforts, but neither admitted nor denied the SEC's allegations. The SEC described Monsanto's actions as "the latest page from a well-worn playbook of accounting misstatements" and stated that "[f]inancial reporting and disclosure cases continue to be a high priority for the Commission."

The allegations here arose out of Monsanto's accounting for steps it took to compensate retailers and distributors in the US, Canada, Germany and France that purchased Roundup when Monsanto was planning on soon decreasing the price to compete with lower-cost generic competitors. The SEC alleged that Monsanto encouraged its US retailers to purchase greater amounts of Roundup at the end of Monsanto's fiscal year 2009 by making the retailers eligible for rebates in the following fiscal year to compensate them for Monsanto's upcoming price reduction. Monsanto was also alleged to have

encouraged certain of its US distributors to fail to qualify for rebates in Monsanto's fiscal years 2009 and 2010 in exchange for the distributors' being given the opportunity to earn back those rebates in the following years. According to the SEC, accounting rules required Monsanto to recognize the cost of these rebates and similar incentives at the time they were offered, rather than in the following years when they were formally paid. Monsanto's failure to do so increased its revenues in the earlier years in which it did not account for these benefits provided to its customers. In addition, Monsanto was alleged in Canada, France and Germany to have accounted for rebates as business expenses rather than as a reduction in revenues, thereby improperly boosting its revenues.

Monsanto's allegedly improper conduct in managing the programs described above included making false statements to its auditor concerning when some of these programs were implemented and extending certain of these incentives even though its customers did not meet the sales and marketing requirements for receiving them. Monsanto has restated several financial statements to correct some of these errors. The SEC alleged that these accounting improprieties violated provisions of the Securities Act and the Exchange Act dealing with the sale of securities, reporting requirements and duties to keep accurate books and records.

In addition to paying an $80 million civil penalty, Monsanto agreed: (i) to engage an independent ethics and compliance consultant to review the company's internal accounting controls relating to the alleged violations; (ii) to report the consultant's findings to the SEC; and (iii) to adopt the consultant's recommendations. The three Monsanto employees who were alleged to have been involved in the practices at issue agreed to pay a total of $135,000 in monetary penalties and two of them were denied the ability to appear as an accountant before the SEC for a limited period of time, after which they could apply for reinstatement. The SEC found no personal misconduct on the part of the company's chief executive officer and former chief financial officer ("CFO"). In addition, the SEC explained that because these top executives reimbursed the company for the relevant portions of the compensation that they received during the period at issue (which totaled approximately $4 million), the SEC did not need to pursue a clawback action under the Sarbanes-Oxley Act to try to recoup their money for the company. The SEC's decision not to pursue these claims against the company's leading executives highlights the more favorable treatment available when such executives voluntarily reimburse their companies and otherwise cooperate with regulatory inquiries. It also underscores, however, that certain senior executives are potentially responsible for securities and accounting violations even if they are not personally involved in the alleged misconduct. Overall, this matter serves as a reminder of the SEC's interest in bringing cases arising from accounting deficiencies in companies' financial statements.

In the Matter of Magnum Hunter Resources Corp.: SEC Charges Company, Officers and External Advisers with Improperly Evaluating and Failing to Maintain Internal Controls

On 10 March 2016, Magnum Hunter Resources Corporation ("MHR"), its CFO, chief accounting officer (the "CAO"), an external audit engagement partner and a consultant reached settlements through cease-and-desist orders with the SEC to resolve charges that they had failed to properly maintain MHR's internal control over financial reporting ("ICFR") between 31 December 2011 and 30 September 2013.

As set forth in the orders containing the terms of the parties' settlements, MHR's rapid growth and significant acquisitions in 2010 and 2011 strained its accounting resources, preventing the company from completing its standard monthly close process on time. On this basis, the SEC found a "material weakness" in MHR's internal control over financial reporting. A "material weakness" is defined in Regulation S-X as a "deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis."

The SEC found that the CFO and CAO were in full knowledge of the stress placed on MHR's accounting department as a result of its rapid growth. Nonetheless, they failed to apply appropriate standards when determining the severity of MHR's internal control deficiency.

Before the SEC commenced this proceeding, MHR had engaged a public accounting firm to provide consulting and internal auditing services. The consulting firm documented and tested the company's controls and identified problems in the accounting department that evidenced "inadequate and inappropriately aligned staffing." Nevertheless, the partner of the consulting firm concluded that the staffing deficiency in the company's accounting department did not rise to the level of a material weakness.

Similarly, MHR's independent auditor recognized during the audit that MHR lacked "adequate internal control over financial reporting due to inadequate and inappropriately aligned staffing," which "increases the possibility of a material error occurring and being undetected." Despite this assessment, the external audit partner concluded that the weakness did not rise to the level of "material weakness." The SEC found that there was inadequate documentary support for such a conclusion, that the independent auditor did not apply the applicable auditing standards appropriately and that the CFO and CAO did not sufficiently consider the independent auditor's findings. Accordingly, the public was not informed that MHR had a material weakness in its ICFR.

SEC rules require company management to evaluate and annually report on the effectiveness of ICFR, including disclosing any identified material weaknesses that create a reasonable possibility that the company will not timely prevent or detect a material misstatement in its financial statements. Management may not conclude ICFR is effective if a material weakness exists.

Without admitting or denying the findings in the cease-and-desist orders, MHR agreed to pay a penalty of $250,000 subject to bankruptcy court approval, the CFO and the partner of the consulting firm agreed to pay penalties of $25,000 and $15,000, respectively, and the CAO and the partner of MHR's independent auditor agreed to be suspended from appearing and practicing before the SEC as an accountant until reinstatement after at least one year. This matter shows the SEC's willingness to initiate an enforcement action against senior executives and outside audit parties for internal control deficiencies even though the practices at issue could be portrayed as not material weaknesses.

EU DEVELOPMENTS

Transparency Directive: Updated ESMA Q&As

On 23 October 2015, the European Securities and Markets Authority ("ESMA") published an update to its Q&As on the Transparency Directive.

The update includes the insertion of new questions on, amongst others, the reporting of payments to governments at consolidated level, horizontal aggregation, changes of home member state during a transitional period, financial reporting and information, publication of sanctions and shareholder notifications.

A copy of the updated Q&As is available at:

https://www.esma.europa.eu/sites/default/files/library/2015/11/esma-2015-1595_document_qas_on_td.pdf

Financial Reporting: ESMA Public Statement on Improving the Quality of Disclosures in Financial Statements

On 27 October 2015, ESMA published a public statement on improving the quality of disclosures in IFRS financial statements to address concerns surrounding the lack of relevant information and increasing size of annual reports.

ESMA proposes that the following principles be considered with regards to disclosures made in annual reports:

- Provide information that is as entity-specific as possible and avoid boilerplate language;
- Provide information that is necessary to understand the issuer's financial performance and position;

- Use the materiality concept under IFRS more effectively and remove irrelevant information;
- Financial statements should be as clear and concise as possible; and
- Issuers and auditors should ensure that financial statements and supporting documents are consistent.

A copy of the report is available at:

https://www.esma.europa.eu/search/site/quality%2520of%2520disclosures

Financial Reporting: Commission Consultation on Guidelines for Reporting Non-Financial Information

On 15 January 2016, the European Commission published a consultation document on the non-binding guidelines for reporting of non-financial information by companies, as required under Article 2 of the Directive amending the Accounting Directive on disclosure of non-financial and diversity information.

The new disclosure requirements of the Directive aim to improve the transparency of EU companies in relation to non-financial information and they are applicable to large public-interest entities with more than 500 employees. The Directive itself is flexible so under Article 2, the Commission is required to produce these non-binding guidelines to assist with interpretation.

The consultation asks a broad series of questions on the approach that should be taken to drawing up the guidelines and on what the scope of the guidelines should be. The consultation will close on 15 April 2016.

A copy of the consultation document is available at:

http://ec.europa.eu/finance/consultations/2016/non-financial-reporting-guidelines/docs/consultation-document_en.pdf

MiFID II: ESMA Note on MiFID II Implementation Delay

On 17 November 2015, ESMA published a note on delaying the implementation of the Markets in Financial Instruments Directive ("MiFID") II. It is unlikely that the Level 2 provisions will be published until March 2016, leaving insufficient time to develop the systems for MiFID II implementation.

ESMA identifies four areas where the complexity, interaction and need for a harmonized start date of the systems are especially acute: reference data, transaction reporting, transparency parameters and position reporting.

ESMA also discusses the pros and cons of different options for imposing an implementation delay.

The full text of the note is available at:

https://www.esma.europa.eu/search/site/MiFID%2520II%2520Implementation%2520Day?page=1

Invest Europe Updated Handbook of Professional Standards

On 24 November 2015, Invest Europe, previously EVCA, published a new version of its handbook relevant to the private equity industry.

Amendments to the version published in January 2014 include amendments to:

- Section 3.3 (investing), to emphasize the various factors the general partner ("GP") should consider with regards to responsible investing;
- Paragraph 3.3.7 (GP's consent to portfolio company actions and board appointments), suggesting that the GP obtain investor consent for various matters;
- Paragraph 3.4.10 (follow-on-investments), suggesting that follow-on investments in a portfolio company should be made by the fund that made the original investment;

- Paragraph 3.4.11 (underperforming investments), specifying that local legal advice must be sought when managing an underperforming investment, and the portfolio company must ensure to remain in compliance with all applicable legal and regulatory requirements;
- Paragraph 3.4.12 (factors particular to investing in distressed assets) has been inserted, which focuses on key considerations when dealing with distressed assets; and
- Paragraph 3.5.1 (implementation of divestment planning), which recommends that the GP should consider any relevant environmental, social and governance factors when preparing for a portfolio company exit.

The full text of the adopted amendments is available at:

http://www.investeurope.eu/media/431779/Invest-Europe-Professional-Standards-Handbook-2015.pdf

Prospectus Directive: Commission Proposal for a New Prospectus Regulation

On 30 November 2015, the European Commission proposed a new Prospectus Regulation to repeal and replace the Prospectus Directive.

Amendments to be made by the new Prospectus Regulation include:

- A higher threshold of capital raisings of €500,000 or above before companies must issue a prospectus. Member states will be able to set higher thresholds with the option to exempt offers to securities to the public from the prospectus requirement where such offer is only made within that member state and the total consideration does not exceed €10 million;
- A 'lighter prospectus' for small and medium-sized enterprises ("SMEs"). SMEs with a market capitalization of under €200 million and with no securities admitted to trading on a regulated market would be allowed to prepare a distinct prospectus;
- A simplified prospectus for companies already listed on the public market who are making a secondary issuance;
- A new prospectus summary;
- A new annual 'universal registration document' which would contain all the necessary information on a company wanting to list shares or issue debt. Issuers who maintain this document would benefit from a five day fast track approval when issuing shares, bonds or derivatives; and
- A single access point for all EU prospectuses (likely to be ESMA).

Further information on the proposal is available at:

http://ec.europa.eu/finance/securities/prospectus/index_en.htm

Prospectus Directive: ESMA Publishes Opinion Assessing Turkish Laws and Regulations on Prospectuses

On 8 February 2016, the European Securities and Markets Authority ("ESMA") published an opinion on Turkish laws and regulations on prospectuses. The opinion compares the Turkish and EU requirements set out in the Prospectus Regulation. It considers that:

- a prospectus drawn up according to Turkish laws and regulations can constitute a valid prospectus under the Prospectus Directive; and
- it is not necessary for a Turkish prospectus for shares to be accompanied by a wrap, provided that the prospectus contains financial statements in accordance with International Financial Reporting Standards ("IFRS").

It is noted that the ESMA opinion does prevent the national authorities having discretion to request additional information in a wrap or the prospectus.

A copy of the opinion is available at:

https://www.esma.europa.eu/sites/default/files/library/2016-268_opinion_on_equivalence_of_the_turkish_prospectus_regime.pdf

European Company Law: Codification of Directives

On 3 December 2015, the European Commission published a proposal for a directive which would repeal and codify the following:

- Sixth Company Law Directive (82/891/EEC) on the division of public limited liability companies;
- Eleventh Company Law Directive (89/666/EEC) on disclosure requirements in respect of branches;
- The Cross Border Mergers Directive (2005/56/EC);
- Directive 2009/101/EC on coordination of safeguards;
- Third Company Law Directive concerning mergers of public limited liability companies (codified) (2011/35/EU); and
- Second Company Law Directive on the formation of public limited companies and the alteration and maintenance of their capital (recast) (2012/30/EU).

The full text of the proposal is available at:

http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1452266398361&uri=CELEX:52015PC0616

European Union: EU Referendum

On 20 February 2016, it was announced that the UK would hold a vote on their membership of the EU on 23 June 2016.

Our EU referendum overview is available at:

http://www.shearman.com/~/media/Files/NewsInsights/Publications/2016/03/Brexit-Options-for-and-Impact-of-the-Possible-Alternatives-to-EU-Membership-FIAFR-032116.pdf

UK DEVELOPMENTS

PSC Register: Draft Non-Statutory Guidance for Companies

On 21 December 2015, the Department for Business, Innovation and Skills ("BIS") published draft non-statutory guidance for consultation on the requirement for companies to maintain a register of people with significant control (a "PSC").

The draft sets out government guidance relevant to the interpretation and application of new Part 21A of the Companies Act 2006, which substantially comes into force on 6 April 2016.

The guidance covers the process of identifying and recording PSCs. It does not cover detail of how to complete filings in relation to PSC information at Companies House.

The draft also provides guidance on how to apply the specified conditions for determining whether an individual is or is not a person with "significant control and influence." The guidance states that a person will have significant control over a company if one of the specified conditions is satisfied. The first three specified conditions require the holding of more than 25% of the company's shares, or voting rights in the company, or the right to appoint or remove the majority of the board of directors. The fourth and fifth specified conditions require a person to have "significant influence or control" either over the company itself, or over the activities of a trust or a firm which meets any of the other specified conditions in relation to the company.

The consultation closed on 11 January 2016.

A copy of the draft guidelines is available at:

https://www.icsa.org.uk/assets/files/pdfs/Policy/PSC-Draft-Guidance-for-companies-17-December-2015.pdf

PSC Register: Government Response to Consultation

On 17 December 2015, BIS published the government's response to its consultation paper seeking views on the draft Register of People with Significant Control Regulations 2015.

The response included:

- A statement that companies with voting shares admitted to trading on a regulated market in an EEA state and companies listed on certain markets in Japan, the US, Switzerland and Israel will be exempt from the PSC requirements;
- A note that the government intends to put in place the application process proposed in the consultation paper for protecting secured information. The response also states that the registrar will be able to seek advice on the nature or extent of the risk of violence or intimidation from any authority as it deems fit;
- A section setting out proposals for the conditions to be satisfied for a person to be treated as having significant control of a LLP; and
- A statement that participants in foreign arrangements similar to limited partners in an English limited partnership, who do not take part in the management of that arrangement, will not meet the first three conditions mentioned above for significant control just by virtue of being in a position similar to that of a limited partner.

The government response can be found at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/486520/BIS-15-622-register-of-people-with-significant-control-consultation-response.pdf

PSC Register: Draft Statutory Guidance on the Meaning of Significant Influence or Control

On 21 December 2015, BIS published a consultation paper on the draft statutory guidance on the meaning of "significant influence or control" for the purposes of a company determining whether a person is a person with significant influence or control under the fourth or fifth specified conditions mentioned above (under "PSC register: draft non-statutory guidance for companies").

The draft guidance also sets out specific safe harbors that will avoid a person being treated as having "significant influence" purely because it has a function in relation to the company falling within the safe harbor. These safe harbors include:

- A person providing advice or direction in a professional capacity;
- A person engaging in a third party commercial or financial agreement;
- An employee acting in the course of their employment; and
- A director of the company.

The consultation closed on 11 January 2016.

A copy of the draft guidelines is available at:

https://www.icsa.org.uk/assets/files/pdfs/Policy/PSC-register---Draft-Statutory-Guidance---3-December-2015.pdf

PSC Register: Register of People with Significant Control Regulations 2016

On 21 March 2016, the Register of People with Significant Control ("PSC") Regulations were published.

The PSC regulations have been amended from the draft published in June 2015 to include:

- a provision that companies who have voting shares admitted to trading on various markets in Israel, Japan, Switzerland and the US are not required to keep a PSC register;
- a more extensive list of legal entities that are deemed subject to their own disclosure requirements in order to cover companies with voting shares admitted to trading on certain markets in Israel, Japan, Switzerland and the US;
- a new Schedule which sets out the amendments that are necessary to be made to the Companies (Disclosure of Address) Regulations 2009 in order to align the 2009 regulations' regime for the protection of director's addresses from disclosure with the regime in the PSC regulations protecting a person with significant control's usual residential address;
- a provision stating that the fee for requesting a copy of a company's PSC register (or any part of it) will be fixed at £12; and
- an extension of the time limits in connection with applications to prevent disclosure of the usual residential addresses or other secured information in relation to the PSC register.

The Register of People with Significant Control Regulations 2016 can be accessed at:

http://www.legislation.gov.uk/uksi/2016/339/pdfs/uksi_20160339_en.pdf

PSC Register: Limited Liability Partnerships (Register of People with Significant Control) Regulations 2016

On 18 March 2016, the Limited Liability Partnerships (Register of People with Significant Control) Regulations were published.

Limited Liability Partnerships ("LLPs") will be required to maintain a PSC register in the same way as UK companies. The regulations apply the relevant provisions of the Companies Act 2006 to LLPs with certain adaptations, for example the criteria for whether someone is a PSC of an LLP are different from the criteria determining whether someone is a PSC of a company.

With regards to an LLP, an individual will be a person with significant control if he directly or indirectly holds the right to:

- more than 25% of the voting rights on matters to be decided by a vote of members of the LLP;
- share in more than 25% of any surplus assets of the LLP on a winding up;
- appoint or remove the majority of persons entitled to take part in the LLP's management;
- exercise significant influence or control over the LLP; or
- exercise significant influence or control over the trustees or members of a trust or firm that is not a legal person, where those trustees or members would meet any of the specified conditions (or would do if they were individuals).

The Limited Liability Partnerships (Register of People with Significant Control) Regulations 2016 can be accessed at:

http://www.legislation.gov.uk/uksi/2016/340/pdfs/uksi_20160340_en.pdf

PSC Register: Statutory Guidance on the Meaning of Significant Influence or Control

On 27 January 2016, the Department for Business, Innovation and Skills ("BIS") published its amended draft statutory guidance on the meaning of significant influence or control in the context of PSC registers, one in relation to companies and the other in relation to LLPs.

For a summary of the previous draft statutory guidance published by BIS on 21 December 2015, our Q4 2015 newsletter is available on page 1.

The new amendments to the draft statutory guidance include:

- expanding and clarifying the meaning of the right to exercise significant influence or control over a company or LLP; and

- amending and extending the list of excepted roles and relationships with respect to companies and LLPs which will not, on their own, result in a person being considered to be exercising significant influence or control (formerly described as safe harbors) and clarifying that this list is non-exhaustive.

The amended draft statutory guidance was laid before Parliament on 6 April 2016 and can be accessed at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/498275/Statutory_company_PSC_Guidance.pdf

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/495414/LLP_Statutory_Guidance_for_PSC_register.pdf

PSC Register: Non-Statutory BIS Guidance for Companies, SEs And LLPs

On 11 February 2016, BIS published its final non-statutory guidance for companies, Societates Europaeae ("SEs") and LLPs on the register of people with significant control. This guidance was updated on 4 March 2016.

This guidance was broadly similar to the draft guidance for companies which BIS published on 21 December 2015. For a summary of the draft guidance, our Q4 2015 newsletter is available on page 1.

However, the final guidance does include minor amendments which clarify the guidance. For example, the final guidance inserts several paragraphs clarifying how condition (i) (ownership of shares) applies to companies without share capital, including charitable companies. Additionally, the updated guidance clarifies when rights in a company may be exercisable in certain circumstances, for example situations involving voting rights, rights to appoint or remove directors and options to acquire shares. The revised guidance makes clear that these three examples are not an exhaustive list.

This final guidance can be accessed at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/505303/NON-STATUTORY_GUIDANCE_FOR_COMPANIES_AND_LLPS.pdf

PSC Register: BIS Guidance for PSCs

On 23 March 2016, BIS published guidance on the register for PSCs of companies, SEs and LLPs.

The guidance focuses on the obligations of persons who may be PSCs and registrable Relevant Legal Entities. However, it is substantially similar to the guidance for companies, SEs and LLPs.

The guidance can be accessed at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/510011/PSC_guidance_v1.pdf

PSC Register: Ministerial Written Statements

On 26 January 2016, the House of Lords issued a written statement on the draft Register of People with Significant Control Regulations 2016.

The written statement makes clear that the Secretary of State will not use the power to make general exemptions to new information and registration requirements, unless using the exemption would be in the interests of national security, the economic well-being of the UK or the support of the prevention or detection of a serious crime. The Secretary of State will also only grant this exemption if it is clear that the company or LLP is not being run for the personal benefit of any individual and that the exemption was necessary for the person seeking it to achieve their lawful objectives.

The written statement can be accessed at:

http://qnadailyreport.blob.core.windows.net/qnadailyreportxml/Written-Questions-Answers-Statements-Daily-Report-Lords-2016-01-26.pdf

PSC Register: Companies Act 2006 (Amendment of Part 21A) Regulations 2016

On 9 February 2016, the Companies Act 2006 (Amendment of Part 21A) Regulations 2016 were published. The regulations amend section 790C of Part 21A to remove the unnecessary requirement to record every company in a chain of companies on a company register of people with significant control over the company. Instead, they allow the registration of just the first company in the chain of ownership which is subject to its non-beneficial ownership disclosure requirements.

These regulations came into force on 8 February 2016 and can be accessed at:

http://www.legislation.gov.uk/uksi/2016/136/pdfs/uksi_20160136_en.pdf

Statutory Audit: Updated BIS Consultation on Implementation of EU Audit Reform

On 17 November 2015, BIS published updated proposals to amend the Companies Act 2006. These proposals, alongside the draft Statutory Auditors and Third Country Auditors Regulations 2016 consulted in October 2015, form part of the government's proposals to incorporate the EU Directive amending the Statutory Audit Directive into national law and on legislative provisions needed as part of the application of the EU Regulation on the statutory audit of public interest entities (generally listed and certain credit and insurance entities).

The updated draft proposals include provisions which enable either (a) the Financial Reporting Council ("FRC") or (b) shareholders representing 5% or more of the voting rights or of the share capital of the company to bring a claim before a national court for the dismissal of the statutory auditor of a public interest entity where there are proper grounds for doing so. However, the consultation paper notes that the government has not prescribed what constitutes "proper" or "improper grounds."

The draft amendments also include an updated definition of public interest entity in section 519A of the Act.

The consultation closed on 9 December 2015.

The draft amendments can be accessed at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/483287/BIS-15-609-draft-schedule-of-amendments.pdf

Corporate Governance: PLSA Corporate Governance Policy and Voting Guidelines 2015/2016

On 12 December 2015, the Pensions and Lifetime Savings Association ("PLSA") published an updated edition of its Corporate Governance Policy and Voting Guidelines. These guidelines seek to reflect current market best practice as determined through consultation with PLSA members, and the aim of the guidelines is to assist members in promoting the long-term success of the companies they invest in and ensuring that the board and management of these companies are accountable to shareholders. The guidelines also aim to assist investors and proxy voting agents in their interpretation of the provisions of the UK Corporate Governance Code.

Key aspects which have been revised in this version of the guidelines include:

- An emphasis on the need for the company to articulate clearly how key tangible and intangible assets are engaged in the generation of sustainable value creation when reporting on strategic risk in accordance with Section C of the Code;
- A note that shareholders should be mindful of any concurrent directorships and other time commitments that non-executive directors and chairs may have;

- A comment on dividend policy disclosure, which the guidelines suggest should be specific enough to understand what the policy means in practice;
- A new requirement that companies should clearly signal, at their earliest opportunity, any intention they may have to undertake a non-pre-emptive share issue and to engage in dialogue with their shareholders about this;
- A statement that the board should provide investors with an understanding of the process used to identify when a share buyback is appropriate, the maximum price the company would be prepared to pay and the hurdle rate in respect of the buyback linking it to the overall capital management framework of the company; and
- New detailed voting guidelines on shareholder resolutions and the need for management to be available to engage with shareholders to facilitate an understanding of the rationale and merits of a resolution.

A copy of these guidelines can be found at:

http://www.plsa.co.uk/PolicyandResearch/DocumentLibrary/~/media/Policy/Documents/0556-2016-Corporate-Governance-Policy-and-Voting-Guidelines.pdf

Corporate Governance: ISS UKI Proxy Voting Guidelines Update

On 20 November 2015, Institutional Shareholder Services Inc ("ISS") published an update to its benchmark proxy voting policies in light of the responses received to the October 2015 Consultation paper on changes to ISS UKI Proxy Voting Guidelines.

This update confirms that ISS will make the following changes to its UK and Ireland Proxy Voting Guidelines:

- A disapplication of pre-emption rights for up to 10% of the issued share capital will now be acceptable, provided that the extra 5% above the original 5% is used only for the purposes of an acquisition or a specified capital investment;
- There will be a recommended maximum number of boards on which directors should sit and ISS may recommend voting against the election or re-election of directors who sit on too many boards; and
- ISS' policy on non-audit service fees will be extended to smaller companies.

The updated policies will generally be applied for shareholder meetings on or after 1 February 2016. The update can be found at:

http://www.issgovernance.com/file/policy/executive-summary-of-key-2016-updates-and-policy.pdf

Corporate Governance: FRC to Introduce Public Assessment of Reporting Against Stewardship Code

On 14 December 2015, the FRC announced that it will introduce public tiering of signatories to the Stewardship Code in July 2016 to improve reporting against the principles of the Stewardship Code and assist investors. The FRC stated that improved reporting will help asset owners judge how well their fund manager is delivering on their commitments under the Stewardship Code, help those who value engagement to choose the right manager and in consequence provide a market incentive in support of engagement.

To promote commitment to stewardship, the FRC will assess signatories' reporting against the Stewardship Code and make public its assessment. Signatories that meet reporting expectations on stewardship activities will be classed as Tier 1, with Tier 2 covering all those not meeting reporting expectations.

The FRC press release can be found at:

https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2015/December/FRC-promotes-improved-reporting-by-signatories-to.aspx

Corporate Governance: Investment Association Principles of Remuneration 2015

On 11 November 2015, the Investment Association published its 2015 principles of remuneration. These are an updated version of the previous Association of British Insurers ("ABI") remuneration principles.

These principles set out the Investment Association's view of the role of the shareholders and the remuneration committee in relation to director's remuneration.

There are no significant changes to the principles other than a statement that Investment Association members expect long-term incentive plan awards to have a total performance and holding period of at least 5 years.

The 2015 principles can be accessed at:

https://www.ivis.co.uk/media/11101/Principles-of-Remuneration-2015-Final.pdf

For a summary of the previous ABI remuneration principles, our Q4 2013 Governance and Securities Newsletter is available at:

http://www.shearman.com/~/media/Files/NewsInsights/Publications/2014/01/Governance_and_Securities_Q4_BulletinCMCGFIAECEBLT012414.pdf

Corporate Governance: EHRC Guidance on Improving Board Diversity

On 23 March 2016, the Equality and Human Rights Commission ("EHRC") published guidance for companies, among others, on how to improve the diversity of company boards within the framework of the Equality Act 2010 and the UK Corporate Governance Code.

The recommendations include:

- defining the selection criteria in terms of measurable skills, experience, knowledge and personal qualities;
- reaching the widest possible candidate pool by using a range of recruitment methods and positive action;
- providing a clear brief, including diversity targets, to executive search firms;
- assessing candidates against the role specification in a consistent way throughout the process;
- establishing a clear board accountability for diversity; and
- widening diversity in the senior leadership talent pool to ensure future diversity in succession planning.

The EHRC guidance can be found at:

https://www.equalityhumanrights.com/sites/default/files/how_to_improve_board_diversity_web.pdf

Corporate Governance: PIRC Shareholder Voting Guidelines 2016

Pensions Investment Research Consultants ("PIRC"), the shareholder advisory body, has published the 23rd edition of its UK Shareholder Voting Guidelines. These guidelines replace the version published in April 2015.

The new 2016 guidelines make clear that:

- PIRC will not support authorities for the disapplication of pre-emption rights up to an amount equal to 10% of the company's issued ordinary share capital unless the board has made a clear, cogent and compelling case as to why the 10% level is appropriate for the company;
- PIRC will only support future requests for share buyback authorities if the board has made out a clear, cogent and compelling case to demonstrate how the authority would be used to benefit the long-term shareholders and that the directors are not conflicted in recommending the authority;

- in relation to the provision of non-audit services by audit firms, PIRC will normally recommend abstaining where non-audit fees are between 25% and 50% of audit fees and opposing where non-audit fees exceed 50% of audit fees for either year under review or the previous three years;
- PIRC supports the efforts of Lord Davies to increase board diversity and therefore, in line with the updated Davies target, has updated the target in its Guidelines to 33% female board representation by 2020; and
- PIRC continues to oppose excessive remuneration and has added some new criticism of "absurd" retention awards made where there is no indication that a director wishes to move on or that there is outside demand for the director's services. The new Guidelines are also now more prescriptive about who should be allowed to sit on the remuneration committee. PIRC states that remuneration committee members should not be executive directors of other UK listed companies and that, in 2016, PIRC will abstain on the election of any such directors who sit on the remuneration committee.

The PIRC UK Shareholder Voting Guidelines 2016 are available to purchase from PIRC and can be accessed at:

http://pirc.co.uk/news-and-resources2/guidelines

Corporate Governance: FRC Report on Developments in Corporate Governance and Stewardship

On 14 January 2016, the Financial Reporting Council ("FRC") published a report on developments in corporate governance during 2015 which reviewed the impact and implementation of the UK Corporate Governance and Stewardship Codes during the last 12 months. The report highlights the FRC's views on performance by companies and stakeholders during 2015 and addresses areas for potential improvement. The report also sets out the statistical findings of several reports conducted by professional associations and advisers.

The key points that the report makes in terms of the UK Corporate Governance Code are as follows:

- The FRC does not intend to make any substantial revisions to the Code before 2019;
- Strict compliance with all Code provisions has dropped slightly due to newly listed companies not yet having observed all governance requirements and due to FTSE 100 companies awaiting finalization of implementation of the EU Statutory Audit Directive and Regulation and, in particular, as regards audit rendering;
- The FRC intends to focus on corporate culture and practices that embed good corporate behavior over the next year; and
- The FRC is assessing feedback to its consultation on implementation of the EU Audit Directive and Regulation and plans to release revised versions of the Code and Guidance later in 2016.

The key points that the report makes in terms of the Stewardship Code are as follows:

- The FRC encourages investors to notify companies in advance of votes against or abstentions, following a decrease in these notifications in 2015;
- The FRC intends to ensure that its activities capture the perspectives of long-term investors and international investors active in the UK market; and
- The FRC intends to scrutinize the Stewardship Code signatory statements and then contact firms to allow for improvements, before making its assessments public in summer 2016.

This report can be accessed at:

https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Developments-in-Corporate-Governance-and-Stewa-(1).pdf

Financial Reporting: FRC Report on Developments in Clear and Concise Narrative Reporting

On 17 December 2015, the FRC issued a report entitled "Clear & Concise: Developments in Narrative Reporting." The report focuses on the steps that companies have taken to achieve clear and concise reporting where annual reports provide relevant and easily understandable information for investors. The report highlights emerging best practice in narrative reporting and offers investor and company perspectives on processes that aid improvements in annual reports.

The report focuses on three areas:

- Clear and concise reporting – The FRC includes a description of what this term means and how companies can aim to achieve it;
- Impact of the strategic report – The FRC states that strategy reporting provides useful insights into how a company is managed. The report generally finds that the overall quality of corporate reporting has been improved by the use of the strategic report although opportunities for further improvement still exist (for example, there is scope for companies to take a longer-term view in their strategic reports); and
- Emerging developments – The report discusses a number of developments that will soon be enforced that will have an impact on corporate reporting in the future including, for example, new disclosure requirements.

The report also highlights focus areas for the next reporting period such as the application of materiality and improving reporting of key performance indicators, principle risks and forward-looking information.

The report can be accessed at:

https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Clear-Concise-Developments-in-Narrative-Reporti.aspx

Financial Reporting: FRC Letter to Audit Committee Chairs on Improving Corporate Reporting

On 15 December 2015, in preparation of the reporting season, the FRC wrote to audit committee chairs in larger listed companies summarizing key developments for 2015 annual reports.

The letter states that, generally, the quality of corporate reporting is high but there are some areas where companies could improve their reporting. For example, the letter states that the annual reports should go beyond a compliance driven approach and avoid boilerplate statements so that investors receive the relevant information in a clear and concise format.

The letter identifies some of the key themes in corporate governance and reporting, including considering the risks a company is exposed to and the importance of materiality assessments to underpin effective, tailored disclosure.

This letter can be accessed at:

https://frc.org.uk/Our-Work/Publications/FRC-Board/Year-end-advice-to-preparers-larger-listed-compa.pdf

Financial Reporting: FRC Letter of Advice to Smaller Listed and AIM Companies on How to Improve Annual Reports

On 11 November 2015, the FRC published a letter of advice to smaller listed and AIM companies on how to improve annual reports in areas of particular interest to investors.

The letter states that in particular, investors expect:

- The Strategic Report to be clear, concise, balanced and understandable;
- Accounting policies to be clear and specific, particularly in relation to revenue recognition and expenditure capitalization; and
- A clear explanation of how the company generates cash flow.

This letter can be found at:

https://www.frc.org.uk/Our-Work/Publications/FRC-Board/FRC-Letter-Year-end-advice-to-preparers-smaller.pdf

Financial Reporting: FRC Review of Companies' Tax Reporting

On 1 December 2015, the FRC stated that it plans to conduct a thematic review of companies' tax reporting in order to promote transparent recording of the relationship between the tax charges and accounting profit.

The FRC stated that it intends to write to a number of FTSE 350 companies prior to their year-end informing them that the Corporate Reporting Review Team will review the tax disclosures in their next published reports. The FRC stated that the aim of this monitoring is to ensure that the quality of corporate reporting is improved.

The FRC is particularly interested in:

- The transparency of tax reconciliation disclosures and how well the sustainability of the effective tax rate is covered; and
- Uncertainties relating to tax liabilities (and assets) where the value at risk in the short-term is not identified.

The FRC also noted that companies are required to disclose the principal risks and uncertainties they face and are expected to explain the actions they propose to mitigate the impact of those risks. The FRC confirmed that the targeted review will consider the totality of the companies' reporting, including relevant disclosures in their strategic and other narrative reports, as well as the detailed accounting disclosures.

A copy of the FRC statement is accessible at:

https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2015/December/FRC-calls-for-transparent-disclosure-of-tax-risks.aspx

Financial Reporting: Financial Reporting Lab Publish Report on Disclosure of Dividends

On 24 November 2015, the FRC's Financial Reporting Lab published a project report on the policy and practice in relation to disclosure about dividends which sets out the findings from its discussions with investors.

The report states that investors want information on:

- Why the company's dividend policy was selected;
- What the policy means in practice;
- What the risks and constraints associated with the policy are; and
- How the policy is delivered in practice.

The report also makes clear that investors are also seeking disclosure of the circumstances in which companies expect to pay special dividends or buy back shares and whether they are in the best interests of the shareholders.

The report can be found at:

https://www.frc.org.uk/Our-Work/Publications/Financial-Reporting-Lab/Lab-Project-Report-Disclosure-of-dividends-%E2%80%93-poli.pdf

Financial Reporting: FRC Discussion Paper on Succession Planning

On 27 October 2015, the FRC published a discussion paper on UK board succession planning, focusing on board succession for executives and non-executives of those companies to which the UK Corporate Governance Code applies. The FRC is requesting comments by 29 January 2016.

The FRC anticipates that feedback will contribute to six key areas:

- Business strategy and culture: The FRC seeks views on how succession planning can be linked to the development of business strategy and company culture, and how that link can be reported on in practice;
- The Nomination Committee: The FRC is requesting opinions on whether the Code is sufficiently clear on the role and responsibility of the committee;
- Board evaluation: The FRC seeks suggestions of practical changes that could help ensure that boards fully consider succession planning within the annual evaluation process;
- The pipeline for executives and non-executives: The FRC wants to gain more information on how companies review their internal talent;
- Diversity: The FRC is seeking ideas on how a succession plan could incorporate and deliver diversity objectives; and
- The role of institutional investors: The FRC seeks views on the experience that companies or investors may have had in terms of engagement about the introduction of new talent to a board.

This discussion paper can be found at:

https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Discussion-Paper-UK-Board-Succession-Planning-(1)-File.pdf

Financial Reporting: FRC Corporate Reporting Review

On 22 October 2015, the FRC published its Corporate Reporting Review Annual Report for 2015 covering its review of reports and accounts conducted in the year to 31 March 2015.

The report states that:

- The FRC is concerned about how some boards assess materiality. Materiality assessments should not be used to conceal errors or present a desired outcome;
- Some smaller companies do not comply with the relevant standards;
- There were ten areas of corporate reporting that were commonly queried by the FRC during the year including clear and concise reporting, critical judgment, strategic reports and accounting policies;
- Boards should be focusing on disclosures relevant to investors in their strategic report rather than including irrelevant information;
- Boards should make meaningful disclosures of specific judgments when applying their accounting policies; and
- Boards should not include irrelevant information in their reports and accounts but should advocate clear and concise reporting.

This report can be accessed at:

https://www.frc.org.uk/Our-Work/Publications/Corporate-Reporting-Review/Corporate-Reporting-Review-Annual-Report-2015.pdf

Financial Reporting: Modern Slavery Act 2015

On 28 October 2015, two sets of regulations relating to the Modern Slavery Act 2015 ("MSA") were published.

The Modern Slavery Act (Transparency in Supply Chains) Regulations 2015 sets the figure of £36 million as the global turnover above which businesses will, under the MSA, have to publish a slavery and human trafficking statement each year. This requirement came into force on 29 October 2015.

The MSA makes clear that the total turnover is the annual global turnover. It will include the turnover of the commercial organization and that of its subsidiaries. It is not limited to turnover in the UK.

This legislation can be accessed at:

http://www.legislation.gov.uk/ukdsi/2015/9780111138847

The Modern Slavery Act 2015 (Commencement no 3 and Transitional Provision) Regulations 2015 provide that, although section 54 MSA came into force on 29 October 2015, the requirement (requiring the publication of this slavery and human trafficking statement) only applies in respect of financial years ending on or before 31 March 2016.

This legislation can be accessed at:

http://www.legislation.gov.uk/uksi/2015/1816/regulation/3/made

A copy of our client briefing on the MSA's annual statement requirements is available at:

http://www.shearman.com/~/media/Files/NewsInsights/Publications/2015/12/The-Modern-Slavery-Act-2015--New-Reporting-Requirement-CORP-122215.pdf

Financial Reporting: FRC Publishes Thematic Review on Audit Quality Monitoring

On 5 January 2016, the FRC published a thematic review of audit firms' internal quality control procedures. Of particular interest are a number of suggestions proposed to audit committees to help maintain the key role they play in reviewing and monitoring the effectiveness of the audit process. The report states that this should help to build investor confidence in the quality of external audits and therefore, by extension, the reliability of financial statements.

The suggestions to audit committees proposed by the FRC include:

- requesting audit firms to provide an overall annual report of their monitoring activities which will be more detailed than that which is contained in the annual Transparency Reports required by the Statutory Audit Directive to be published by auditors of UK companies with securities admitted to trading on a UK regulated exchange;
- discussing the findings of any audit review, together with any necessary remedial action, with their auditor;
- discussing with their audit partner the scope of the firm's audit monitoring to ascertain whether any UK components were included or if the review was restricted to work at group level; and
- asking whether the audit team have received any feedback from the monitoring performed by network firms responsible for audit work on overseas companies.

The full FRC report is available at:

https://www.frc.org.uk/Our-Work/Publications/Audit-Quality-Review/Audit-Quality-Thematic-Review-Firms-audit-qualit.pdf

Financial Reporting: New Draft Regulations Published Regarding Accounting Regulatory Framework for LLPs

On 8 March 2016, draft regulations (the Limited Liability Partnerships, Partnerships and Groups (Account and Audit) Regulations 2016) were published and laid before Parliament, which introduce changes to the accounting regulatory framework for LLPs. Broadly, these changes reflect those introduced for companies in the Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015.

The key changes in the draft regulations include:

- an increase in the turnover and balance sheet thresholds used to determine whether an LLP or group qualifies as "small" or "medium" sized;

- a limit for small LLPs on the number of mandatory notes to the accounts;
- provisions which enable LLPs to adapt the formats for profit and loss accounts and balance sheets;
- permitting abridged balance sheets and profit and loss accounts for small LLPs in circumstances where this is approved unanimously by the members of the LLP; and
- permitting the use of the equity method of accounting in individual LLP accounts.

The regulations apply to financial years commencing on or after 1 January 2016. They will come into force on the seventh day after they are made.

The draft regulations are available at:

http://www.legislation.gov.uk/ukdsi/2015/9780111127896/pdfs/ukdsi_9780111127896_en.pdf

Financial Reporting: FRC Publishes Letter of Advice to Audit Committee Chairs Regarding Volatile Asset Prices and Uncertainty Over Interest Rates for Corporate Reporting Season

On 8 March 2016, the FRC published a letter of advice to audit committee chairs containing guidance in relation to how issues such as volatile asset and oil prices, uncertainty over interest rates in certain jurisdictions and the UK's EU membership referendum should be dealt with in annual reports and accounts.

The letter highlights that:

- the strategic report in particular provides an opportunity to provide the most current view of prospects and, as such, it should be carefully reviewed by the board to ensure that statements which may have been drafted some time ago in preparation for the reporting season remain pertinent;
- key to the understanding of a company's prospects will be the disclosure of the directors' judgments as to the principal risks and their potential impact and, therefore, more disclosure as to sensitivities may be required to aid understanding;
- accounts should be drawn up on the basis of the conditions existing at the balance sheet date but events or information that come to light at a later date which affect valuations need careful consideration and may need to be disclosed;
- Financial Reporting Standards require companies to disclose material post-balance sheet events, including the nature of each event and its estimated financial impact or a statement that such an estimate cannot be made; and
- audit committee chairs may need to consider whether the events have a material impact on the preparation of the accounts on a going concern basis of accounting and/or whether there are material uncertainties relating to that assessment requiring disclosure.

The letter is available at:

https://www.frc.org.uk/FRC-Documents/Audit-and-Assurance-Council/Letter-to-ACC-on-relevant-reporting-considerations.pdf

FCA: Revised Guidance on Advancing its Objectives

On 16 December 2015, the Financial Conduct Authority ("FCA") published updated guidance on its approach to advancing its objectives. This guidance was produced in response to comments on the FCA's 2013 version. This guidance sets out what firms and consumers can expect from the FCA and how they intend to deliver their statutory responsibilities. It is based around three operational objectives including protecting consumers, ensuring market integrity and promoting effective competition.

This guidance can be found at:

http://www.fca.org.uk/static/fca/documents/corporate/fca-approach-advancing-objectives-2015.pdf

For a summary of the FCA's 2013 guidance on its approach to advancing its objectives, our Q3 2013 Governance and Securities Newsletter is available at:

http://www.shearman.com/~/media/Files/NewsInsights/Publications/2013/10/Governance--Securities-Law-Focus-Europe-Edition-__/Files/View-newsletter-Governance--Securities-Law-Focus__/FileAttachment/GovernanceSecuritiesLawFocusCM1013.pdf

FCA Quarterly Consultation No 11

On 4 December 2015, the FCA published its eleventh quarterly consultation paper.

This paper proposes to make changes to different parts of the Handbook as follows:

- Implementation of the Transparency Directive Amending Directive: The FCA is consulting on amendments to its Enforcement Guide ("EG") to comply with the requirement that Member States provide competent authorities with the power to suspend voting rights for shareholders who do not comply with certain Transparency Directive requirements. The FCA is proposing to add rule EG 7.3A to reflect its ability to apply to court for a voting rights suspension order. In deciding whether to apply to the court for such an order, the FCA will consider the full circumstances of each case. The FCA is requesting comments on these proposals by 4 February 2016; and
- Impact on the Listing Rules of proposed Prospectus Rules amendments pursuant to EU regulatory technical standards: The FCA has noted that there are three Listing Rules dealing with listing particulars that cross-refer to rules in the Prospectus Rules which will be amended under CP15/28.

The consultation can be found at:

http://www.fca.org.uk/static/documents/consultation-papers/cp15-42.pdf

FCA Handbook: Listing Rules and Disclosure and Transparency Rules (Miscellaneous Amendments Instrument 2016 (FCA 2016/6)

On 29 January 2016, the Financial Conduct Authority ("FCA") published an instrument which gives effect to a number of amendments to the Listing Rules and Disclosure and Transparency Rules. These amendments are intended to enhance investor protection and bring the Disclosure and Transparency Rules in line with the EU Accounting Directive. The amendments include increased protection for minority shareholders by making it more difficult for a controlling shareholder to cancel an issuer's listing. The amendments also include a requirement for the management report to give an indication of any important events that have occurred since the end of the financial year, unless those events are reflected in the issuer's profit and loss account or balance sheet, or disclosed in the notes to the issuer's audited financial statements.

These changes are effective as of 29 January 2016 and the instrument can be found at:

https://www.handbook.fca.org.uk/instrument/2016/FCA_2016_6.pdf

Listing Rules, Prospectus Rules and Disclosure and Transparency Rules: FCA Quarterly Consultation No 12

On 18 March 2016, the FCA published its twelfth quarterly consultation paper (CP16/8). This consultation paper sets out the FCA's proposals to make changes to the:

- definition of reverse takeover in LR 5.6.4R to clarify that a transaction cannot be artificially broken up to avoid the reverse takeover requirements. The FCA reminds issuers of its policy of considering the substance of a transaction over its legal form;
- list of documents set out in PR 1.1.6G that need to be considered when determining the effect of the Prospectus Directive as there are now four ESMA opinions relating to prospectuses; and

- rule relating to reports on payments to governments (as required by the Transparency Directive) by inserting a new rule DTR 4.3A.10R. The FCA is proposing that reports under the Transparency Directive should be prepared in the same format and use the same data scheme as required under the Accounting Directive. The FCA is also proposing to require issuers to file reports on payments to governments prepared under the Transparency Directive with the FCA and to upload them to the system identified by the FCA on its website as the national storage mechanism for regulatory announcements and certain documents published by issuers.

This consultation paper can be accessed at:

http://www.fca.org.uk/static/fca/article-type/consultation%20paper/cp16-8.pdf

LR and DTR: FCA Publishes Handbook Notice No 26 and Response to CP15/19

On 23 October 2015, the FCA published a handbook notice containing the feedback it received on its ninth quarterly consultation paper.

The final instrument is very similar to the draft instrument proposed in the consultation paper. The FCA states that it does not believe that the new LR requirement, with respect to the directors' statement regarding the "going concern" basis of accounting in the annual report, exceeds to comply or explain principle of the Code, or that the FCA is imposing substantively new requirements or introducing a new liability regime. The notice makes clear that the FCA believes that the requirement to prepare the relevant statements in accordance with the FRC's official guidance (on risk management and internal control published in September 2015) is appropriate. All changes to the Handbook are now in force as of 1 December 2015.

The Handbook Notice can be found at:

http://www.fca.org.uk/static/fca/documents/handbook-notices/fca-handbook-notice-26.pdf

The instrument can be found at:

https://www.handbook.fca.org.uk/instrument/2015/FCA_2015_51.pdf

For a summary of the FCA's ninth quarterly consultation paper, our Q2 Governance and Securities Newsletter published July 2015 is available at:

http://www.shearman.com/~/media/Files/NewsInsights/Publications/2015/07/Governance-and-Securities-Law-Focus-Europe-CM-071415.pdf

Narrative Reporting: BIS Publishes Consultation Paper on UK Implementation of the EU Non-Financial Reporting Directive

On 16 February 2016, BIS published a consultation paper requesting feedback on the best approach for implementing the requirements of the EU Non-Financial Reporting Directive (Directive 2014/95/EU) (the "NFR Directive") into UK law. The aim of the NFR Directive is to bring consistency and conformity across Europe in relation to non-financial disclosure requirements in order to provide investors and other stakeholders with a comprehensive picture of a company's performance.

BIS has invited feedback on a number of issues, including whether:

- companies should be permitted to meet the NFR Directive's non-financial reporting requirements in a separate statement outside the annual report;
- there should be a reduction in scope of the existing UK non-financial reporting requirements for all quoted companies and a limitation on those required by the NFR Directive; and
- the UK should require non-financial statements to be independently verified by assurance service providers.

In addition, BIS has consulted on a number of other issues that fall outside the scope of implementation of the Directive, including whether:

- companies should be permitted to provide their separate non-financial statement on their website and, if so, the additional legislative protections that might be required to facilitate this;
- the definition of "senior manager" as set out in the Companies Act 2006 should be improved and, if so, how, particularly in relation to requirements for gender balance reporting by quoted companies in their strategic reports; and
- any existing narrative reporting requirements can be repealed due to being redundant or of little use.

The consultation closes to responses on 15 April 2016.

The consultation is available at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/500760/BIS-16-35-non-financial-reporting-directive-consultation-February-2016.pdf

Prospectus Directive: FCA Note on Sending Final Terms to Host Competent Authorities

On 27 November 2015, the FCA published a note regarding the upcoming changes to sending final terms to host competent authorities under the Prospectus Directive from 1 January 2016.

The note reiterates that from 1 January 2016, Article 5(4) of the Prospectus Directive will not require issuers to send final terms to the competent authority of host member states. Instead, the home competent authority must send final terms that have been filed with it as home competent authority to the competent authority of host member states.

The note can be found at:

http://www.fca.org.uk/firms/markets/ukla/information-for-issuers/changes-to-final-terms

UKLA Guidance Note: Primary Market Bulletin No 12

On 23 November 2015, the FCA published the twelfth edition of its Primary Market Bulletin. The FCA confirms that several amendments have been made to the UKLA Knowledge Base, which were consulted on in the eleventh Primary Market Bulletin, and also proposes some further changes for consultation.

Proposals for additional amendments to be consulted on include:

- The amendment to the existing procedural note on public offer prospectus—drafting and approval to refer to Article 4(a) of the Prospectus Regulation set out in PR 2.3.1 (minimum information to be included in a prospectus);
- A further draft of a proposed new technical note on the application of related party rules to funds investing in highly illiquid asset classes which has been amended to further clarify when acquisitions from a related party should be considered to be in the ordinary course for a closed-ended investment fund focused on large scale infrastructure assets (and therefore not subject to the related party rules in LR 11);
- The amendment of the existing note on Listing Principle 2—dealing with the FCA in an open and cooperative manner, to reflect that LP 2 applies to all listed companies, not just those with a premium listing; and
- The amendment of technical notes relating to periodic financial information and disclosures of positions held by issuers, investors and management, to reflect the amendments to the DTR which came into force on 26 November 2015.

The FCA Bulletin can be found at:

http://www.fca.org.uk/static/documents/ukla/primary-market-bulletin-12.pdf

Disclosure and Transparency Rules: FCA Consultation on Delaying Disclosure of Inside Information

On 20 November 2015, the FCA produced a consultation paper requesting responses to its proposal to amend its guidance about delaying disclosure of inside information in the Disclosure and Transparency Rules ("DTRs"). The FCA is seeking views on their proposals by 20 February 2016. The FCA notes that it is in the interests of both issuers and investors to have a clear understanding of the basis for classifying information as inside information so that they can properly understand their duties. The FCA states that its aim is to ensure the maintenance of a regime which produces transparency which is useful to investors.

The FCA is proposing to delete the last sentence of DTR 2.5.5.G to clarify that issuers may have a legitimate reason to delay disclosure in circumstances other than the non-exhaustive examples listed in DTR 2.5.3R or the circumstances listed in DTR 2.5.5AR.

The consultation paper also states that:

- Where an issuer has a commercial or PR-related preference to delay disclosure of inside information but public disclosure would not actually damage its interests, the issuer could not justify a delay by claiming that it would prejudice its legitimate interests; and
- Delaying disclosure to protect the price of a relevant security does not fall within the meaning of a legitimate interest.

This consultation paper can be found at:

http://www.fca.org.uk/static/documents/cp15-38.pdf

Directors' Remuneration: GC100 and Investor Group's 2015 Statement

On 10 December 2015, the GC100 and Investor Group published a statement relating to their guidance on remuneration reporting which was originally published in September 2013 and reviewed in December 2014. The 2015 statement concludes that the Group believes that the 2013 guidance coupled with the 2014 statement continues to serve its purpose effectively and therefore no changes will be made.

The statement also makes clear that the group will undertake a full review of the guidance and publish an update in 2016.

This statement can be found at:

http://uk.practicallaw.com/cs/Satellite?blobcol=urldata&blobheader=application%2Fpdf&blobkey=id&blobtable=MungoBlobs&blobwhere=1248069178728&ssbinary=true

For a summary of the 2014 statement, our Q4 Governance and Securities newsletter published in January 2015 is available at:

http://www.shearman.com/~/media/Files/NewsInsights/Publications/2015/01/Governance--Securities-Law-Focus-Europe-Edition-CM-012815.pdf

Admission and Disclosure Standards: Consultation on Amendments to Standards and High Growth Segment Rulebook

On 4 December 2015, the London Stock Exchange ("LSE") published Notice N19/15 to consult on proposed amendments to the Admission and Disclosure Standards and the High Growth Segment Rulebook. The notice makes clear that that the majority of the proposed changes relate to the structure of the Standards and are of an "administrative or clarificatory nature."

The Standards are being:

- Restructured so that they may serve as a consolidated resource for issuers and advisors (they will include schedules which contain further detail on the admission process and criteria for each of the relevant markets and segments);

- Revised so as to include an exemption for life science companies; and
- Amended so that the Executive Panel has increased powers to impose a fine of up to a maximum of £100,000 per breach of compliance procedures.

The consultation closed on 8 January 2016.

The notice can be found at:

http://www.londonstockexchange.com/traders-and-brokers/rules-regulations/change-and-updates/stock-exchange-notices/2015/n19.pdf

Admission and Disclosure Standards: Feedback on Amendments to Standards and High Growth Segment Rulebook

On 14 March 2016, the London Stock Exchange published N02/16, which is a notice setting out the revised Admission and Disclosure Standards and High Growth Segment Rulebook. The majority of the amendments to the standards relate to the structure and are of an administrative or clarificatory nature. The High Growth Segment rulebook is now incorporated into Schedule 5 to the standards.

This notice can be accessed at:

http://www.londonstockexchange.com/traders-and-brokers/rules-regulations/change-and-updates/stock-exchange-notices/2016/n0216.pdf

Draft Financial Services and Markets Act 2000 (Market Abuse) Regulations 2016

HM Treasury are asking for comments on the preliminary draft of the Financial Services and Markets Act 2000 (Market Abuse) Regulations 2016 to be submitted before 4 February 2016. This draft is only available from HM Treasury on request. The draft Regulations (which will be subject to further policy and legal review and amendment before being finalized) make a number of proposed amendments to FSMA and other primary and secondary legislation, and provide clarification for the purposes of implementation of the Market Abuse Regulation in a number of areas.

The preliminary draft of the Financial Services and Markets Act 2000 (Market Abuse) Regulations 2016 include provisions which:

- Clarify who falls within the meaning of "persons closely associated" with persons discharging managerial responsibilities ("PDMRs");
- Delete all references to "disclosure rules" in Part 6 of FSMA;
- Delete provisions of FSMA which include the definition of the offense of market abuse, the behaviors that constitute market abuse, the definition of what constitutes an "insider" and what constitutes "insider information" and the requirement for the FCA to produce a code giving guidance to those determining whether or not behavior amounts to market abuse;
- Give the FCA various powers to require information from issuers, PDMRs and people associated with PDMRs for the purposes of protecting investors, the orderly functioning of the markets and to exercise its functions under the Market Abuse Regulations ("MAR");
- Include administrative powers for the FCA, including the power to require an issuer to publish specific information or a specific statement where it considers this necessary; the power, subject to certain conditions, to require publication of a corrective statement, correcting false or misleading information made public or a false or misleading impression given to the public, by a person; and the power to suspend trading in financial instruments in certain circumstances; and
- Empower the FCA to impose penalties or issue censure for contravention of the provisions of MAR or contravention of the information requirements.

The FCA's consultation webpage can be accessed at:

http://www.fca.org.uk/news/cp15-35-implementing-market-abuse-regulation

Takeover Code: Statement of Public Censure of Advisers for Code Breaches

On 5 November 2015, the Takeover Panel issued a statement of public criticism of Credit Suisse, Freshfields Bruckhaus Deringer ("Freshfields") and Holman Fenwick Willan ("HFW") relating to their conduct as advisers in the acquisition by Vallar plc of interests in two Indonesian coal mining companies which gave rise to a number of breaches of the code.

The breaches were identified as:

- Failure to consult the Panel over whether the two sellers were concert parties and thus a whitewash dispensation to them being required to make a rule 9 mandatory offer (because of the size of shareholding in Vallar plc) should be applied for. Credit Suisse, JP Morgan and HFW were criticized for failing to consult the Panel; with regards to Freshfields, the Panel says it "*could have done more regarding the concert party issue but makes no finding of breach in relation to Section 6(b)*";
- Failure by the financial advisers to discharge their "particular responsibility" to advise their clients. Credit Suisse and JP Morgan were the only parties criticized for this; and
- Failure to provide full disclosure to the Panel of all relevant information Credit Suisse, Freshfields and HFW were criticized and, importantly, the Panel says it accepts that there was no intention on the part of any of them to mislead the Panel. It was only in relation to this breach that the Takeover Panel issued its statement of public criticism.

This statement by the Panel makes clear that:

- The Panel system of regulation relies on parties and their advisers consulting the Panel whenever they are in any doubt as to the application of the Code;
- Where there are doubts as to whether the parties are acting in concert, the need to consult the Panel is heightened;
- Taking legal or professional advice is not an alternative to consultation with the Panel;
- When the Panel is consulted, all relevant facts must be disclosed; and
- Financial advisors have a responsibility to comply with the Code and to ensure that their client and its directors are aware of their responsibilities under the Code.

This statement can be accessed at:

http://www.thetakeoverpanel.org.uk/publication/view/201515-asia-resource-minerals-plc-formerly-bumi-plc

Takeover Code: Response Statement on Additional Presumptions to the Definitions of Acting in Concert

On 23 October 2015, the Code Committee of the Takeover Panel published response statement RS 2015/3 on the introduction of three new presumptions to the definition of "acting in concert" in the Code. This statement was made in response to the Code Committee's publication of a consultation paper on 14 July 2015. The statement makes clear that the Code Committee is proceeding with the amendments to the Code in substantively the same form as those suggested in the consultation paper.

The amendments to the Code came into force on 23 November 2015.

The response statement can be accessed at:

http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/RS201503.pdf

For a summary of the consultation paper of 14 July 2015, our Q3 2015 Governance and Securities newsletter is available at:

http://www.shearman.com/~/media/Files/NewsInsights/Publications/2015/10/Governance-and-Securities-Law-Focus-CM-101315.pdf

Takeover Code: Response Statement on Amendments to the Definition of Voting Rights

On 23 October 2015, the Code Committee of the Takeover Panel published a response statement in relation to the feedback received on its consultation paper proposing to amend the definition of voting rights in the Code, make minor amendments to the Note on Rule 9.7 (voting restrictions and disposal of interests) and make consequential amendments to Rule 11.1 (when a cash offer is required). The Code Committee have adopted the amendments to the Code as proposed in the consultation paper with some minor amendments.

The amendments to the Code came into effect on 23 November 2015.

The response statement can be accessed at:

http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/RS201502.pdf

For a summary of the consultation, our Q3 2015, Governance and Securities newsletter published October 2015 is available at:

http://www.shearman.com/~/media/Files/NewsInsights/Publications/2015/10/Governance-and-Securities-Law-Focus-CM-101315.pdf

Takeover Code: New Panel Practice Statements

On 8 October 2015, the Takeover Panel Executive published Practice Statement No 29 and Practice Statement No 30 and withdrew Practice Statement No 27 and Practice Statement No 23 where the relevant sections have now been incorporated into new Practice Statement No 29.

Practice Statement No 29 provides guidance on the Takeover Panel Executive's interpretation and application of Rule 21.2 regarding exclusions to the prohibition on offer related arrangements; agreements between an offeror and offeree relating to the conduct, implementation and terms of an offer; and agreements by which an offeree may agree to pay an inducement fee to an offeror in circumstances set out in Notes 1 and 2 on Rule 21.2.

Practice Statement No 30 explains the compliance of Rule 20.2 in circumstances where commercially sensitive information is supplied to lawyers or economists advising an offeror of an "outside counsel only" basis.

The Panel Statement can be accessed at:

http://www.thetakeoverpanel.org.uk/publication/view/201512-publication-and-withdrawal-of-practice-statements

The Practice Statements can be accessed at:

http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/PS-29-New.pdf; and
http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/PS-30-New.pdf

Takeover Code: Code Committee Publishes Consultation on Communication and Distribution of Information

On 15 February 2016, the Code Committee of the Takeover Panel published a consultation (PCP 2016/1) on *The communication and distribution of information during an offer*. The paper seeks feedback on proposed amendments to the Takeover Code relating to the communication and distribution of information and opinions during an offer by or on behalf of an offeror or offeree.

The proposed amendments to certain rules of the Takeover Code include:

Equality of Information to Shareholders (Rule 20.1)

Information about an offer will have to be made available to offeree shareholders and persons with information rights via a RIS.

In addition, any offer information, whether presentations or documents, made available to (or used in meetings with) any shareholder or other relevant person, or any article, letter or other written information provided to the media, must be published on a website promptly after it is released, whether or not it contains any material new information or significant new opinion.

Meetings and Telephone Calls with Shareholders, etc. (Rule 20.1, note 3)

The existing chaperoning rule (requiring a financial adviser to be present at meetings) in note 3 to Rule 20.1 is being replaced by new rules which:

- clarify that the rule applies as much to telephone calls as to physical meetings;
- subject to prior consultation with the Panel, remove the chaperoning requirement for recommended offers after the announcement of a firm offer and where there is no competitive situation. Instead, a senior representative of the offeror or offeree who attended the meeting or call can provide to the Panel confirmation that no new material was released, etc.;
- remove the requirement for post-meeting financial adviser confirmation relating to meetings or calls attended by advisers (other than the financial adviser or corporate broker), e.g. the PR advisers, and one or more "sell-side" investment analysts. Instead, the confirmation that no new material information was provided can be provided by a senior adviser who attended the meeting;
- require that, where the above rules allow the post-meeting confirmation to be provided by someone other than the financial adviser, the financial adviser must have provided an appropriate briefing to the representatives or adviser attending the meeting or call about what can and cannot be provided at the meeting; and
- disapply the "confirmation" requirement to any meetings or calls only attended by the financial advisers/corporate brokers.

Advertisements and Other Amendments

Various other related changes are proposed that are not so significant, other than a change that will mean that advertisements will no longer have to include a directors' responsibility statement.

The consultation closes to responses on 15 April 2016.

The full text of the consultation is available at:

http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/PCP201601.pdf

Transparency of Beneficial Ownership of Foreign Companies: BIS Discussion Paper

On 4 March 2016, BIS published a discussion paper setting out various proposals requiring foreign companies to provide information on their beneficial ownership before undertaking certain economic activities in the UK in order to enhance transparency.

The government is considering whether foreign companies wishing to buy land or property in England and Wales, or wishing to enter into public procurement contracts in England, should be under a similar obligation to UK companies that will, from 6 April 2016, have to keep a register of people with significant control or declare that there are no such people.

The closing date for responses was 1 April 2016, and the discussion paper can be accessed at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/505546/bis-16-161-beneficial-ownership-transparency.pdf

Consultation on Changes to AIM Rules for Companies

On 15 October 2015, the LSE issued AIM Notice 42 as a consultation paper on the proposed changes to the AIM Rules for Companies which apply to investing companies.

LSE proposes to amend:

- AIM Rule 8 (investing companies), to increase the amount in cash that an applicant seeking admission must raise from £3 million to £6 million; and
- AIM Rule 15 (fundamental changes of business), to introduce a provision that an AIM company that becomes a cash shell following fundamental disposal will be regarded as an "AIM Rule 15 cash shell." This Rule will also state that, within 6 months of becoming an AIM Rule 15 cash shell, the AIM company must make an acquisition or acquisitions which constitute a reverse takeover under AIM Rule 14. There is also a proposal to ensure that where an AIM company became an investing company prior to the date on which the new rules come into effect, the previous AIM Rule 15 (as set out in May 2014) will apply. LSE also proposes to include some new Guidance Notes on AIM Rule 15.

This consultation closed on 12 November 2015, and on 22 December 2015 the LSE published AIM Notice 43 which provides feedback on Aim Notice 42 and confirms the changes to the AIM Rules. The revised AIM rules have been effective from 1 January 2016.

This consultation paper can be accessed at:

http://www.londonstockexchange.com/companies-and-advisors/aim/advisers/aim-notices/aimnotice42.pdf

The feedback on AIM Notice 42 can be accessed at:

http://www.londonstockexchange.com/companies-and-advisors/aim/advisers/aim-notices/aim43.pdf

First UK Deferred Prosecution Agreement Approved by the English Courts

On 30 November 2015, the English Court approved the first Deferred Prosecution Agreement ("DPA") in the UK between the Serious Fraud Office ("SFO") and Standard Bank ("SB"). The Court concluded that the DPA was in the interests of justice and its terms were fair, reasonable and proportionate.

The SB offense relates to a $ 6 million payment in March 2013 by a former sister company of SB to a local partner in Tanzania, which the SFO alleged was intended to induce members of the Government of Tanzania to show favor to SB. The terms of the DPA provide that SB will pay to HM Treasury a total of $25.2 million (consisting of a financial penalty of $16.8 million and $ 8.4 million disgorgement of profits) and will pay the Government of Tanzania a further $ 7 million in compensation. SB will also pay the SFO's reasonable costs of £330,000 in relation to the investigation and subsequent resolution of the DPA. In addition, SB will be subject to an independent review of its existing anti-bribery and corruption controls, policies and procedures regarding compliance with the Bribery Act 2010 and other applicable anti-corruption laws and will be required to implement recommendations of the independent reviewer.

As a result of the DPA, the charge against SB has been suspended for three years. SB also agreed to a statement of facts, which it will not contest in any future proceedings. After the expiry of the three year period, and provided that SB complies with the terms of the DPA, the SFO will discontinue the proceedings.

It is likely that further DPAs will be announced over the course of this year and David Green, the Director of the SFO, has stated that the SB DPA will serve as a template for future agreements. Green has, however, cautioned that "significant cooperation from the company will be required to convince the overseeing judge that the agreement is fair and just." For example, Green highlighted that the SFO would not advocate a DPA unless the company concerned has

shown the maximum amount of cooperation (including, potentially, waiving privilege over certain documents). Similarly, Ben Morgan, the SFO's joint head of bribery and corruption, made it clear that a prerequisite of a DPA is that the company concerned should make early and full disclosure to the SFO. In SB's case, the SFO was complimentary of SB's conduct in promptly bringing the offense to the SFO's attention.

This particular DPA is also significant as it follows the first indictment brought by the SFO against a corporate body alleging failure to prevent bribery contrary to section 7 of the Bribery Act 2010. The SB DPA contrasts with the subsequent case of Sweett Group PLC, which became the second company charged under section 7 of the Bribery Act in relation to conduct in the Middle East. Sweett Group subsequently pleaded guilty to that offense and sentencing will take place on 12 February 2016.

First UK Corporate Conviction for Failure to Prevent Bribery

As previously reported in our January 2016 edition, on 18 December 2015, Sweett Group PLC ("Sweett") pleaded guilty to failing to prevent an associated person bribing another in order to obtain or retain a business advantage for Sweett contrary to section 7(1)(b) of the Bribery Act 2010. Sweett was sentenced on 19 February 2016. This represents the first successful prosecution and conviction by the Serious Fraud Office ("SFO") of a corporate for that offense.

The Sweett offense relates to payments totaling about £680,000 between January 2013 and July 2014 made by Cyril Sweett International Limited ("CSI"), a Cypriot incorporated company and a wholly-owned subsidiary of Sweett which was responsible for Sweett's Middle East operations, under a sub-contract, to a company owned by the Vice Chairman of the Board, and Chairman of the Real Estate and Investment Committee, of Al Ain Ahlia Insurance Company ("AAAI"). The payments were made to secure the award of a £1.6 million contract by AAAI to CSI for the building of luxury hotel in the UAE. The payments represented about 1.08% of the overall value of the project (£63 million). There was no suggestion that Sweett's senior management were aware that the sub-contract was a sham until it began its own internal investigations into CSI's practices in 2013.

Sweett was ordered to pay £2.35 million, comprising a fine of £1.4 million, £851,152 in confiscation and the SFO's prosecution costs of around £95,000. The SFO did not seek, and the English Court did not order, Sweett to pay compensation. The Court ordered Sweett to pay the confiscation monies by 19 May 2016. Half the fine is due by 19 February 2017, with the balance payable by 19 February 2018. The penalty represents almost 18% of Sweett's market capitalization as on the date of sentencing (around £13 million).

Despite being a separate legal entity, distinct from Sweett, the Court considered that CSI was not independent of Sweett and that Sweett treated and ran CSI as an internal department. It is a useful example of the circumstances in which a foreign-registered subsidiary may be considered an "associated person" of its UK parent company for the purposes of the Bribery Act.

It is notable that the SFO refused to enter into a Deferred Prosecution Agreement ("DPA") with Sweett, despite having entered into one in November 2015 with Standard Bank ("SB"). It appears that the differences between Sweett's and SB's conduct before and during the SFO's investigations were a key factor in determining the different outcomes to each prosecution.

For example, whilst SB reported itself to the SFO promptly once it became aware of the circumstances surrounding its sister company's illegal payments to a local partner in Tanzania, Sweett only self-reported in December 2014 (the SFO began its investigation into CSI's Middle East practices in July 2014) after it was notified that the Wall Street Journal was going to publish allegations linking it and CSI to bribery offenses rather than of its own volition. The Court criticized Sweett's failure to cooperate fully and openly with the SFO, for deliberately attempting to mislead the SFO as to the illegal nature of the payments, and for attempting to 'spin' the findings of its own internal investigation when it presented them to the SFO. The Court was also critical of Sweett's inadequate internal procedures, finding that Sweett

had made "no real effort" to put in place adequate anti-corruption and bribery safeguards and procedures, having been aware since at least 2011 that its and CSI's systems were unfit for purpose and "willfully" choosing to ignore these failings.

Sweett's conviction is particularly significant because it sets down the SFO's clear serious intention to pursue any corporation with connections to the UK for bribery offenses, regardless of where the offense(s) took place. Internal anti-bribery and corruption procedures should be monitored (and, where appropriate, updated) periodically with regular mandatory training provided to all staff, agents and contractors, not just senior management, executives and officers.

The importance of early and voluntary self-reporting to, and together with full cooperation with, the SFO cannot be overstated: the SFO was deeply critical of Sweett's decision both to continue its internal investigation after the SFO had begun its investigation and to withhold disclosure of certain documentation covered by Legal Professional Privilege. Companies should be aware that the SFO may consider them to be uncooperative—or at least not sufficiently cooperative—and so refuse to offer a DPA if they do not waive legal privilege over all documentation pertaining to the investigation and continue with their internal investigation after the SFO begins its own investigation.

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:

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