SHEARMAN & STERLING LLP

A QUARTERLY NEWSLETTER FOR CORPORATES

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EUROPE

Governance & Securities Law Focus

In this newsletter, we provide a snapshot of the principal European, US and selected international governance and securities law developments of interest to European corporates.

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

Financial regulation developments are available here.

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EU Developments

General

European Commission 2017 Work Programme

On 25 October 2016, the European Commission ("**Commission**") adopted its 2017 Work Programme. The Commission proposes 21 key initiatives for 2017 to implement ten priorities for the year. The Commission proposes to:

- Follow up on the call for evidence on the cumulative impact of the EU regulatory framework for financial services, which gathered feedback on areas including the extent to which the regulatory framework has caused excessive compliance costs and burdens and to identify areas giving rise to duplicative or unhelpful reporting and disclosure obligations.
- Present a mid-term review of the capital markets union action plan identifying obstacles and any additional measures required (in Q2 of 2017). The Commission notes that the adoption of the Prospectus Regulation is a priority pending proposal and needs to be accelerated.
- Present a new company law initiative to facilitate the use of digital technologies throughout a company's lifecycle and cross-border mergers and divisions (in Q3-4 of 2017).
- Put forward additional delegated legislation to facilitate funding by institutional investors of corporate entities and groups which carry out infrastructure activities.

The Commission's communication can be accessed at:

- *http://ec.europa.eu/atwork/pdf/cwp_2017_en.pdf*

Accounting Directive: Third Country Extractive Industries Equivalence Decision in Relation to Canada

On 29 October 2016, the Commission Implementing Decision (EU) 2016/1910 of 28 October 2016 on the equivalence of the reporting requirements of certain third countries on payments to governments to the requirements of Chapter 10 of the Accounting Directive was published in the Official Journal of the EU ("**Official Journal**"), and entered into force on 18 November 2016.

Chapter 10 of the Accounting Directive requires large companies and public interest entities that are active in the extractive and forestry industries to report all material payments they make to governments on a country and project basis. In order to reduce administrative burden and avoid double reporting issues, EU companies may choose to prepare their reports in compliance with the reporting requirements of a third country assessed as equivalent in accordance with Article 47.

The decision provides that the reporting requirements adopted by Canada meet the criteria set out in Article 46(3) of Directive 2013/34/EU, and shall therefore be considered equivalent to the requirements of Chapter 10 of the Accounting Directive on payments to governments.

The Commission Implementing Decision (EU) 2016/1910 can be accessed at:

- *http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016D1910&from=EN*

MAR: ESMA Updated Q&As

On 26 October 2016, the European Securities and Markets Authority ("**ESMA**") published an updated version of its Q&A on the Market Abuse Regulation ("**MAR**") confirming:

- Under Article 19(1) of MAR (Managers' transactions), with regards to the EUR 5,000 threshold for the reporting of managers' transactions, that when the transaction currency is not euro, the exchange rate that should be used to determine if the threshold set out in Article 19(8) of MAR of EUR 5,000 has been crossed is the official daily spot foreign exchange rate which is applicable at the end of the business day when the

transaction is conducted. Where available, the daily euro foreign exchange reference rate published by the European Central Bank on its website should be used.

- In relation to MAR's application to "investment recommendations", material which concerns financial instruments is considered as information implicitly recommending or suggesting an investment strategy insofar as it contains a valuation statement as to the price of the relevant financial instruments, or contains an estimated value such as a "quantitative fair value estimate" that is providing a projected price level or "price target". This catches statements indicating that the financial instruments are "undervalued", "fairly valued" or "overvalued".

On 20 December 2016, ESMA published a further updated version of its Q&As on MAR, confirming, amongst other points:

- That, for the purposes of calculating whether the EUR 5,000 threshold triggering the notification of managers' transactions under MAR has been reached, the transactions carried out by a manager (i.e., a person discharging managerial responsibilities ("**PDMR**")) and by closely associated persons to that PDMR are not to be aggregated.
- How to calculate the price of gifts, donations and inheritances for the purpose of the notification and disclosure of managers' transactions under MAR.
- That, if a PDMR enters into a remuneration package contract entitling the PDMR to receive shares upon the occurrence of certain conditions, a notification only has to be made upon the occurrence of those conditions and the actual execution of the transaction.
- That a communication containing purely factual information on financial instruments or issuers does not constitute an investment recommendation for the purposes of MAR, unless it explicitly or implicitly recommends or suggests an investment strategy.
- That, if the price or value of a derivative traded outside a trading venue does not depend on or have an effect on the price or value of a financial instrument referred to in Article 2(1)(a), (b) or (c) of MAR, the derivative is not in scope of MAR and neither is any recommendation relating to the financial instrument.

The full Q&A which includes both updates can be accessed at:

- *https://www.esma.europa.eu/sites/default/files/library/2016-1664_mar_qa_december_2016.pdf*

UK Developments

Corporate Governance

Investment Association Updates Principles of Remuneration for 2017

On 31 October 2016, the Investment Association ("**IA**") wrote to chairmen of remuneration committees of FTSE 350 companies setting out significant changes in its principles of remuneration, mostly made in response to the Executive Remuneration Working Group's recommendations, published on 26 July 2016.

The IA's letter is available at:

- *http://www.theinvestmentassociation.org/assets/files/press/2016/2016%20Letter%20of%20introduction%20for%20Principles%20of%20Remuneration.pdf*

The main changes include:

- increased flexibility for remuneration committees to adopt the structure most appropriate for the implementation of their business strategy;
- a requirement for companies to disclose pay ratios between the CEO and median employee, and the CEO and the Executive team, to provide context to remuneration;

- a requirement for executives to continue to hold shares for a time period after termination of employment;
- an obligation on companies to consult shareholders if more than 20% of votes cast are against a remuneration proposal, to understand the opposition and take measures to address concerns; and
- new guidance on restricted share awards.

The updated principles of remuneration can be accessed here:

- *http://www.theinvestmentassociation.org/assets/files/press/2016/Principles%20of%20Remuneration%202016.pdf*

Institutional Shareholder Services 2017 Proxy Voting Guidelines Updates

Institutional Shareholder Services Inc. ("**ISS**") has published the updates to its UK benchmark proxy voting policies for 2017, which includes changes to the following policies:

- *Overboarding definition*. The policy has been amended to clarify potentially ambiguous language as to the acceptable number of directorships. Under the revised policy, where directors have multiple board appointments, ISS may recommend a vote against directors who appear to hold an excessive number of board roles at publicly listed companies.
  - An adverse vote recommendation will not be applied to a director within a company where they serve as CEO. Rather, it would apply to their additional seats on other company boards.
  - The same applies to chairs, except where they exclusively hold other chair and/or executive positions or where they are elected as chair for the first time.
- *Remuneration*. Sections will be amended to reflect developments in UK market practice and investor expectations, including the introduction of:
  - A direct reference to companies that seek to implement pay structures (for example non-performance related restricted shares) which sit outside of the typical UK model; a greater level of certainty of reward should be matched by lower award levels.
  - A reference to a potential recommendation against the chair of the remuneration committee when serious issues are identified.
  - For the remuneration report resolution, a reference to the use of ISS' Pay-for-Performance methodology (defined), and clarification that appropriate pro-rating on outstanding share awards should be applied in termination scenarios.
- *Board and Committee Composition—UK Smaller Companies.* The policy for AIM companies also applies to certain other companies. ISS has also brought the policy into line with the Quoted Companies Alliance Code by specifying that audit and remuneration committees should be fully independent.

The policies will be applied to shareholder meetings taking place on or after 1 February 2017, other than the policy with respect to the board and committee composition of smaller companies, which will apply with effect from February 2018 to give small companies time to comply with this significant change.

The EMEA Proxy Voting Guidelines Updates can be accessed here:

- *https://www.issgovernance.com/file/policy/2017-emea-iss-policy-updates.pdf*

Parker Review Report on Ethnic Diversity on Boards

On 2 November 2016, the Parker Review Committee published a consultation version report summarising the findings of a review of the ethnic diversity of UK boards. It found that ethnic minority representation on the boards of such companies is disproportionately low, and made recommendations with three key aims for members of the FTSE 100 and FTSE 250:

- Increase the ethnic diversity of boards through director targets and policies to identify and consider qualified people of colour for board appointments.
- Develop mechanisms to identify, cultivate and promote people of colour candidates for the pipeline and plan for succession. Existing directors should mentor and/or sponsor employees of colour, and companies should encourage and support candidates drawn from diverse backgrounds, including people of colour, to take on board roles internally and with external organisations.
- Enhance transparency and disclosure. The board's policy on diversity and a description of actions taken should be set out in a company's annual report. Companies not meeting board composition recommendations by the relevant date should disclose why they have not been able to achieve compliance.

Comments on the report are requested by 28 February 2017, after which a report containing the final recommendations and findings of the review will be published.

The consultation version can be accessed here:

- *http://www.ey.com/Publication/vwLUAssets/A_Report_into_the_Ethnic_Diversity_of_UK_Boards/$FILE/Beyond%20One%20by%2021%20PDF%20Report.pdf*

Hampton-Alexander Review on Gender Balance in FTSE Leadership

On 9 November 2016, the Hampton-Alexander Review ("**Review**") published a report on improving the gender balance in the leadership of FTSE companies. The Review builds on the work of the Davies Review for Women on Boards, extending the scope to include FTSE 350 executive committees and direct reports to such executive committees.

The report provides a progress update on women on boards as at 1 October 2016; after five years of excellent progress and the FTSE 100 achieving its 25% target six months ahead of schedule in 2015, further progress has slowed in 2016.

The report contains a number of recommendations, including that:

- FTSE 350 companies should aim for a minimum of 33% women's representation on their boards by 2020. CEOs should have a clear plan of action to tackle underrepresentation, and the chair of the nominations committee should oversee progress.
- FTSE 350 companies should voluntarily publish details of the number of women on the executive committee and in the direct reports to the executive committee on an annual basis and submit this data to the Review.
- The Financial Reporting Council ("**FRC**") should amend the UK Corporate Governance Code to require FTSE 350 companies to disclose the gender balance on their executive committee and in direct reports to the executive committee in their annual report.
- Institutional investors should have a transparent process for evaluating the gender balance of FTSE 350 investee companies as well as a clear voting policy.

The report can be accessed here:

- *http://ftsewomenleaders.com/wp-content/uploads/2016/11/Hampton-Alexander-2016.pdf*

IA Guidelines on Viability Statements

On 16 November 2016, the IA published new guidelines setting out the expectations of institutional investors in relation to viability statements prepared by companies under provision C.2.2 of the UK Corporate Governance Code. The guidelines include a number of recommendations concerning the period of the viability assessment, the prospects and risks considered when assessing viability and transparency around stress testing and qualifications and assumptions.

Among other things, the guidelines indicate that:

- Longer time horizons should be considered when selecting the appropriate period for assessing a company's future viability. Three to five years seems to have become standard practice, but the IA's members expect greater differentiation between companies, and viability statements addressing longer timeframes given the long-term nature of equity capital and directors' fiduciary duties. Viability statements should state clearly why a particular assessment period was chosen. Factors such as the company's business and sector and its investment and business cycles should be considered.
- Directors should look at the current state of affairs, and not limit their consideration of viability to medium or long-term risks.
- Investors would welcome the viability assessment addressing the sustainability of dividends.
- Risks that impact performance should be distinguished from those that threaten operations; the viability assessment should focus on the latter.
- Viability statements should explain why the disclosed risks are important, and how they are managed and controlled as well as the likelihood of a risk occurring and its possible impact. It is helpful to rank the disclosed risks (for example, low, medium, high) and indicate whether it has increased or decreased in likelihood from the previous year.
- Investors would welcome greater transparency around stress testing. The guidelines suggest disclosure of the specific scenarios considered and likely outcomes, as well as a description of the specific mitigating actions taken or any remedial actions which may be necessary. Reverse stress testing is also encouraged.
- Qualifications should be clearly distinguished from assumptions. Both should be specific to the company rather than generic, and they should not include matters that are highly unlikely either to arise or have a significant impact on the company.

Companies are encouraged to treat the guidelines, though directed at premium-listed companies, as best practice. The November version can be accessed here:

- *https://www.ivis.co.uk/media/12474/Guidance-viability-statements-final.pdf*

FRC Tiering of Signatories to the Stewardship Code

On 14 November 2016, the FRC published its assessment of signatories' reporting against the Stewardship Code ("**Code**"), which categorises signatories into tiers based on the quality of the reporting in their statements based on the seven principles of the Code and the supporting guidance. The tiering exercise was undertaken with the aim of improving the quality of reporting against, and maintaining the credibility of, the Stewardship Code, and encouraging greater transparency in the market.

The FRC has categorised asset managers in three tiers and other signatories to the Code in two tiers. The additional tier for asset managers reflects the greater relevance of the Code's provisions to asset managers, their role as agents and the wide range of reporting quality. The FRC has also indicated that asset managers who have not achieved at least Tier 2 status after six months will be removed from the list of signatories to the Code. The FRC invites contact from signatories, particularly those in Tier 3, to discuss improvements to their reporting.

- *Tier 1*: Signatories provide a good quality and transparent description of their approach to stewardship and explanations of an alternative approach where necessary.
- *Tier 2*: Signatories meet many of the reporting expectations but report less transparently on their approach to stewardship or do not provide explanations where they depart from provisions of the Code.
- *Tier 3*: Significant reporting improvements need to be made to ensure the approach is more transparent. Signatories have not engaged with the process of improving their statements and their statements continue to be generic and provide no, or poor, explanations where they depart from provisions of the Code.

Further information can be found here:

- *https://www.frc.org.uk/Our-Work/Corporate-Governance-Reporting/Corporate-governance/UK-Stewardship-Code/UK-Stewardship-Code-statements.aspx*

Financial Reporting

FRC Financial Reporting Guidance to Listed Companies on 2016 Annual Reports

On 11 October 2016 the FRC published its advice to audit committee chairs and finance directors of listed companies, highlighting key issues and improvements it considers can be made to annual reports in the 2016 reporting season.

The advice includes:

- A call for annual reports to be more user-friendly and information to be communicated more clearly in a clear and concise manner.
- Encouragement to consider a broad range of factors when determining the principal risks and uncertainties facing the business and performing their analysis for the viability statement, for example cyber security and climate change. Companies should also provide clear disclosure of why the period of assessment selected is appropriate, what qualifications and assumptions were made, and how the underlying analysis was performed.
- In light of the Brexit referendum result, the FRC expects boards to provide increasingly company-specific disclosures with quantification of effects as the economic and political effects of the referendum become more certain.
- The relationship between alternative performance measures (e.g., IFRS or UK GAAP) should be clearly explained.
- Business model reporting should provide clarity of explanations of how the company makes money and what differentiates it from its peers.
- There should be a clear link between the business model and the revenue recognition policies to be disclosed.
- Rationalisation of tax strategies should be clearly described in the report and accounts, including where tax is paid, a consideration on sustainability, and any material risks to which this gives rise.
- Dividend disclosures should detail how dividend policies operate in practice and how these policies may be impacted by risks and capital management decisions facing the company.
- More informative reporting about specific actions taken by audit committees.

The FRC's full guidance can be accessed here:

- *https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Letter-Year-End-Advice-to-Preparers-2016.pdf*

FRC Lab Report on Business Model Reporting

On 27 October 2016, the FRC's Financial Reporting Lab published a project report on business model reporting, which examines the reporting of quoted companies' business models in the annual report.

The Lab found:

- Business model information is fundamental to investors' analysis and understanding of a company, and a lack of good disclosure on business model raises concerns over the quality of management;
- As business model information provides context to the other information in the annual report, most investors want it positioned towards the front of the Strategic Report;

- Where a company operates a number of business models, disclosures of each significant business model is desired;
- Investors are looking for better natural linkage of business model information to other sections of the Strategic Report, and consistency with disclosure in the annual report; and
- Investors are looking for more detail than is currently provided by most companies. In particular investors find disclosures are often lacking information that answers questions such as:
  - What are the key revenue and profit drivers and how do profits convert to cash?
  - Are there any key asset and liability items that support the business model?
  - What is the company's competitive advantage?

The Lab report also includes examples of current good practice as well as highlighting how disclosure could be modified to provide more value to investors. The report can be accessed here:

- *https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2016/October/FRC-Lab-report-confirms-the-importance-of-business.aspx*

FRC Report on Companies' Tax Reporting

On 31 October 2016, the FRC published a report following its review of certain aspects of tax reporting of 33 pre-informed FTSE 350 companies' annual reports and accounts. The objective of the review was to encourage more transparent reporting of the relationship between tax charges and accounting profit and the factors that could affect that relationship in the future. The report sets out the FRC's principal findings and examples of good practice in three areas: tax in strategic reports; effective tax rate (ETR) reconciliation disclosures; and uncertainties relating to tax liabilities and assets.

The FRC found evidence of improvement in the transparency of tax disclosures included in strategic reports and in the quality of information provided in ETR reconciliations but identified areas for improvement in disclosures concerning tax uncertainties by explaining the bases for recognition and measurement. The FRC encourages companies to:

- Consider carefully whether there are significant judgements and estimation uncertainties relating to tax. Where estimation uncertainties are repeated unchanged year on year, the FRC will question whether the disclosure of quantified risk specifically relating to the next year is clear.
- Appraise what specific information about judgements and estimation uncertainties would be most helpful to users of the accounts. The FRC's Financial Reporting Lab found that investors value an understanding of the judgements made and estimations applied by management.

The FRC commented that it will continue to challenge companies that do not disclose the amount of uncertain tax provisions when these are subject to risk of material change in the following year. The audit of uncertain tax provisions is an area of particular focus of the FRC's audit monitoring activities for 2016/2017.

The FRC's corporate reporting thematic review on tax disclosures can be accessed here:
https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2016/October/FRC-thematic-review-welcomes-improved-transparency.aspx

IA Public Position Statement on Quarterly Reporting

On 17 November 2016, the IA issued a public position statement on interim management statements, calling for companies to cease reporting quarterly and refocus reporting on a broader range of strategic issues.

A key focus of the IA's Productivity Action Plan launched in March 2016 was to improve company reporting by encouraging a greater focus on long-term strategic drivers. Members expressed concern that quarterly reporting can pose a distraction, and promote myopic behaviour by

senior management by channelling its focus on short-term fluctuations in performance - resulting in the risk of it managing the market, rather than the business.

The IA also queries the value for investors, suggesting that the additional resource required to analyse the often formulaic reports, containing excessive or redundant information, makes it harder for investors to properly assess a business and its prospects for growth, potentially undermining the trust and confidence between companies and their shareholders.

Since mandatory quarterly reporting requirements were removed in 2014, just under a third of FTSE 100 companies and just over half of FTSE 250 companies had stopped publishing quarterly reports (as at 5 October 2016).

The IA calls on companies that believe it is important to continue reporting quarterly to publicly explain their position, and how it is relevant to achieving their long-term strategy.

The IA stated that it would be hosting a series of roundtables to discuss the benefits and challenges of ending quarterly reporting, following which it intends to issue a guidance document on the issues raised.

The IA's public position statement on quarterly reporting can be accessed here:

- *https://www.ivis.co.uk/media/12477/Public-Position-Statement-Quarterly-Reporting.pdf*

Confirmation Statements: Revised Companies House Guidance

Companies House has updated its guidance on annual confirmation statements. These are required to be given by companies confirming certain filings and other information in relation to the company over the preceding 12 months. It has formally clarified that if the company is filing its first confirmation statement and has not previously filed a new style statement of capital (after 30 June 2016), it must file a full statement of capital along with the confirmation statement, as it would not have previously given the aggregate amount unpaid on the total capital of the company.

The revised Companies House guidance on confirmation statements can be accessed here:

- *https://www.gov.uk/government/publications/confirmation-statement/confirmation-statement*

Duty to Report on Payment Practices and Performance

On 2 December 2016, the Department for Business, Energy & Industrial Strategy ("**BEIS**") published its response to its consultation paper of November 2014 seeking views on the duty to report on payment practices and performance, including revised draft regulations.

The revised regulations will apply to large companies (quoted and unquoted) and large limited liability partnerships. Businesses within the scope of this duty will be required to publish reports twice yearly.

The revised regulations are intended to increase transparency of payment behaviour for large companies and promote a more responsible payment culture, particularly towards small businesses.

The government expects the regulations to come into force on 6 April 2017. Breach of the reporting requirements will be a criminal offence.

The government response and draft regulations can be accessed below:

- *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/574312/duty-to-report-on-payment-practices-and-performance-government-response.pdf*

FCA Final Report on Investment and Corporate Banking Market Study

On 18 October 2016, the Financial Conduct Authority ("**FCA**") published the final findings of its investment and corporate market study.

The final report found that, whilst many clients feel well served by primary capital market services, there were some areas where improvements could be made to encourage competition, particularly for smaller clients.

The FCA's final report outlined a package of remedies, including:

- Banning banks from using contractual clauses that seek to limit clients' choice on future transactions.
- Ending league table misrepresentation in banks' pitches to clients.
- Removing incentives for loss-making trades to climb league tables.
- A supervisory programme to address the issue of allocations of shares in IPOs, which are at times skewed towards buy-side investors from whom banks derive greater revenues from other business lines. As well as reviewing allocation policies, the FCA will work with firms to ensure that principles of compliant policies are embodied in allocation practices.

In a discussion paper published at the same time as the interim investment and corporate banking report DP16/3 (which focused on the availability of information in the UK equity IPO process), the FCA proposed changes to the IPO process, and a separate consultation paper on these changes is expected in winter 2016/2017.

The FCA's final report can be accessed here:

- *https://www.fca.org.uk/publication/market-studies/ms15-1-3-final-report.pdf*

Fourth Money Laundering Directive: BEIS Discussion Paper on the Transposition of Beneficial Ownership Provisions

On 3 November 2016, the BEIS published a discussion paper on the transposition of Article 30 of the Fourth Money Laundering Directive ("**Money Laundering Directive**") (the implementation of the Money Laundering Directive as a whole being separately addressed in a consultation with the HM Treasury) relating to the beneficial ownership of corporate and other legal entities.

Article 30 essentially requires that (i) EU Member States hold adequate, accurate and current information on beneficial ownership of corporate and other legal entities incorporated within their territory in a central register and (ii) that such information is made available to specific authorities and organisations across the EU. BEIS considers that the existing UK people with significant control ("**PSC**") regime largely meets these requirements, but that some amendments and additions to the following areas may be necessary to comply with the Money Laundering Directive:

- Scope of the entities required to obtain and hold information. BEIS considers that the scope of the existing domestic legislation should be extended to all entities that are incorporated in the UK and constitutionally capable of legitimately having a beneficial owner. This would include: European economic interest groupings; unregistered and open ended investment companies; investment companies with variable capital; co-operative/community benefit societies; building and friendly societies; credit unions; European cooperative society; charitable incorporated organisations; European groupings of territorial cooperation; Scottish partnerships and limited partnerships; and royal chartered bodies. The current tests of "significant control" in Part 1 of Schedule 1A to the Companies Act 2006 would be adapted to correspond with the structure of the new legal entities brought within scope.
- The nature of the information on beneficial ownership collected. It must be "adequate, accurate and current". BEIS is proposing to amend the existing requirement of updating with Companies House at least once every 12 months, to an obligation for all entities to update their PSC information within 6 months of a change occurring.
- Access to information on beneficial ownership. For new entities brought into scope of the Money Laundering Directive, BEIS is proposing that information on beneficial ownership should be publicly accessible in a similar manner to that of the PSC register (i.e., fully searchable online by anyone in any country, free of charge). There is, however, a small proportion of the PSC information which is suppressed from the public register and, as a requirement of the Money Laundering Directive, this will be protected information available to credit and financial institutions.

The Money Laundering Directive must be implemented by 26 June 2017. However, in its action plan against terrorist financing, the European Commission called on Members States to bring forward the transposition date to 1 January 2017.

The BEIS discussion paper can be accessed here:

- *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/565095/beis-16-38-4th-money-laundering-directive-transposition-discussion-paper.pdf*

AIM Regulation Statement on Interaction of Social Media With Disclosure Obligations Under AIM Rules

On 12 December 2016, the London Stock Exchange's AIM Regulation team published an Inside AIM update on how social media (such as "Twitter", the company's website and other non-regulatory news feeds) interacts with the disclosure obligations under the AIM Rules. The update advised, amongst other points, that:

- social media is subject to the same rules regarding disclosure of regulatory information;
- disclosure by social media alone will not meet an AIM company's disclosure obligations; and
- precedence should still be given to the use of traditional means of regulatory dissemination (such as the regulatory information service (RIS)).

The update further advised that any AIM company that uses social media should have a clear policy on its use which is regularly reviewed and understood by all relevant persons.

The update can be accessed below:

- *http://www.londonstockexchange.com/companies-and-advisors/aim/advisers/inside-aim-newsletter/inside-aim-newsletter.htm*

Takeover Code: New Checklists and Supplementary Forms

On 14 December 2016, the Takeover Panel Executive ("**Panel**") published Panel Statement 2016/9 which refers to a new set of checklists and supplementary forms that have been published by the Executive and can be downloaded from the Takeover Panel website.

These documents must accompany any final form firm offer announcement, offer document, offeree board circular, scheme circular or Rule 15 offer/proposal required to be sent to the Panel before or at the time of publication in accordance with Rules 30.5(a) or 30.5(b) of the Takeover Code.

The checklists relate to the following documents:

- firm offer announcement;
- offer document/offeree board circular;
- scheme circular; and
- Rule 15 offer/proposal.

The supplementary forms relate to the following:

- intention statements schedule;
- profit forecast;
- quantified financial benefits statement;
- asset valuation; and
- partial offer.

The checklists and supplementary forms should be used with immediate effect and can be accessed here:

- *http://www.thetakeoverpanel.org.uk/checklists*

Guidance on completing the documents can be accessed here:

- *http://www.thetakeoverpanel.org.uk/checklists/how-to-complete*

Securities

FCA Handbook Notice No. 38 and Response to CP16/17

On 4 November 2016, the FCA published its Handbook Notice No 38, setting out its response to feedback received on its Quarterly Consultation Paper No 13 (CP16/17).

The final instrument is in substantially the same form as the draft in the consultation paper. The key proposals which the FCA is proceeding with include the insertion of a new rule applying to financial years beginning on/after 1 January 2017, DTR 7.2.8A, to implement the Non-Financial Reporting Directive (2014/95/EU) requirement for certain issuers to disclose their diversity policy in the corporate governance statement.

The FCA Handbook Notice No. 38 can be accessed here:

- *https://www.fca.org.uk/publication/handbook/handbook-notice-38.pdf*

The final instrument, which came into force on 4 November 2016, can be accessed here:

- *https://www.handbook.fca.org.uk/instrument/2016/FCA_2016_70.pdf*

FCA Quarterly Consultation No. 15

On 2 December 2016, the FCA published its fifteenth quarterly consultation paper. Among other things the FCA proposes to make changes to the Disclosure and Transparency Rules to enable it to comply with the requirements set out in Articles 7 and 9 of the regulatory technical standards on the Transparency Directive (2004/109/EC) concerning the European electronic access point.

The new rules to DTR 6.2 require issuers, whenever they file regulated information under DTR 6.2.2R:

- to notify the FCA of its legal entity identifier, a unique 20-character reference code which an entity must obtain if involved in a financial transaction; and
- to notify the FCA of the classifications of all regulated information.

The FCA encourages issuers to abide by these changes from 1 January 2017.

The consultation paper can be accessed below:

- *https://www.fca.org.uk/publication/consultation/cp16-39.pdf*

Litigation and Investigations

UK Government Creating New "Failure to Prevent" Offences

The UK Bribery Act 2010 broke new ground by expanding corporate liability beyond the traditional "directing mind" model and establishing strict corporate criminal liability for the wrongful acts of an "associated person," albeit subject to an affirmative compliance defence. This new model, although so far only modestly used in corruption cases, appears to have won supporters in the UK Government who intend to expand it beyond

the corruption context. Following a public consultation in the early part of last year, in October 2016, the UK Government presented its Criminal Finances Bill ("**Bill**") to Parliament.

The Bill introduces two new criminal offences for a body corporate or partnership (referred to in the Bill as a "relevant body"), wherever incorporated or formed: (i) of failure to prevent the facilitation of UK tax evasion offences; and (ii) of failure to prevent the facilitation of foreign tax evasion offences by a person with whom the relevant body is associated, provided that the person commits the facilitation of tax evasion offence in their capacity as the relevant body's associated person.

The Bill is expected to pass through the House of Commons (the lower chamber) in Q1 2017 before being introduced in the House of Lords (the upper chamber). It is not expected to come into force before Q3 2017 at the earliest.

On 13 January 2017, the UK Government published its long-awaited consultation on the merits of expanding the corporate economic crime offences beyond failing to prevent bribery and the facilitation of tax evasion offences, in order to better hold companies to account for the criminal wrongdoings of their employees, agents and representatives.

The Rt Hon Sir Olver Heald QC, Justice Minister, noted the importance of ensuring that corporates are:

> "*properly held to account for criminal activity that takes place within them, or by others on their behalf and at their behest. It is equally important to foster and promote economic crime prevention as part of corporate good governance. Good corporate governance is a means to create a business environment of trust, transparency and accountability in order to promote investment, financial stability and sustainable economic growth.*"

At present, corporate criminal liability for economic crime is governed by common law rules, known collectively as the "identification" doctrine, which require prosecutors to show that those individuals who are the "directing mind" of the company knew about, actively condoned or played a part in the offending. As part of the consultation, the Government is seeking evidence on the extent to which the identification doctrine may be "hindering effective criminal law enforcement".

In its consultation paper, the Government proposes 5 options:

- Amending, but not abolishing, the identification doctrine.
- Creating a strict (vicarious) liability offence. This would make companies guilty, through the actions of their employees, agents or representatives, of the substantive offence, without the need to prove any fault element (such as knowledge or complicity at the companies' centres).
- Creating a strict (direct) liability offence. This would focus on the responsibility of companies to ensure that offences are not committed in their names or on their behalves. Companies would be convicted without the need for proof of any fault element of an offence comparable to breach of statutory duty to ensure that economic crime is not committed in their names or on their behalf. A strict direct liability offence might be accompanied by, and subject to, a due diligence type defence, similar to section 7 of the Bribery Act 2010 and the Criminal Finance Bill.
- Having "failure to prevent" as an element of the offence.
- The Government is also investigating the possibility of introducing regulatory reform on a sector by sector basis.

It is anticipated that the economic crimes contained in any new legislation will include the most common and serious economic crime offences, such as common law conspiracy to defraud, fraud, false accounting and money laundering. Other offences may also include aiding and abetting, statutory conspiracy, attempt and assisting and encouraging the economic crime offences.

The consultation closes on 24 March 2017. The Government expects to publish its response during summer 2017. The consultation document can be accessed below:

- *https://consult.justice.gov.uk/digital-communications/corporate-liability-for-economic-crime/* and *https://consult.justice.gov.uk/digital-communications/corporate-liability-for-economic-crime/supporting_documents/corporateliabilityforeconomiccrimeconsultationdocument.pdf*

SFO – Former Sweett Group Executive Convicted for Destroying Evidence

A former executive of Sweett Group PLC has been convicted of two destruction of evidence offences, contrary to section 2(16) of the UK Criminal Justice Act 1987. On 21 December 2016, Richard Kingston, previously a Managing Director of Sweett's Middle East and India operations, was found guilty of concealing, destroying or otherwise disposing of two mobile phones, knowing or suspecting that the data stored on those phones—namely emails, text and WhatsApp messages—was pertinent to the Serious Fraud Office's ("**SFO**") investigation into suspected bribes paid by Sweett. Kingston has been sentenced to 12 months' imprisonment on each count, to run concurrently.

The SFO's General Counsel, Alun Milford, said that Kingston "actively took steps to frustrate our inquiries into his involvement, and that of others, in the suspected payment of bribes. We will not hesitate to pursue those who may set out similarly to disrupt our investigations."

The SFO's prosecution and successful conviction of Kingston highlights its commitment to investigate and pursue not just those who engage in bribery and corruption, but also those who facilitate, fail to prevent or otherwise seek to conceal evidence of such conduct.

US Developments

SEC and NYSE/Nasdaq Developments

SEC Scrutiny of Non-GAAP Financial Measures

One of the recent areas of focus in the review by the US Securities and Exchange Commission ("**SEC**") of company disclosures has been the use of "non-GAAP" financial measures, which are financial measures that do not conform either to US generally accepted accounting principles ("**GAAP**") or international financial reporting standards ("**IFRS**"), as applicable. In May 2016, the SEC updated its compliance and disclosure interpretations ("**C&DIs**") regarding the use of non-GAAP financial measures.

In October 2016, we published a review of comment letters issued by the staff of the SEC's Division of Corporation Finance relating to the use of non-GAAP measures in company disclosures, which highlights the following topics in comment letters to SEC reporting companies:

- *Equal or Greater Prominence*: The SEC has requested, as required by Regulation G and Item 10 of Regulation S-K, that a presentation of the most directly comparable GAAP or IFRS financial measure must be presented "with equal or greater prominence" whenever a non-GAAP measure is disclosed. Accordingly, headings, bullets and tables must first present the GAAP or IFRS and then the non-GAAP measures (in that order). Further, non-GAAP margins, ratios and per share metrics, such as adjusted EBITDA as a percentage of sales, need both reconciliation and a presentation of the comparable GAAP or IFRS measure in a location of equal or greater prominence; in this case, a presentation of net income as a percentage of sales. To the extent such measures appear in several places in a disclosure document, they should be presented in the same order wherever they appear.
- *Reasons for the Inclusion of Non-GAAP Measures*: Boilerplate language that management believes the company's non-GAAP measures provide investors with helpful supplemental information may not be sufficient. In several comment letters, the SEC has asked companies to elaborate on the usefulness of each non-GAAP measure to the specific circumstances of the company, sometimes focusing on particular adjustments.
- *Accurate Labeling*: Measures such as EBITDA or free cash flow must be labeled as "adjusted" if they include adjustments beyond those customarily made for measures with those names. Similarly, financial measures should only be described as "pro forma" if they have been prepared in accordance with the SEC's rules for pro forma financial statements in Regulation S-X.

- *Proper Adjustments and Reconciliation*: In its updated non-GAAP C&DIs, the SEC has identified several adjustments as problematic, taking the position that certain non-GAAP adjustments, while not expressly prohibited, are presumed to be misleading. Those adjustments include, among others: normal, recurring cash operating expenses; acquisition-related expenses; and purchase accounting adjustments. While companies can still provide explanations as to why such adjustments are relevant, they may increasingly face an uphill battle in defending those adjustments.

For further details, please see our relevant client publication available at:

- *http://www.shearman.com/~/media/Files/NewsInsights/Publications/2016/10/Updated-NonGAAP-Guidance-The-First-150-Comment-Letters-CM-101920163.pdf*

SEC No Longer Requires "Tandy" Representation in Filing Reviews

Since the mid-1970s the SEC has required companies to acknowledge in writing that the disclosure in any filed documents was the responsibility of the filer and that the SEC review process would not be raised as a defence in legal proceedings. The SEC has required the same acknowledgement, known as the "Tandy" language (after the first company to receive a comment letter containing this language), in comment letters since they became publicly available in 2004.

While companies remain responsible for the accuracy and adequacy of their disclosure, going forward, the SEC will include the following statement in comment letters, without requiring an affirmative response in the form of the "Tandy" representation from the reviewed filer:

- "*We remind you that the company and its management are responsible for the accuracy and adequacy of their disclosures, notwithstanding any review, comments, action or absence of action by the staff.*"

The relevant SEC announcement is available at:

- *https://www.sec.gov/corpfin/announcement/cf-announcement---no-more-tandy-language.html*

SEC's Division of Corporation Finance Updates Its Financial Reporting Manual

On 9 November 2016, the SEC revised its Financial Reporting Manual to add guidance with regard to the implementation of IFRS 15, *Revenue from Contracts With Customers* and IFRS 16*, Leases*, and Accounting Standards Update No. 2015-09, *Disclosures about Short-Duration Contracts (Topic 944)*.

The update also seeks to clarify guidance on emerging growth company financial statements and to reflect recent C&DIs on non-GAAP financial measures, among other topics.

For further information, see the updated manual at:

- *https://www.sec.gov/divisions/corpfin/cffinancialreportingmanual.pdf*

SEC Clarifies Its Guidance on Abbreviated Debt Tender Offers and Debt Exchange Offers

On 18 November 2016, the SEC published several new C&DIs seeking to clarify certain of the requirements that a debt tender or exchange offer must satisfy to fall under the scope of the SEC no-action letter regarding abbreviated debt tender offers and debt exchange offers for non-convertible securities, which was issued in January 2015.

A foreign private issuer may furnish a press release announcing the offer on a Form 6-K filed prior to 12:00 p.m. (Eastern time) on the first business day of the offer, rather than on Form 8-K, as specified in the no-action letter.

While abbreviated offers must be made for "any and all" of the debt securities subject to the offer, the offer may have minimum tender conditions.

The C&DIs provide additional guidance on the use of "qualified debt securities" as consideration in abbreviated offers and clarifies that abbreviated offers for cash consideration to all holders may be made for a fixed amount of cash or for an amount of cash calculated with reference to a fixed spread to a benchmark as of the last business day of the offer.

The guidance further specifies that a generic disclosure, such as "customary compensation", will normally not satisfy the requirement to provide a summary of all material terms of employment or other arrangement for compensation paid to all persons employed, retained or compensated to make solicitations or recommendations in connection with the relevant transaction.

The new guidance also provides further clarification on the conditions in the no-action letter applicable to abbreviated offers in connection with transactions, such as a purchase, sale or transfer by the issuer or any of its subsidiaries of a material business or amount of assets, that would trigger the requirement to furnish pro forma financial statements under Regulation S-X.

The new guidance is available at:

- *https://www.sec.gov/divisions/corpfin/guidance/cdi-tender-offers-and-schedules.htm*

The SEC no-action letter relating to abbreviated offers is available at:

- *https://www.sec.gov/divisions/corpfin/cf-noaction/2015/abbreviated-offers-debt-securities012315-sec14.pdf*

SEC Releases New Interpretations Relevant for Foreign Private Issuers

On 8 December 2016, the SEC released new C&DIs, certain of which are applicable to foreign private issuers, providing greater certainty for companies seeking to establish or maintain a US listing.

In particular, the new C&DIs provide guidance on the determination of "foreign private issuer" status, including:

- how to determine the proportion of a company's voting securities that are owned of record by US residents, for the purposes of both foreign private issuer status and the safe harbor available under Regulation S;
- how to determine the US citizenship or residency status of directors and officers; and
- how to determine whether more than 50% of a company's assets are located in the US and whether a company's business is administered principally in the US.

The new interpretations also address SEC registration statement and reporting rules for debt securities (i) that are issued by a subsidiary that is not a foreign private issuer and guaranteed by a foreign private issuer parent and (ii) that are issued by a foreign private issuer parent and guaranteed or co-issued by subsidiaries that are not foreign private issuers. In both cases, the company can use an F-series registration statement to register the offering and Form 20-F to comply with Exchange Act reporting obligations going forward.

Exchange Act Rule 12g-3 details the process for a non-SEC reporting issuer to succeed to the reporting obligations and registration of a registered issuer in connection with a merger or similar transaction that qualifies as a succession. The new interpretations clarify that when both parties are foreign private issuers, the initial filing evidencing the succession should be a Form 6-K filed using the Form 8-K submission type that is appropriate to the transaction.

The new interpretations clarify the requirements for a foreign private issuer to terminate its Exchange Act registration and reporting obligations under Rule 12h-6, which requires, among other things, that the primary trading market for the securities be outside the United States. For the primary trading market determination, the EU can be considered as a single foreign jurisdiction.

Our related client publication is available at:

- *http://www.shearman.com/en/newsinsights/publications/2016/12/sec-new-interpretations-for-rule-144a*

20-F Filing Season

It is the time of year for a large number of companies to prepare their annual reports on Form 20-F. For companies with a calendar year-end, the Form 20-F must be filed with the SEC by 2 May 2017.

Our client publication, which highlights recent developments, trends and topics that may be important focus areas of the SEC in the 2017 review process, is available at:

- *http://www.shearman.com/en/newsinsights/publications/2017/01/its-annual-report-time-recent-developments*

Noteworthy US Securities Litigation

Salman v. United States: Supreme Court Holds That Tips Made to Relatives Do Not Require Monetary Benefit to Qualify As Insider Trading

On 6 December 2016, in *Salman v. United States*, the US Supreme Court ("**Court**") affirmed the insider trading conviction of a defendant who traded on inside information after receiving it from his brother-in-law, who, in turn, had received it from his brother, the original tipper. The Court held unanimously that the narrow issue presented by the fact that the inside information was originally tipped between close relatives was "easily resolve[d]" by the Supreme Court's 1983 decision in *Dirks v. S.E.C.* The Court, however, declined to address other aspects of insider trading law that went beyond the facts presented in this case.

The defendant in *Salman* received confidential information about pending mergers and acquisitions from his brother-in-law (the brother of the original tipper). That original tipper had access to the inside information in his role as an investment banker. The evidence showed that the two brothers had a very close relationship. The tipper provided the inside information to benefit his brother and expected that his brother would trade on it. In addition, the defendant's brother-in-law told the defendant that the information originated with his brother.

The transmittal of confidential information constitutes insider trading only if the original tipper receives a personal benefit in exchange for providing the information. The Court determined that this requirement was met here because *Dirks* held that the personal benefit requirement is satisfied when a tipper "makes a gift of confidential information to a trading relative or friend". To bolster this conclusion, the Court explained that, just as it would be illegal for an individual with inside information to trade on that information and give the proceeds to a relative or close friend as a gift, it is illegal to pass along the inside information as a gift so that the relative or close friend can trade on it. The Court noted that it might sometimes be difficult to determine whether a tipper receives a benefit by providing a gift of inside information without any monetary benefit in return. But this was not such a case. Because the original tip was made to the tipper's brother (with whom he had a close personal relationship), this scenario fell "in the heartland of *Dirks*'s rule concerning gifts".

Because this case was easily resolved based on the family relationship between tipper and tippee, the Court did not address the standard that the federal appeals court in New York recently articulated in *United States v. Newman* (which we have written about in a previous edition of this newsletter) for determining when a benefit exists in other scenarios. In addition, the Court did not address *Newman*'s holding that a remote tippee—i.e., a defendant (such as the defendant in both *Salman* and *Newman*) who receives inside information from intermediaries rather than from the original tipper—must know that the original tipper received a personal benefit. While the Supreme Court's decision in *Salman* now makes clear that a gift of inside information to a relative or close friend by its very nature constitutes a personal benefit to the tipper, the decision leaves intact the holdings of *Newman* (at least within the jurisdiction of the *Newman* court), which the Court did not address here.

Our client note, which discusses this case in further detail, is available at:

- *http://www.shearman.com/en/newsinsights/publications/2016/12/supreme-court-pecuniary-benefit-not-required*

In re: Volkswagen "Clean Diesel" Marketing, Sales Practices, and Products Liability Litigation: Federal District Court Holds That a Purchase of ADRs That Are Not Listed on a US Exchange Can Qualify as a "Domestic Transaction" Under Morrison

On 4 January 2017, in *In re: Volkswagen "Clean Diesel" Marketing, Sales Practices, and Products Liability Litigation*, a federal district court in California held that the US Supreme Court's landmark decision in *Morrison v. National Australia Bank* did not preclude claims under Section 10(b) of the Securities Exchange Act of 1934 (the "**Exchange Act**") arising from the purchase of American Depositary Receipts ("**ADRs**") on an over-the-counter market in the United States. Such claims, the court said, qualify as "domestic transactions".

In *Morrison* (as we have discussed in prior editions of this newsletter), the Supreme Court ruled that Section 10(b) does not apply extraterritorially to transactions outside the United States. The court in *Volkswagen* explained that "[a]fter *Morrison*, courts have applied a two-prong test to determine whether a particular securities transaction is properly within the territorial reach of Section 10(b): (1) whether the transaction is in 'securities listed on domestic exchanges'; or (2) whether the transaction is a 'domestic transaction[] in other securities.'" The first of these two prongs was not satisfied here because the court ruled that the over-the-counter market on which the plaintiffs purchased their Volkswagen ADRs is not a "domestic exchange." The court then said that the plaintiffs' ADR purchases were clearly "domestic transactions" because they involved securities sold to US investment advisers for the benefit of US investors and were processed through "the principal US securities clearing and settlement system, to accounts at US financial institutions, and title transferred in the" United States.

The court here also explained, "for the sake of completeness", that the plaintiffs' transactions are considered "domestic transactions" under the more contextual "predominantly foreign" test established by the federal appeals court in New York, even though the federal appeals court in California has not stated that this test applies within its jurisdiction. Because the ADRs here were sponsored by the defendant company, the company was therefore directly involved in those securities being offered for sale in the United States. Volkswagen "took affirmative steps to make its securities available to investors in the" United States, "the ADRs were and are offered to domestic investors on an OTC market located in the United States—and Plaintiffs in fact purchased the ADRs in the United States". Further supporting jurisdiction in the United States was the fact that Volkswagen was required to provide English-language versions of its disclosures from its home country and the allegations that Volkswagen's US subsidiaries, as well as certain individual defendants, made false statements in the United States concerning compliance with emissions limits and regulations. The court here accordingly concluded that allowing the plaintiffs' Section 10(b) claims to proceed was "not an impermissible extraterritorial application of the Securities Exchange Act as prohibited by Morrison". After this threshold ruling, the court went on to address defendants' other arguments for dismissal, and concluded that most of the plaintiffs' claims could proceed.

Based on all of the US connections described above, it is not surprising that the court here ruled that *Morrison* did not bar the plaintiffs' Section 10(b) claims. But the case also demonstrates the fact-specific nature of the *Morrison* determination when the securities at issue are not listed on a US exchange.

Schueneman v. Arena Pharmaceuticals, Inc.: Federal Appeals Court Reverses Dismissal of Complaint Because Pharmaceutical Company Was Required to Disclose Information Necessary to Clarify Other Statements That It Made

On 26 October 2016, in *Schueneman v. Arena Pharmaceuticals, Inc.*, the federal appeals court based in California reversed the lower court's dismissal of claims brought under the Exchange Act for failure to plead scienter (i.e., fraudulent intent). The court reached its conclusion based on the principle that, while a party trading securities has no freestanding duty under the Exchange Act to disclose information, once the party decides to speak about an issue, it must do so accurately and cannot withhold information that contradicts positive statements it has made.

While it was applying to the US Food and Drug Administration ("**FDA**") for approval of a weight-loss drug that it was developing, Arena Pharmaceuticals made positive statements to the public about its chances for FDA approval, including that its efforts were supported by "all the animal studies that ha[d] been completed" at that time. Despite these positive statements, the plaintiffs alleged that the defendants (Arena and several of its high-level officers) knew that a study done on rats showed the drug to have potentially carcinogenic effects that concerned the

FDA. The lower court held that the defendants did not have fraudulent intent when failing to disclose the existence of the rat study because the defendants had a legitimate difference of opinion with the FDA about the study's significance.

According to the court of appeals, however, it was clear that the defendants understood that the FDA did not agree with the company's view of the rat study. The FDA had asked the company to defend its continued clinical testing of the drug in light of the rat study and the company then hired a world-renowned toxicologist to address the FDA's concerns. The court's finding of scienter was closely tied to its holding that the company's positive statements about animal studies gave rise to a duty to disclose the rat study. As the court explained, while the "securities laws do not create an affirmative duty to disclose any and all material information", once a party chooses to make positive statements to the market, it is bound to "do so in a manner that wouldn't mislead investors". The company could have "remained silent about the dispute or it could have addressed its discussions with the FDA head-on. But it could not represent that there was no controversy here because all the data was favorable."

Recent Regulatory Enforcement Matters

United States v. Odebrecht S.A. and United States v. Braskem S.A.: Companies Reach Record-Breaking Settlement to Resolve Bribery Charges in Three Countries

On 21 December 2016, Odebrecht S.A. ("**Odebrecht**"), a global construction conglomerate based in Brazil, and its affiliate Braskem S.A. ("**Braskem**"), a Brazilian petrochemical company, pleaded guilty to violating the anti-bribery provisions of the Foreign Corrupt Practices Act ("**FCPA**"), as well as anti-corruption claims brought by authorities in Brazil and Switzerland. The companies agreed to pay $3.5 billion in total—the largest sum ever paid to resolve a global foreign bribery scheme—to settle charges that they paid approximately $1 billion in bribes to government officials around the world. Both companies pleaded guilty to conspiracy to violate the anti-bribery provisions of the FCPA.

The bribery scheme in this case took place between 2001 and 2016 and involved payments of approximately $788 million by Odebrecht to government officials in 12 countries in Central and South America and Africa in order to obtain business in connection with over 100 projects. According to the US Department of Justice (the "**DOJ**"), Odebrecht had an internal division called the Division of Structured Operations that was dedicated to overseeing the company's bribe payments and, until 2009, reported to the highest levels of the company. To make the illicit payments, this division used sophisticated communications and computer systems, a shadow budget and offshore entities. In addition, Braskem, which was charged by both the DOJ and the SEC, was alleged to have paid approximately $250 million (partly through Odebrecht) between 2006 and 2014 to Brazilian officials, including an official at Petróleo Brasileiro S.A. – Petrobras, the state-controlled oil company of Brazil, in exchange for various benefits from Petrobras and other government entities.

The DOJ and SEC worked alongside Brazilian and Swiss authorities on this enforcement action. Under the settlement, the penalties of at least $2.6 billion against Odebrecht and $957 million against Braskem will be split between the United States, Brazil and Switzerland, with the vast majority paid to Brazil. Odebrecht and Braskem received 25 percent and 15 percent reductions in their penalties for their full and partial co-operation with authorities, respectively. Odebrecht also represented that it would not be able to pay more than $2.6 billion, but agreed that a criminal fine of $4.5 billion would be appropriate under the circumstances. The DOJ and Brazilian authorities are therefore continuing to determine the precise amount of Odebrecht's fine based on its ability to pay. While the companies received some co-operation credit, they were penalised for their failure to voluntarily disclose the underlying conduct in the first place, and for the nature and seriousness of the long-term bribery scheme, which involved sophisticated techniques to bribe high-level government officials in many countries and reached to the highest levels of the companies. Among other remedial measures, the companies agreed to adopt better internal controls and anti-corruption compliance protocols, devote more resources to those efforts, engage an independent compliance monitor and terminate and discipline individuals involved in the bribery scheme.

This FCPA enforcement action is noteworthy not only because of the record size of the settlement and the far-reaching level of activity involved, but also because US regulators worked with their counterparts in other countries to punish corrupt activity by companies based in Brazil. As the DOJ stated when announcing the settlement, "[j]ust because [foreign officials are] out of our sight, doesn't mean they're beyond our reach".

Bandimere v. SEC: Federal Appeals Court Creates Circuit Split Over Constitutionality of SEC's Administrative Law Judges

On 27 December 2016, in *Bandimere v. Securities and Exchange Commission*, the federal appeals court in Denver, Colorado held that the administrative law judges ("**ALJs**") who preside over enforcement proceedings brought by the SEC are "Officers of the United States" but are not appointed in accordance with the Appointments Clause of the US Constitution. In thus concluding that the SEC's ALJs are unconstitutional, the court disagreed with the recent decision of the federal appeals court in Washington, D.C., in *Raymond J. Lucia Companies, Inc. v. SEC*, which we discussed in the last edition of this newsletter.

In *Bandimere*, the SEC brought an administrative enforcement action against a Colorado businessman alleging that he violated several federal securities laws. After the SEC concluded that he committed two securities fraud violations and two violations for failing to obtain proper securities registrations, the businessman argued to the federal appeals court that the SEC's determination was not valid because the ALJ that reached the initial decision in this case was not appointed in accordance with the Appointments Clause.

Under the Appointments Clause, "Officers of the United States" must be appointed by the President or, in the case of inferior officers, by certain other methods determined by statute. The SEC conceded that its ALJs are not appointed in accordance with the Appointments Clause, but argued that they are not subject to this constitutional provision because they are mere employees rather than inferior officers. The court relied heavily on a 1991 Supreme Court decision, *Freytag v. Commissioner of Internal Revenue*, that determined that special trial judges appointed by the US Tax Court are considered inferior officers rather than employees. Based on *Freytag*, the court ruled that SEC ALJs are also considered inferior officers because their position is established by law (the Administrative Procedures Act), their "duties, salary, and means of appointment . . . are specified by statute", and they "exercise significant discretion" in "carrying out . . . important functions", such as overseeing administrative proceedings.

The court determined that the federal appeals court in *Lucia* incorrectly placed too much weight on its determination that SEC ALJs cannot issue final decisions, without addressing the other aspects of their role that the Supreme Court identified as relevant in *Freytag*. One of the three judges deciding this case dissented, in part because of what he viewed as the far-reaching consequences that the court's decision would have for ALJs throughout the federal government. But the court explained that it was addressing only the narrow question at issue in this case about the status of SEC ALJs and not any questions about the potential consequences of that decision. Because of the significance of this decision, the SEC might ask for a rehearing *en banc* before the full court of appeals. Whether or not the SEC seeks *en banc* review, it could still ask the US Supreme Court to hear the case, especially in light of the split between this court and the federal appeals court in Washington, D.C. An *en banc* petition is already pending in the *Lucia* case*.* One way or another, it seems likely that the Supreme Court will eventually have to decide the issue.

Recent Trends and Patterns in Foreign Corrupt Practices Act Enforcement

In January 2017, we published our bi-annual Recent Trends and Patterns in FCPA Enforcement report, part of our FCPA Digest, which provides an analysis of recent enforcement trends and patterns in the United States, the UK and elsewhere, as well as guidance on emerging best practices in FCPA and global anti-corruption compliance programs.

2016 was a banner year for FCPA enforcement. The DOJ and SEC's combined 27 corporate enforcement actions and $6 billion in total corporate sanctions (due in large part to the sanctions levied against Odebrecht) are the highest since the statute's enactment. However, while the 2016 enforcement year has seen a series of blockbuster FCPA enforcement actions, by and large the remainder of the 2016 FCPA cases have involved relatively small-to-medium-sized penalties over relatively run-of-the-mill bribery schemes. Among the highlights from 2016 were:

- The Odebrecht, VimpelCom, Teva, Och-Ziff, JPMorgan and Embraer enforcement actions have distorted the average corporate sanction for 2016 to $223.4 million, while the median corporate sanction of $14.4 million is comparable to past years.
- China and the healthcare/life science industries dominated the headlines for the 2016 FCPA enforcement actions.
- The cases of Qualcomm, JPMorgan and VimpelCom reflect new expansions of regulators' views as to the scope of the term "anything of value" in FCPA cases.
- A ruling in the SEC's ongoing case against the Magyar executives upheld a novel theory on the SEC's jurisdiction to enforce the FCPA.
- The DOJ has generally continued its practice of declining to bring charges where the SEC successfully forced a company to disgorge the illicit profits, reserving criminal charges for instances in which the company's conduct was sufficiently egregious.
- The incoming Trump administration raised new questions over the future of enforcement policies and priorities in relation to the FCPA.

Our full January 2017 report is available at:

- *http://www.shearman.com/~/media/Files/NewsInsights/Publications/2017/Shearman--Sterlings-Recent-Trends-and-Patterns-in-the-Enforcement-of-the-Foreign-Corrupt-Practices-Act.pdf*

International Developments

International Bodies Publish Second Consultation on Harmonisation of Key OTC Derivatives Data Elements

On 19 October 2016, the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions published a joint consultative report on the harmonisation of a second batch of key over-the-counter ("**OTC**") derivatives data elements. The report is in response to the 2009 G20 agreement that all OTC derivatives contracts would be reported to trade repositories—part of the G20's overall commitment to reforming the OTC derivatives markets to improve transparency, mitigate systemic risk and prevent market abuse. This consultation complements the consultation on harmonisation of key OTC derivatives data elements (other than the Unique Transaction Identifier and the Unique Product Identifier ("**UPI**")), published in September 2015 and other reports on the harmonization of the UPI.

The purpose of this consultation is to develop guidance for regulators on definitions for the second batch of critical data elements that are important for global consistency and the meaningful aggregation of trade repository OTC derivatives transactions data. The consultation seeks views on matters including: (i) proposed definitions of key data elements; (ii) whether the proposed definitions cover different market practices globally; (iii) whether any alternative approaches to those mentioned in the report would better achieve the stated objectives; and (iv) whether the consultative guidance is unambiguous. A consultation on the third batch of key data elements is expected in 2017. Responses to the proposals were due by 30 November 2016.

The consultation paper is available at:

- *https://www.iosco.org/library/pubdocs/pdf/IOSCOPD545.pdf*

The consultative report on the first batch of OTC derivatives data elements is available at:

- *http://www.iosco.org/library/pubdocs/pdf/IOSCOPD503.pdf*

Asia Developments

Launch of Shenzhen-Hong Kong Stock Connect

On 5 December 2016, Shenzhen-Hong Kong Stock Connect, the mutual stock market access programme between the Shenzhen Stock Exchange ("**SZSE**") and The Stock Exchange of Hong Kong Limited ("**SEHK**"), was officially launched. Under Shenzhen-Hong Kong Stock Connect, Hong Kong and international investors may trade in eligible shares listed on SZSE through SEHK via a Northbound Shenzhen Trading Link. Likewise, eligible Mainland investors may trade in eligible shares listed on SEHK through SZSE via a Southbound Hong Kong Trading Link. Shenzhen-Hong Kong Stock Connect was modelled on Shanghai-Hong Kong Stock Connect launched in November 2014 and is a significant step towards broadening mutual stock market access between Hong Kong and the Mainland. For the key features of Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect, you may refer to the January 2015 issue and October 2016 issue of *Governance & Securities Law Focus*.

Each of Shenzhen-Hong Kong Stock Connect and Shanghai-Hong Kong Stock Connect is subject to a daily quota of RMB 13 billion for its Northbound Trading Link and a daily quota of RMB 10.5 billion for its Southbound Trading Link. Please see below market highlights of 5 December 2016, the first trading day under Shenzhen-Hong Kong Stock Connect:

Stock Connect Highlights – 5 December 2016

	Hong Kong (Southbound)	**Shenzhen** (Northbound)	**Shanghai** (Northbound)
Turnover	Total HK$5,350 million - Shenzhen HK$923 million - Shanghai HK$4,427 million	RMB 2,669 million	RMB 6,800 million
Shares traded	Total 1,312 million - Shenzhen 285 million - Shanghai 1,027 million	163 million	587 million

Source: HKEX News Release issued on 5 December 2016

To strengthen the enforcement co-operation between the China Securities Regulatory Commission ("**CSRC**") and the Hong Kong Securities and Futures Commission ("**SFC**") and signify their joint commitment to take effective action against cross-boundary illegal activities and market misconduct, the CSRC and the SFC have entered into a new memorandum of understanding, which supersedes the "Memorandum of Understanding between the CSRC and the SFC on Strengthening of Regulatory and Enforcement Cooperation under Shanghai-Hong Kong Stock Connect" signed on 17 October 2014. In addition, the CSRC and the SFC have established arrangements and procedures for cross-boundary regulatory co-operation on any contingency or major event that may affect the mutual trading access, and for referring and handling investors' complaints.

The Joint Announcement by the CSRC and the SFC on 25 November 2016 approving the official launch of Shenzhen-Hong Kong Stock Connect is available at:

- http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=16PR126

The lists of eligible stocks under Shenzhen-Hong Kong Stock Connect and Shanghai-Hong Kong Stock Connect are available at the Stock Connect section of the HKEX website:

- http://www.hkex.com.hk/eng/csm/securities_eligible_stocks.htm

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.

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