

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

Directive Regarding Disclosure of Non-Financial and Diversity Information Published in Official Journal

The Accounting Directive (2013/34/EU) has been amended by a directive dealing with the disclosure of non-financial and diversity information by certain large companies and groups. This directive was published in the Official Journal on 15 November 2014.

The Commission is planning to consult stakeholders on the mode and practice of non-financial reporting, and aims to publish a set of guidelines on the topic by 6 December 2016 addressing, among other things, general and sector-based non-financial KPIs.

The directive came into force on 5 December 2014 and it will be necessary for member states to implement it by 6 December 2016. The text published in the Official Journal largely reflects the text adopted by the Council on 29 September 2014 and which was discussed in the October 2014 edition of this publication.

A copy of the consolidated text of the Accounting Directive incorporating the above changes is available at:

http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:JOL_2014_330_R_0001&from=EN.

ESMA Publishes Transparency Directive Consultation on European Electronic Access Point

A consultation paper on draft regulatory technical standards (“RTSs”) for a European Electronic Access Point (“EEAP”) was published by European Securities and Market Authority (“ESMA”) on 19 December 2014, as required by the amended Transparency Directive.

The directive amending the Transparency Directive provides for an EEAP – *i.e.*, a centralised internet portal through which regulated information throughout the EU may be accessed and easily searched for. It is to be developed and maintained by ESMA and to be launched on or before 1 January 2016. Member states shall be obliged to provide access to their national storage mechanisms (“NSMs”) through the EEAP.

Summary

The draft RTSs cover the following:

- A centralised search across the EU;
- Specific communication technologies to be recommended by ESMA;
- A unique identifier to be assigned to each issuer for ease and speed of reference;
- A standardised format for information; and
- A standardised method of classification for regulated information.

ESMA does not intend these changes to increase the obligations already placed on issuers and NSMs and has noted that the intention of the EEAP is not to provide a replacement for NSMs themselves.

Consultation

The consultation will close on 30 March 2015, and the deadline for the draft RTSs to be submitted to the Commission is 27 November 2015 – responses received by ESMA will be taken into account before submission.

A copy of the consultation is available at:

<http://www.esma.europa.eu>.

ESMA Technical Advice and Consultation on MiFID II

Technical Advice

ESMA's final report on its technical advice to the Commission relating to the registration of a multilateral trading facility ("MTF") as an SME growth market (SME-GM) under the second Markets in Financial Instruments Directive ("MiFID II") and the Markets in Financial Instruments Regulation ("MiFIR") was published on 19 December 2014. This report substantially reflects ESMA's draft technical advice published on 22 May 2014, with the exception of the following changes:

- SME-GMs' eligibility criteria (when ascertaining whether an SME-GM has at least 50% SME issuers, non-equity issuers can be considered SMEs if the total nominal value of the issuer's debt securities is below €200m or the issuer is an SME under Article 2(1)(f) of the Prospectus Directive);
- Criteria for the admission to trading of issuer's financial instruments (there should not be more onerous obligations on issuers in an SME growth market than the obligations in regulated markets);
- Admission document criteria (an admission document must clearly state whether it has been reviewed or approved, and by whom);
- On-going periodic financial reporting (local financial reporting rules must be followed as a minimum when drafting annual reports and half-yearly financial statements);
- Market Abuse Regulation ("MAR") compliance (only issuers on SME growth markets must comply with MAR, *i.e.*, PDMRs should not be required to comply); and
- Storage and dissemination of regulatory information (all regulatory information should be published on the SME-GM market operator's website, rather than that of the issuer).

A copy of the final report is available at:

<http://www.esma.europa.eu/content/Technical-Advice-Commission-MiFID-II-and-MiFIR>.

Consultation

ESMA also published a consultation paper on MiFID II and MiFIR on 19 December 2014. In this paper, ESMA put forward a set of draft technical standards relating to the ways in which financial instruments should be admitted to trading on regulated markets, soliciting general feedback on these draft standards.

The draft standards will require regulated markets to formulate a policy outlining steps they will use to verify that an issuer is compliant with its obligations under EU law and to publish this policy online. Furthermore, regulated markets will be required to make public information more accessible and state the ways in which they have done this on their website.

The deadline for responses to this consultation paper is 2 March 2015.

A copy of the consultation paper is available at:

<http://www.esma.europa.eu>.

Draft Commission Delegated Regulation Published on Technical Standards on Major Holdings

A draft delegated regulation was published by the European Commission on 17 December 2014, in connection with RTSs with respect to the notification of major holdings under the amended Transparency Directive. The regulation largely reflects the draft RTSs published by ESMA in a final report published on 29 September 2014.

The RTSs aim to clarify certain parts of the Transparency Directive and provide more specific and detailed rules for its implementation.

The points covered by the draft technical standards include the following:

- Further principles for the aggregation of different classifications of holdings;
- A list of financial instruments that fall under the notification requirement; and
- How voting rights can be calculated in reference to financial instruments.

The European Parliament and Council will now review the draft, which will proceed to publication in the Official Journal provided no objections are raised.

A copy of the draft delegated regulation is available at:

<http://ec.europa.eu/transparency/regdoc/rep/3/2014/EN/3-2014-9656-EN-F1-1.Pdf>.

A copy of the final report of ESMA on the draft RTSs is available at:

<http://www.esma.europa.eu>.

ESMA 22nd Version: Questions and Answers on Prospectuses

Since the 21st version of the Questions and Answers (published in January 2014), a further version has been issued by ESMA (on 22 October 2014) with three new questions relating to the disclosures required in prospectus summaries. Additionally, answers to two other questions concerned with summaries have been updated in this version.

New Questions

Question 93: In cases where the relevant Prospectus Regulation annexes do not require selected financial information to be disclosed in the prospectus, how should the selected historical key financial information required to be disclosed in the prospectus summary be presented? ESMA states that it should be taken from the financial information required under the relevant annex to be disclosed in the prospectus itself.

Question 94: What is the minimum information required to be disclosed in the Risks section of the prospectus summary? ESMA has stated that only the risks considered key by the issuer should be included in the Risks section of the summary and therefore not all the risks included in the risks factor section of the prospectus itself need to be included in the summary. The key risks disclosure required should enable investors to distinguish the origin, nature and, if possible, ramifications of the risk in the context of the issuer.

Question 95: Can a summary relating to an individual securities issue incorporate further information for which there is neither an option nor placeholder in the earlier summary in the base prospectus? ESMA has stated that this is not possible.

Revised Answers

Question 82: How should a summary be prepared in relation to proportionate disclosure regimes (“PDRs”) (*i.e.*, the reduced prospectus disclosure allowed in the case of rights issues and certain SME issuers)? The answer now clarifies

that the Regulation's prospectus summary requirements apply to the various PDRs and indicates the summary requirements applicable to the relevant PDR annexes.

Question 91: What are the permissible formats for the individual summary relating to several securities? ESMA has clarified what "differing only in some limited details" means; it says that an individual summary relating to several securities is permitted provided that the securities differ only in "some limited details".

A copy of version 22 of ESMA's Q&A on prospectuses is available at:

<http://www.esma.europa.eu>.

ESMA Publishes Consultation Paper on Draft Prospectus Standards

On 23 May 2014 the Omnibus II Directive amended the Prospectus Directive, providing for ESMA to draft RTSs covering a number of prospectus-related issues that are to be submitted to the Commission and which then have the potential to be adopted through delegated regulation. On 26 September 2014 ESMA published a consultation paper with regard to certain draft standards in this area.

The draft standards address the following topics:

- Incorporation by reference (the standards set out a full list of information compliant with Article 11(1) of the Prospectus Directive);
- Prospectus approval procedure (the standards cover submission requirements for accompanying documents, submission procedure for prospectuses and draft prospectuses, as well as specifying the communication channels between authority and applicant);
- Prospectus publication (the standards introduce rules that facilitate access to electronic prospectuses); and
- Availability of information relating to public offers and admission to trading on a regulated market (the standards set out four categories of communication for advertisements).

The deadline for the draft standards to be submitted to the Commission is 1 July 2015 and the consultation was closed on 19 December 2014.

The consultation is available at:

<http://www.esma.europa.eu>.

GERMAN DEVELOPMENTS

German Federal Court of Justice on Prospectus Liability of Deutsche Telekom

In 2000, more than 200 million registered shares in Deutsche Telekom were publicly offered, accompanied by a voluntary prospectus. Shortly after the public offering, many shareholders sued Deutsche Telekom for damages arising from an alleged incorrect prospectus in accordance with German law applicable at the time. Investors claimed, *inter alia*, that Deutsche Telekom had included a wrong value of its real estate and had misrepresented an accounting profit resulting from an inter-group "sale" of shares in the U.S. company Sprint to a subsidiary. With its decision dated 21 October 2014, the German Federal Court of Justice has ruled that the prospectus issued by Deutsche Telekom was at least partially incorrect.

The Court ruled that although the evaluation of the company's real estate deviated from its actual value, evaluations of real estate are always estimates, as there is no "true" value of real property. The Court pointed out that slight deviations within an acceptable range did not make the prospectus incorrect. Definition of such range lies within the judgment of the courts. In similar cases, deviations of 18% and 20% have been ruled acceptable. The method of evaluation needs to be disclosed only if knowledge of the method is relevant for the investor's decision, for example if the evaluation method may produce inaccurate results. The Court ruled that these provisions were upheld in the prospectus.

However, in the Court's opinion the prospectus contained an incorrect presentation regarding the accounting profit booked after the inter-group transfer of Sprint shares to a subsidiary, as the transfer was referred to as a "sale" in the prospectus, whereas the shares had effectively been transferred to the subsidiary by way of a capital injection. According to the Court, the use of the expression "sale" rather suggested that the accounting profit resulted from the payment of a sale price to Deutsche Telekom and left the investor oblivious to the fact that Deutsche Telekom still carried the risk of a depreciation of Sprints stock, a depreciation that took place after the public offering.

ITALIAN DEVELOPMENTS

Shares with Increased Voting Rights and Multiple Voting Rights: Implementation of the New Rules Relating to Transparency of the Ownership Structures and Tender Offer Rules into the Regulation on Issuers

Law Decree No. 91 of 24 June 2014, converted into law by Law No. 116 of 11 August 2014 (the "Law Decree 91"), amended the Legislative Decree No. 58 of 24 February 1998 (the "Italian Securities Act"), introducing a new set of rules relating to shares with increased voting rights and multiple-voting rights shares. As a consequence of such legislative innovation, CONSOB, the Italian securities regulator, adopted the resolution No. 19084 of 19 December 2014 (the "19 December Resolution"), aimed at implementing the changes introduced by Law Decree 91 into Regulation No. 11971 of 14 May 1999 (the "Regulation on Issuers"), in particular with respect to the transparency of the ownership structures and the tender offer legal framework.

Through the 19 December Resolution, CONSOB established that (i) "significant interest", pursuant to Article 120 of the Italian Securities Act and Article 117 et seqq. of the Regulation on Issuers, must be calculated taking into consideration the number of voting rights rather than the number of shares held; (ii) the communication of the overcoming of the 2% threshold in the share capital of a company (which is, otherwise, a "significant interest" required to be disclosed to CONSOB and to the relevant company) is exempted if such threshold is exceeded as a consequence of a "passive variation" (*i.e.*, a variation due to changes in the share capital of the company or voting rights relating thereto); (iii) the calculation of the threshold relevant for the application of the mandatory tender offer rules must be based on the number of voting rights rather than the number of shares held; and (iv) the obligation to carry out a tender offer does not apply in case the relevant threshold has been exceeded by way of a "passive variation" (*i.e.*, a variation due to a reduction of voting rights caused by the application of the rules on shares with increased voting rights or multiple voting rights shares), unless an interest higher than 30% has actually been acquired.

Moreover, CONSOB indicated the information that must be included in the list of shareholders of the companies intending to use shares with increased voting rights, such as identification data of the shareholders and number of shares with increased voting rights held by them. Such information must be updated on a monthly basis and must be held available for the shareholders who request to access them. If such information refers to "significant shareholders" (*i.e.*, shareholders owning an interest higher than 2% in the share capital) the company must publish it on its website.

CONSOB Communication on Distribution of Complex Financial Products to Retail Investors

On 22 December 2014, CONSOB issued the Communication No. 0097996 (the “22 December Communication”) for intermediaries active in the distribution of complex financial products to retail investors, with the aim to increase the level of protection in favour of the “least aware and therefore weakest and most vulnerable component of the market”.

Through the 22 December Communication, CONSOB (i) recommends intermediaries not to offer to retail investors complex financial products that have been indicated in a specific list, including, but not limited to, securitizations, instruments convertible at the discretion of the issuer, structured and credit-linked instruments; (ii) reminds intermediaries that they must ascertain coherence between the products offered and the investors’ profile; (iii) reminds intermediaries to prevent conflicts of interest which may occur in the distribution of complex financial products to retail investors and, for such purpose, recommends to remove incentives that can emphasize the sale of such products in a situation of a potential conflict of interest; and (iv) invites intermediaries to use the same assessment and simulation methods that are used for internal purposes to manage risks also in relation to the information to be provided to retail investors in the distribution stage.

In the event intermediaries decide to deviate from the abovementioned recommendations, such decision must be taken, on a justified basis, by the top management and the intermediary must inform the client of the fact that CONSOB considers such product “unsuitable” for retail investors.

UK DEVELOPMENTS

Takeover Panel’s Response Statement: Post-Offer Undertakings and Intention Statements

On 23 December 2014 the Panel published a response statement to its consultation on post-offer undertakings (“POUs”) and post-offer intention statements (PCP 2014/2) which was discussed in the October 2014 edition of this newsletter. The majority of the proposed changes were adopted; however certain of these amendments have been modified in their final form.

Modified proposals include the following:

- The definitions of “post-offer undertaking” and “post offer intention statement” have been clarified; only POUs and intention statements published by a party to an offer come under the ambit of the new framework (whereas private statements published by a third party do not).
- Note 1(b) has been added to Rule 19.7. This states that the Panel must be consulted in advance by a party proposing to commit to take (or not to take) a specific course of action, made otherwise than by a POU, after an offer period expires. The Panel will then weigh up whether the commitment would be better made as a POU.
- Note 1(a) has been added to Rule 19.7. This allows the Panel to disallow any commitments in a POU that would be more appropriately made in another form.
- Note 2 has been added to Rule 19.7. A party may not take (or omit to take) any action that would cause an event, act or circumstance to occur that is referred to in a qualification or condition to a POU which that same party has made.
- One of the requirements under Rule 19.7 has been extended: a party must make a document available to the offeror’s (as well as the offeree’s) employee representatives.

These amendments became effective on 12 January 2015.

The response statement is available at:

<http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/RS201402.pdf>.

Takeover Panel Publishes Response Statement on Miscellaneous Amendments to the Takeover Code

The Panel published its response in relation to the miscellaneous amendments to the Code that it consulted on in PCP 2014/1, on 14 November 2014. Modifications and drafting changes have been made to some of the miscellaneous amendments; however the majority of amendments have been adopted as proposed in the consultation.

Amendments made to the Code include the following:

- A potential competing offeror now has a firm deadline by which it must confirm its position – this is now Day 53, which is contained in Rule 2.6 rather than in Note 3 on the rule;
- A note to Rule 32 and amendments to Rules 31.6 and 32.1 to clarify that it is possible, with the offeror's consent, for the offeror to revise its offer once the Day 46 deadline has passed (provided that Day 60 is changed to a later date, and Day 46 re-set);
- The suggested amendment to Rule 2.11(b) has been changed so that it requires irrevocable commitments/ letters of intent procured by an offeree to be disclosed; and
- Amendments to consolidate the Code's provisions regarding publications, announcements and web-based information into one place.

These amendments will be effective from 1 January 2015, and the response statement is available at:

<http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/RS201401.pdf>.

Takeover Panel Issue Practice Statement on Entering Into Talks During a Restricted Period

A practice statement (Practice Statement No. 28) was published on 14 November 2014 on the Panel Executive's practice of allowing an approach to the offeree board by a person who has either:

- Made a 'no intention to bid' statement; or
- Whose offer has been withdrawn or has expired,

during the restricted periods of six months (under Rule 2.8) or 12 months (under Rule 3.5) respectively.

In this practice statement, the Takeover Panel confirms:

- In circumstances where the person in question has made a 'no intention to bid' statement, the situation is considered to fall within the Rule 2.8(e) restriction (on taking any steps in connection with a possible offer), however the Executive will usually allow a relaxation of the requirements to enable a single confidential approach to the offeree board;
- The six month restrictions in Rule 2.8 are overlooked only during the time in which the offeree board and the potential offeror engage in talks. As soon as those talks terminate, the restrictions resume;
- Where a third party announces a third offer and a 'no intention to bid' statement is subsequently made, it is only if the third party's offer is withdrawn or has expired that the maker of the statement is permitted to make a confidential approach to the offeree board;

- The Executive confirms that it will usually only consent to an approach to the offeree board by a potential offeror who has been granted a Rule 2.2 Note 4 dispensation (from announcing a possible offer on the basis that the potential offeror ceased actively to consider making an offer) during the second three months of the restricted period; and
- The same practices as apply to Rule 2.8 will also usually apply to Rule 35.1.

The practice statement is available at:

<http://www.thetakeoverpanel.org.uk/wp-content/uploads/2013/12/2014-8.pdf>.

BIS Consults on EU Audit Reform

A consultation paper was published on 17 December by the Department for Business, Innovation & Skills (“BIS”), setting out potential changes to be made to the UK audit regime. Proposals for changes include:

- Maximum audit engagement duration for public interest entities will increase to 20 years (although retendering must occur every 10 years);
- The financial reporting council (“FRC”) will take on sole responsibility for regulatory tasks relating to the audit regime, in order to be consistent with the concept of ‘single competent authority with ultimate responsibility’ required by the directive and regulation;
- FCA and the Prudential Regulation Authority will implement the revised framework for the audit committee;
- Part 42 of the Companies Act 2006 (dealing with the regulation of statutory auditors) will be extended in terms of scope, and will apply to more entities, including those with securities admitted to trading on a regulated market, electronic money institutions, payment institutions, MiFiD investment firms, undertakings for collective investment in transferable securities and alternative investment funds; and
- FRC will be responsible for certain elements of the Statutory Audit Directive and the new regulation dealing with the statutory audit of public interest entities (on which – see below – it is now consulting).

The main aim of this consultation is to canvas opinion on how the reforms will function as a whole. It does not aim to address technical implementation (which is addressed by the FRC’s own consultation). The consultation closes on 19 February 2015.

The consultation is available at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/386811/bis-14-1285-auditor-regulation-discussion-document-on-implications-of-eu-and-wider-reforms.pdf.

FRC Consult on Impact of EU Reform on Auditing and Ethical Standards

The FRC published a consultation entitled “Auditing and Ethical standards, Implementation of the EU Audit Directive and Audit Regulation”, on 18 December 2014. The FRC is consulting on the options for member states contained in the regulation on the statutory audit of public interest entities, as well as on the amendment to the Statutory Audit Directive. Member states’ options include:

- Fee restrictions for audited public interest entities’ non-audit services (additionally, the audit regulation explicitly allows member states to put more stringent requirements in place);

- Prohibited non-audit services for public interest entities (prohibited services include certain tax services, bookkeeping and preparing accounts, and valuation services);
- Extending increased requirements to entities that are not classified as public interest entities;
- Simplification of some requirements;
- Application of audit standards in a manner proportionate to the complexity and size of the activities concerned; and
- Providing for additional requirements to supplement auditing standards that can be adopted by the Commission.

The consultation is due to close on 20 March 2015. The consultation is available at:

<https://www.frc.org.uk/Our-Work/Publications/Audit-and-Assurance-Team/Consultation-Auditing-and-ethical-standards-implem-File.pdf>.

BIS Publishes Discussion Paper on the Register of People with Significant Control

On 28 October 2014 BIS published a discussion paper that canvasses views on the Small Business, Enterprise and Employment Bill which was laid before Parliament on 25 June 2014. Among other things, this bill provides for the Companies Act 2006 to be amended, requiring companies to keep a register available for inspection, detailing all persons with significant control (“PSCs”) over the company.

Under the bill, the PSCs are required to disclose the following information:

- Name;
- Service address;
- Country or state of residence;
- Nationality;
- Date of birth;
- Usual residential address (to be protected from public disclosure);
- Date on which that person became registrable as a PSC; and
- Nature of the PSC’s control over the company.

BIS is requesting feedback on the following topics:

- How the statutory guidance on “significant control” should be presented and what exactly it should include;
- How the “nature of control” of the PSCs should be presented on the register and what system of classification would best serve the objective of the register;
- Access and costs of access to protected information; and
- The relevant respective impact of the proposals on PSCs.

The discussion paper closed on 9 December 2014, and it is available at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/367578/bis-14-1145-the-register-of-people-with-significant-control-psc-register-register-final-1.pdf.

BIS Consultation on Exceptions to Ban on Corporate Directors

Following the ban on corporate directors as laid out in the Small Business, Enterprise and Employment Bill (as discussed in the July 2014 edition of this publication), BIS sought views in a consultation paper on 27 November 2014 on how far the exceptions should extend.

In this paper, BIS recognises:

- The benefits of allowing corporate directors to be appointed by companies admitted to trading on a regulated market;
- That there may be benefits to allowing companies admitted to prescribed markets to make corporate director appointments, and requests feedback on the possibility and scope of this exception;
- For public companies that do not fall into the two points above, the paper requests views on whether there should be any exceptions, and suggests that any exception be linked to company size; and
- The risks of impeding future investments by extending the changes to LLPs – current rules applying to LLPs will remain the same, however the situation will remain under review.

The consultation closed on 8 January 2015, and is available at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/378197/bis-14-1017-scope-of-exceptions-to-prohibition-of-corporate-directors.pdf.

GC100 and Investor Group publishes Statement on Directors' Remuneration

This GC100 and Investor Group statement, published 18 December 2014, relates to directors' remuneration reporting guidance. The statement provides clarification on certain aspects, and general further guidance. Among other things, the statement aims to promote best practice, and addresses the following:

- Outlining an approach that emphasises a link between remuneration and the strategy of the company;
- Future remuneration reports should mention any assurances the company has given relating to remuneration, for as long as those policies remain active. They should also be published in the annual report section of the company website;
- Remuneration reports need not include full copies of the company policy – the statement outlines that as long as enough information is included to allow shareholders to easily assess the report, this is sufficient;
- Retrospective disclosure of targets and performance criteria are required, however the potential difficulties of prospective disclosure are recognised;
- Maximum levels of remuneration and maximum levels of bonuses should be disclosed for each director (in accordance with the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008);
- The remuneration report should disclose details of how the remuneration committee ensures compliance with guidelines; and
- Clarity and conciseness is emphasised when drawing up remuneration reports.

The statement is available at:

<http://uk.practicallaw.com/0-592-8546>.

NAPF Publish Corporate Governance Policy and Voting Guidelines 2014/15

Updated Corporate Governance Policy and Voting Guidelines were published by the National Association of Pension Funds (“NAPF”) on 8 December 2014. These guidelines reflect the current market best practice, and aim to ensure that the management and board of its members are held accountable to their shareholders.

Since its 2013 Guidelines, the following significant changes have been made:

- The board’s view on key strategic and operating risks, such as governance and reputational risks, must be included in the accounts;
- A coherent and consistent remuneration policy is emphasised, and it is specifically stated that the policies for executive remuneration should not be inconsistent with the general remuneration policies of the company;
- A high importance is placed on shareholder engagement – the board should be accessible to shareholders, and should have an established procedure to effectively deal with their concerns;
- Abstention is no longer generally advocated.

The latest NAPF Corporate Governance Policy and Voting Guidelines are available at:

http://www.napf.co.uk/PolicyandResearch/DocumentLibrary/~media/Policy/Documents/0418_NAPF_corporate_governance_policy_voting_guidelines_2014_2015_DOCUMENT.pdf.

Guidelines Monitoring Group Publishes Seventh Report on Walker Guidelines & Conformity

This seventh annual report from the Guidelines Monitoring Group (“GMG”), published in December 2014, discusses disclosure and transparency in private equity. The report made the following observations:

- Compliance levels have improved in portfolio companies;
- Portfolio disclosure has improved with regard to strategy, the market, and risk assessments, however disclosure around environmental and social matters was not as strong;
- No portfolio companies explained non-compliance, despite the Guidelines applying on the basis that the companies either comply, or explain non-compliance; and
- GMG is considering a consultation on the Guidelines in order to make the requirement to confirm compliance mandatory.

The report is available at:

http://walker-gmg.co.uk/sites/10051/files/141204_gmg_guidelines_final.pdf.

QCA 2014 Audit Committee Guide

The Quoted Companies Alliance (“QCA”) published its Audit Committee Guide for Small and Mid-Size Quoted Companies on 5 November 2014, replacing the 2009 edition. The 2014 edition reflects market best practice

Main amendments from the 2009 edition are the following:

- A strong relationship between the audit committee, the board and third party auditors is emphasised. The 2014 edition includes a table detailing factors that help to indicate how well the audit committee is performing;

- Attention is drawn to the FRC's new Guidance on Risk Management, Internal Control and Related Financial and Business Reporting regarding performance of the audit committee and identification of systemic risk;
- The guidance has been expanded concerning the responsibilities of audit committee members, who are now expected to have more clearly delineated roles;
- Recommended practice guidance on anti-bribery and anti-corruption measures has been added;
- The order in which matters are discussed now reflects the audit committee's annual cycle;
- Agenda items for meetings are included in Annex A – whereas the 2009 edition suggested three meetings every year, the 2014 edition suggests four.

The Audit Committee Guide of QCA is available at:

<http://www.theqca.com/shop/guides/>.

Progress Report on the Kay Review

On 27 October 2014, BIS published a progress report on the Kay review. The key points contained in the report include the following:

- BIS will publish a consultation on how best to increase shareholder engagement;
- The remuneration policy requirements for directors developed by BIS will remain under review, and the implemented changes and their results will be reported on in the near future;
- A review of the platform for holding securities electronically will be undertaken as part of the government's implementation of the EU Central Securities Depositories Regulation;
- BIS agrees with the Takeover Panels' advice that there is no need for additional legal sanctions to enable the Panel to police its proposals with regards to post-offer undertakings and post-offer intention statements; and
- BIS has decided not to act to reduce short-term shareholders' roles during the bid process.

The progress report is available at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/367070/bis-14-1157-implementation-of-the-kay-review-progress-report.pdf.

Investor Forum Launched to Promote Long Term Investment

As originally recommended by the Kay Review, a new Investor Forum was established in October 2014, following specific recommendations from the Collective Engagement Working Group (established in connection with the Kay Review). The Forum has issued a discussion paper outlining its four main focus points, namely:

- Encouragement of debate around long-term investment strategies;
- Provision of advice to investors and boards;
- Collective engagement in circumstances in which shareholders feel a company is losing its competitive edge; and
- Protection of investor rights

The discussion paper is available at:

<http://www.investorforum.org.uk/#!discussion-paper/cm65>.

Corporate Reporting Review Published by FRC

On 14 October 2014, a total of 274 reports and accounts drawn up in the year end 31 March 2014 were reviewed for the purposes of this FRC report. The annual report gives a holistic view on the condition and quality of current reporting, especially noting the following:

- It appears that smaller companies display more deficiencies in both the structure and content of their published reports. The FRC has adopted a 3 year initiative focussing on these smaller companies, and aims to improve their standards of reporting.
- The FRC has frequently had to request confirmation or clarification regarding the following areas of corporate reporting: exceptional terms, critical judgements, principal risks and general policies of accounting.

Boards should bear the following in mind during the next season of reports:

- Providing feedback on the effects of certain new accounting standards;
- Improving the ways in which critical judgements, accounting policies and estimation uncertainties are reported; and
- Compliance with IFRS 13 in terms of intangible assets when contemplating an acquisition.

The annual report is available at:

<https://frc.org.uk>.

Statistics Show Marked Increase of Women on Boards

On 9 October 2014, BIS published statistics which show a growth in the numbers of women board members in the FTSE 100, showing positive progress towards the Davies Review target of 25% FTSE 100 board positions being held by women by 2015, as discussed in the April 2014 edition of this publication.

Female representation on FTSE 100 boards is now 22.8%, and on FTSE 250 boards it stands at 17.4%.

The BIS statistics are available at:

<https://www.gov.uk/government/news/business-must-keep-up-the-momentum-to-reach-25-women-on-boards-target-cable>.

Guidance on Retail Bond Prospectuses Published by the UKLA

In November 2014 the UKLA published guidance, in the form of a technical note, on drawing up retail bond prospectuses, with a view to the prospectuses being as accessible and as easily navigable as possible. The guidance does not apply to prospectuses relating to bonds that will be admitted to trading on a regulated market, and which have a denomination of at least €100,000, or less than €100,000 if the offer is made only to qualified investors.

Five things are emphasised as key in the guidelines:

- The language should be one that a retail investor can comprehend.

- Where the document relates to more than one type of security, this should be clearly stated, and parts of the prospectus dealing with each respective security should be delineated deliberately – an introductory summary is suggested.
- Where the prospectus outlines a structured product that is dependent on an underlying derivative, it must clearly explain how the two are linked, and how the value of one is affected by the other.
- FAQs are deemed useful but not mandatory.
- Prospectuses in which the securities are secured or subordinated, or in any way unusual, should be clear in specifying what kind of bondholder protections apply, and what kinds of features the bonds contain. Useful definitions and/or diagrams are encouraged.

The guidance is available at:

<http://www.fca.org.uk/static/documents/ukla/knowledge-base/tn-632-1-final.pdf>.

UKLA Publishes Ninth Bulletin for Primary Market Participants

In the 9th Primary Market Bulletin published on 27 November 2014, the FCA voices concern over lack of compliance with the Disclosure and Transparency Rules (“DTR”) 3 – there have been breaches of content and missed deadlines by transactions conducted by PDMRs – and LR 8.2 – there have been instances where issuers have failed to seek the guidance of a sponsor.

FCA is also requesting feedback on proposed changes to the current notes to three technical notes, namely:

- The ratification of circulars;
- Transactions by PDMRs; and
- Hostile takeovers (to remove references to premium listed issuers preparing a 28-day circular (relating to material changes in information relating to the offeror within 28 days of a hostile takeover becoming wholly unconditional), the requirement for which was removed on 1 October 2014).

The consultation period for these amendments closed on 12 January 2015. The Primary Market Bulletin No.9 is available at:

<http://fca.org.uk/static/documents/ukla/primary-market-bulletin-9.pdf>.

The UKLA draft technical note on ratification circulars is available at:

<http://www.fca.org.uk/static/documents/ukla/knowledge-base/tn-204-2.pdf>.

The UKLA draft technical note on transactions by PDMRs is available at:

<http://www.fca.org.uk/static/documents/ukla/knowledge-base/tn-540-2.pdf>.

The UKLA draft technical note on hostile takeovers is available at:

<http://www.fca.org.uk/static/documents/ukla/knowledge-base/tn-305-2.pdf>.

The eighth bulletin for primary market participants was covered in the October 2014 edition of this publication.

Transparency Directive Policy Statement: Response to Consultation on Interim Management Statements

Policy statement PS14/15 was published by the FCA on 7 November 2014 by way of response to its previous consultation. The consultation canvassed comments on the proposal to remove DTR 4.3, *i.e.* the requirement to publish interim management

statements (“IMS”). The requirement to publish an IMS was removed at an EU level in the November 2013 amendments to the Transparency Directive, and member states were given two years in which to implement this change.

The proposal has been adopted, and the relevant amendments became effective as of 7 November 2014.

The policy statement is available at:

<http://www.fca.org.uk/static/documents/policy-statements/ps14-15.pdf>.

Investment Management Association publishes Transaction Guidelines

The investment management association (“IMA”) has republished the Transaction Guidelines originally published under ABI. These guidelines address various facets of equity capital market transactions, and were re-issued on 10 November 2014.

The guidelines are in substantially the same form as those published by ABI, with the following exceptions:

- References to ABI have changed to IMA;
- The High Growth Sector of the main market replaces the High Growth Sector of AIM; and
- A paragraph detailing the IMA’s responsibility for the earlier published guidance has been added.

The Transaction Guidelines are available at:

<http://www.ivis.co.uk/media/10296/Transaction-Guidelines-November-2014-.pdf>.

FSMA 2000 (Market Abuse) Regulations 2014

The FSMA 200 (Market Abuse) Regulations 2014 are now published on legislation.gov. The Regulations came into force on 15 December 2014.

The Regulations amend:

- s.118(9) FSMA 2000; and
- s.118A(6) FSMA 2000,

and add a subsection 118(10) FSMA 2000.

These amendments operate to extend the expiry date of the market manipulation prohibition (s.118(8)), the related provisions in s.118A(2) and (3), and the definition of “regular user” (s.130A) until 3 July 2016.

This extension serves to provide continuity to the current market abuse regime, until the application of the new civil regime introduced by the Market Abuse Regulation (Regulation 596/2014).

The FSMA 200 (Market Abuse) Regulations 2014 are available at:

<http://www.legislation.gov.uk/uksi/2014/3081/contents/made>.

Chancellor's 2014 Autumn Statement

The Chancellor's Autumn statement was given on 3 December 2014. Relevant aspects include the following:

- The government plans to put in place legislation that will cause all returns through B share schemes to be taxed in the same way as dividends; and
- Section 641 of the Companies Act 2006 will be amended to prohibit the use of "reduction" or "cancellation" schemes of arrangement in company takeovers, (where a reduction of capital takes place as part of the scheme of arrangement (under which the bidder acquires the target) for the purposes of avoiding a stamp duty charge on the takeover).

The Autumn statement is available at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/382327/44695_Accessible.pdf.

Bank Recovery and Resolution (No.2) Order

The Bank Recovery and Resolution (No.2) Order was submitted to Parliament on 19 December 2014. This Order amends the provisions of the Companies Act 2006 relating to public takeovers and the powers of the Takeover Panel (in Part 28) so that the mandatory bid rules (see Rule 9 of the Takeover Code) do not apply in relation to any change in interest or shares, etc., arising as a result of the Bank of England's exercise of any of its "stabilisation" or "resolution" powers in respect of financial institutions.

On 5 January 2015, Rule 9 of the Takeover Code was amended to reflect the above.

The Order came into force on 10 January 2015. A copy of the Order is available at:

<http://www.legislation.gov.uk/uksi/2014/3348/contents/made>.

Transparency International Guidance on Countering Small Bribes

Transparency International has recently published guidance for companies entitled "Countering Small Bribes". The guidance aims to "help companies to address the significant challenge of countering small bribes, including facilitation payments". This reflects a common reality faced by many companies – that dealing with the risk of such bribes is one of the most challenging issues in countering bribery, as they are often difficult to detect and eliminate.

Under section 7 of the Bribery Act, a company can face liability for these types of small bribes paid overseas or in the UK by its employees or related third parties. However, a company has a defence if it has in place "adequate procedures" designed to prevent persons associated with it from committing bribery. The Transparency International guidance is therefore designed to help companies protect themselves by setting out "Ten Principles for Countering Small Bribes", as follows:

- There is a supporting culture of integrity;
- The company commits to eliminating small bribes;
- Risk assessment is the basis for designing the strategy and programme to eliminate small bribes;
- The company implements a programme to counter small bribes;
- Communication and training are provided to employees;
- Attention is given to countering third party risks;

- The internal accounting controls are designed specifically to counter small bribes;
- Appropriate actions are taken if small bribes are detected;
- The company monitors the effectiveness of its programme to counter small bribes; and
- The company acts strategically to influence the corruption environment in which it operates.

The Guidance can be found at:

<http://www.transparency.org.uk/corruption/resources/publications/15-publications/1096-counterung-small-bribes>.

US DEVELOPMENTS

SEC and NYSE Developments

Conflict Minerals Rules

On 18 November 2014, the United States Court of Appeals for the District of Columbia Circuit granted a petition filed by the US Securities and Exchange Commission (“SEC”) and Amnesty International for rehearing of a case that invalidated a portion of the SEC reporting requirements regarding conflict minerals originating in the Democratic Republic of the Congo and adjoining countries (the “Conflict Minerals Rule”). The court’s decision, once the case is reheard, could potentially affect the existing scope and application of the Conflict Minerals Rule. The Conflict Minerals Rule is set forth in Form SD – Specialized Disclosure Report, which is required under Rule 13p-1 under the Securities Exchange Act of 1934 (the “Exchange Act”).

Under the Conflict Minerals Rule, SEC reporting companies that manufacture products that contain tantalum, tin, tungsten or gold face specific reporting requirements. Conflict minerals disclosure for the year ended 31 December 2014 must be filed with the SEC on Form SD on or before 1 June 2015. Each SEC reporting company is required to make its Form SD available on its company website for one year.

Following a decision of the Court of Appeals in April 2014, which struck down a portion of the Conflict Minerals Rule, the SEC issued a statement clarifying that no company is required to describe its products as “DRC conflict free”, having “not been found to be “DRC conflict free”, or “DRC conflict undeterminable”. If a company voluntarily elects to describe any of its products as “DRC conflict free” in its Conflict Minerals Report, it would be permitted to do so provided it had obtained an independent private sector audit as required by the rule. Pending further action, such an independent private sector audit will not be required unless a company voluntarily elects to describe a product as “DRC conflict free” in its Conflict Minerals Report.

Subject to any further developments, companies should plan to prepare and file Form SD and, if required, a Conflict Minerals Report in the same manner as last year. However, now that the first year of Conflict Minerals Rule compliance is behind us, there is a universe of precedents that companies can use to benchmark their conflict minerals disclosure against peer companies and from which best practices can develop.

SEC Announces 2015 Examination Priorities for Financial Institutions

In January 2015, the SEC announced its Office of Compliance Inspections and Examinations’ priorities for 2015. The 2015 examination priorities address issues across a variety of financial institutions, including investment advisers, investment companies, broker-dealers, transfer agents, clearing agencies and national securities exchanges. The

examination priorities for 2015 focus on three areas: protecting retail investors, especially those saving for or in retirement; assessing market-wide risks; and using data analytics to identify signs of potential illegal activity.

The related SEC press release is available at:

<http://www.sec.gov/news/pressrelease/2015-3.html>.

Recent Trends and Patterns in the Enforcement of the Foreign Corrupt Practices Act ("FCPA")

In January 2015, 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.

The 2014 FCPA enforcement year has been interesting to say the least. While the US Department of Justice (the "DOJ") and SEC continue to prosecute individuals at a relatively steady pace, the big news concerns the government's pursuit of corporate defendants. With a surge of large corporate enforcement actions towards the end of the year, 2014 has generated the second highest corporate penalty total in history despite the fact that the total number of corporate enforcement actions has remained roughly the same as 2013. As a result, average corporate penalties continue to steadily increase, reaching their highest levels ever in 2014.

Among the highlights from 2014 are:

- a series of high profile enforcement actions have resulted in total corporate penalties of \$1,566 million, the second highest on record;
- average corporate fines and penalties of \$156.6 million – by all measures the highest average in history;
- the DOJ's prosecution of Alstom resulted in the largest FCPA-related criminal fine in history of \$772 million – well over the \$450 million criminal fine in Siemens;
- the DOJ's use of plea agreements and the SEC's use of administrative proceedings has increased over the use of deferred prosecution and non-prosecution agreements;
- the Eleventh Circuit issued its opinion in *United States v. Esquenazi*, largely supporting the government's view regarding the definition of "instrumentality" under the FCPA;
- recent paper victories by the SEC could be perceived as setbacks in the SEC's actions against individual defendants; and
- the SEC's 2014 enforcement actions reflect a number of concerning practices including the continued pursuit of a theory of strict liability against parent corporations for acts of corporate subsidiaries and an interpretation of the "obtaining or retaining business" element of FCPA that contradicts *United States v. Kay*.

Our January 2015 report is available at:

<http://www.shearman.com/en/newsinsights/publications/2015/01/fcpa-digest>.

Navigating Russia Sanctions: US, EU and Japan Update

On 10 November 2014, we published our client publication entitled *Navigating Russia Sanctions: US, EU and Japan Update*, which updates our previous note on the topic and highlights the key issues and differences in the US, EU and Japanese sanctions targeting Russia.

US, EU and Japanese sanctions targeting Russia are becoming increasingly aligned as a result of each jurisdiction's continued tailoring of sanctions targeting Russia. In each jurisdiction there are now laws which block funds being made available to certain individuals and entities close to the Russian political regime and, more recently, broader rules which aim to restrict Russia's finance, energy and defence sectors. Although the US, EU and Japanese rules are alike in a number of respects, they also diverge in many ways and may not give the same answer to a particular question. This is particularly relevant to international business, where the rules of more than one jurisdiction may be triggered.

Our related client publication is available at:

<http://www.shearman.com/en/newsinsights/publications/2014/11/navigating-russia-sanctions>.

Sanctions Round-Up

On 14 January 2015, we published the fourth quarter 2014 issue of our quarterly Sanctions Round-Up.

The fourth quarter of 2014 was marked by a major shift in the US approach to Cuban relations. While the parameters of the new relationship between the United States and Cuba have yet to be defined, President Obama has made a strong commitment to thawing relations between the two countries. In contrast, the United States and the European Union maintained strong sanctions against Russia, in an effort to resolve the crisis in Ukraine. Finally, as the P5+1 was unable to reach an agreement with Iran regarding its nuclear program by the November deadline, the United States and the EU have extended temporary sanctions relief until this summer.

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

- the United States and the EU continue sanctions against Russia for its activity in Ukraine;
- US and EU sanctions against the Crimea region;
- the United States makes major change in Cuban relations;
- the EU extends its sanctions programs for Syria;
- US enforcement actions;
- US sanctions target terrorists abroad; and
- OFAC sanctions target drug-trafficking operations in Central and South America.

Our Sanctions Round-Up: Fourth Quarter 2014 is available at:

<http://www.shearman.com/en/newsinsights/publications/2015/01/sanctions-round-up--fourth>.

New York Stock Exchange Publishes Corporate Governance Guide

In January 2015, the New York Stock Exchange (the "NYSE") published NYSE: Corporate Governance Guide in order to help listed companies navigate key corporate governance issues. NYSE: Corporate Governance Guide provides information on a variety of topics, including:

- navigating the changing landscape of corporate governance;
- selecting and developing a high-quality board;
- implementing risk-management controls;
- overseeing a succession plan for senior management;

- communicating effectively with shareholders; and
- assembling a comprehensive ethics and compliance program.

This guide also includes case studies from current sitting directors through the NYSE's Corporate Board Member magazine.

The NYSE: Corporate Governance Guide can be found at:

<https://www.nyse.com/cgguide>.

Noteworthy US Securities Law Litigation

United States v. Newman: Insider Trading Tippee Liability Requires Knowledge of Insider's Personal Benefit

On 10 December 2014, in a widely reported decision, a panel of the federal appellate court based in New York overturned the insider trading convictions of two hedge fund portfolio managers, including a Shearman & Sterling client. The court in *United States v. Newman* clarified an important legal issue by holding that a tippee (*i.e.*, recipient) of material non-public information cannot be liable for trading based on that information unless the tippee knows that the insider disclosed the information in exchange for a personal benefit.

Even before this ruling, the law was clear that a corporate insider's disclosure of material non-public information cannot be the basis for insider trading liability unless that individual received a personal benefit in exchange for the disclosure. The court here clarified "that a tippee's knowledge of the insider's breach necessarily requires knowledge that the insider disclosed confidential information in exchange for a personal benefit."

The court also rejected the government's argument that the "specificity, timing, and frequency" of the information that the defendants received were "so 'overwhelmingly suspicious'" that they must have known that insiders disclosed it in exchange for a personal benefit. Because the type of information at issue regularly comes from non-confidential sources, it cannot support such an inference.

As a separate basis for its conclusion, the court determined that the government failed to prove that the corporate insiders who disclosed the confidential information received any benefit in the first place. "[T]he mere fact of friendship, particularly of a casual or social nature," is not enough of a benefit because then "practically anything would qualify" as a personal benefit. Rather, information must be disclosed in "an exchange that is objective, consequential, and represents at least a potential[ly]" valuable gain.

This decision thus defines the type of benefit a tipper must receive in order for insider trading liability to arise. In addition, while the decision that a tippee must have knowledge of the tipper's benefit might have less of an impact on those who are closer to the original source of information, the court here noted that it had not "found a single case in which tippees as remote as [the defendants] have been held criminally liable for insider trading." If this decision is not altered by the pending appeals to the appellate court or a subsequent appeal to the United States Supreme Court, it will make it more difficult for the government to bring insider trading charges against tippees who are far removed from the original source of inside information. Although the decision is technically limited to the three states over which the appellate court has jurisdiction (including New York, where the largest number of insider trading prosecutions have been brought), it is likely to be influential elsewhere as well.

For more information on the *Newman* decision, please see our press release and CNBC's interview of our partner Stephen Fishbein at:

<http://www.shearman.com/en/newsinsights/news/2014/12/newman-insider-trading-conviction-overturned>.

In Re Omnicare, Inc. Securities Litigation: A Middle Ground on Corporate Scienter Under Section 10(b)

On 10 October 2014, in *In re Omnicare*, the federal appellate court based in Ohio announced a new standard for pleading that a corporation had the requisite level of intent for securities fraud under Section 10(b) of the Exchange Act. Another case involving Omnicare is pending before the United States Supreme Court concerning whether a speaker's state of mind is relevant under a different securities law that does not generally require intent. This case, however, dealt with Section 10(b), which requires a plaintiff to show scienter (*i.e.*, intent). In setting out a new standard for pleading corporate scienter, the court acknowledged a divergence among the federal appellate courts around the country on this issue.

The plaintiff claimed that Omnicare, a health care company, made material misstatements and omissions by affirming legal compliance even though internal audits revealed problems with its billing practices. The court's decision turned on whether the plaintiff had sufficiently pleaded that the corporation knew that these statements were false. The court first explained that some appellate courts around the country hold, under the respondeat superior theory of corporate intent, that a corporation's state of mind can be shown only through the knowledge of the individuals involved in making the statement at issue, but not through the "collective knowledge of all of the corporation's officers and employees." But other appellate courts have suggested that, at least in certain situations, collective scienter may be inferred based on the significance of the misstatements at issue.

The court here explained that a middle ground is necessary. Focusing on only the individuals involved in making the statements at issue risks encouraging corporations to shield key individuals from learning relevant information. On the other hand, a pure collective-knowledge approach could unfairly hold a company liable even if the only person with knowledge is a low-level employee far removed from the statements at issue. The court thus attempted to strike a balance between these approaches by holding that the state of mind of individuals connected to a misrepresentation, as well as of sufficiently senior employees or directors who at least tolerated or recklessly disregarded the misrepresentation, are all relevant to, but not determinative of, the corporation's intent. Applying this standard, the court held that while the auditor's knowledge could be imputed to the corporation, that was still not sufficient because the totality of the circumstances did not support the inference that the corporation "acted to defraud the public."

The test enunciated in *In re Omnicare* is very fact-dependent. In addition, the court's decision here leaves substantial uncertainty as to what a plaintiff must plead to show corporate scienter under Section 10(b), both within this court's jurisdiction and throughout the country. As a result, the applicable standard for corporate scienter could depend on the jurisdiction where the case is litigated.

In Re NVIDIA Corporation Securities Litigation and Fjarde AP-Fonden v. Morgan Stanley: Conflicting Decisions About the Scope of Section 10(b)'s Duty to Disclose

Two federal appellate courts have recently issued conflicting decisions about whether the duty to disclose information under Section 10(b) of the Exchange Act is narrower than the disclosure duty under the SEC's rule requiring the disclosure of certain types of information. The federal appellate court based in California held on 2 October 2014 in *In re NVIDIA Corporation Securities Litigation* that the duty to disclose under Section 10(b) is narrower than the SEC's disclosure requirement, known as Item 303. But on 12 January 2015, in *Fjarde AP-Fonden v. Morgan Stanley*, the federal appellate court based in New York held the opposite as to statements made in quarterly Forms 10-Q (which are filed by US issuers).

In *In re NVIDIA*, the plaintiffs claimed that the defendant semiconductor company improperly delayed disclosure of problems with its computer chips. The court explained the well-known rule set forth by the United States Supreme Court that “silence, absent a duty to disclose, is not misleading” under Section 10(b). Disclosure is required, said the appellate court, only when necessary to make affirmative statements not misleading. The court concluded that Item 303’s disclosure requirement is broader than Section 10(b)’s duty to disclose because Item 303 requires the disclosure of forward-looking information (such as the potential impact of problems with the company’s products) that might not be considered material under Section 10(b), depending on its level of significance. In addition, the court in *In re NVIDIA* distinguished cases holding that a failure to comply with Item 303 is a basis for liability under the Securities Act of 1933 because that law imposes more demanding disclosure duties for offering documents, does not contain Section 10(b)’s scienter (*i.e.*, intent) requirement and is subject to a lower pleading standard.

The court in *Fjarde AP-Fonden*, however, reached the opposite conclusion in a case dealing with alleged omissions concerning Morgan Stanley’s financial exposure in 2007 to certain investments related to subprime residential mortgage-backed securities. In this case, the court explained that the “duty to disclose under Section 10(b) can derive from statutes or regulations that oblige a party to speak.” Based on this principle, the court held, noting its disagreement with the court in *In re NVIDIA*, that Item 303 creates a disclosure obligation for Form 10-Qs under Section 10(b) similar to the Securities Act’s disclosure obligations for offering documents under Section 12(a)(2) because Form 10-Qs, like offering documents, “are mandatory filings” and Item 303 disclosures are “required elements” of those filings.

While the court in *Fjarde AP-Fonden* expressly disagreed with the court’s holding in *In re NVIDIA* concerning the scope of the duty to disclose under Section 10(b), it is not clear how much practical impact this difference of opinion will have. The court in *Fjarde AP-Fonden* went on to acknowledge (as the court in *In re NVIDIA* explained) that the materiality standard is broader under Item 303 than it is under Section 10(b) and a plaintiff must still plead under Section 10(b) that the omitted information meets this more demanding test for materiality. Moreover, both courts ultimately affirmed the district court’s dismissal because the plaintiffs in each case failed to allege that the companies acted with scienter. Lastly, the court’s decision in *Fjarde AP-Fonden* specifically concerned quarterly Form 10-Qs, which the court explained are mandatory filings subject to Item 303’s disclosure requirements. The court in *Fjarde AP-Fonden* did not discuss whether it would agree with the *In re NVIDIA* court about the scope of the duty to disclose under Section 10(b) when dealing with a non-mandatory disclosure.

Recent SEC/DOJ Enforcement Matters

In the Matter of Layne Christensen: SEC Applies a Questionable Interpretation of the FCPA’s “Business Nexus Element”

On 27 October 2014, the Layne Christensen Company, a US corporation specialising in deep drilling for energy resources, entered into a \$5 million settlement with the SEC to resolve charges under the FCPA. The SEC based its charges on a very broad, and possibly overreaching, interpretation of the “business nexus element” of the FCPA’s anti-bribery provisions.

The SEC accused Layne Christensen of bribing officials in several African countries in order to receive reduced tax liability and customs duties worth approximately \$3.9 million. But a bribe under the FCPA must be paid “to assist the issuer in obtaining or retaining business.” The federal appellate court based in Louisiana, in *United-States v. Kay*, held in 2007 that bribes made to obtain a reduction in tax liability or customs duties do not automatically violate the FCPA. Rather, to satisfy the statute’s “business nexus element,” the government must offer proof that the increased profits were used to obtain or retain business.

Both the SEC and the DOJ, however, continue to charge defendants with FCPA violations without alleging how the proceeds of reduced liabilities or duties are connected to obtaining or retaining business. The SEC's actions in Layne Christensen are an example of this trend. The 2012 FCPA Guide produced by the DOJ and the SEC even states that "bribe payments made to secure favourable tax treatment [or] to reduce or eliminate customs duties . . . satisfy the [FCPA's] business [nexus] test."

For more information on *Layne Christensen*, please see our client note at:

<http://www.shearman.com/en/newsinsights/publications/2014/11/sec-settlement-with-layne-christensen>.

Executive Compensation & Employee Benefits Developments

ISS and Glass Lewis Publish 2015 Proxy Voting Guideline Updates

On 6 November 2014, Institutional Shareholder Services Inc. ("ISS") and Glass Lewis & Co. ("Glass Lewis") released their respective 2015 updates to their proxy voting policies. The 2015 policies generally will be effective for shareholder meetings of publicly traded companies held during the 2015 proxy season. The proxy requirements for which the ISS and Glass Lewis policies have been developed do not apply to foreign private issuers.

ISS 2015 Updates

As was the case in 2014, ISS has not adopted sweeping changes to its 2015 policies; however, the proposed modifications reflect movement away from rigid policies towards a more flexible, holistic approach. The ISS updates are in the following areas:

- Management Equity Compensation Plan Proposals
 - Under its 2014 policies, ISS used a series of six "pass/fail" tests to evaluate equity plan proposals. For 2015, ISS has adopted a more nuanced approach to evaluate proposals for stock option plans, restricted stock plans, omnibus stock plans and stock-settled stock appreciation rights plans for employees, which will consider a range of positive and negative factors related to plan features and historical grant practices. This is referred to as the Equity Plan Scorecard ("EPSC"). ISS issued frequently asked questions ("FAQs") on the EPSC on 22 December 2014. As described in the FAQs, the EPSC evaluates the following three pillars:
 - Plan Cost: This pillar considers the total potential cost to a company's shareholders of an equity plan relative to plan costs associated with the sponsoring company's industry or market peers. Cost is measured using ISS's proprietary Shareholder Value Transfer ("SVT") model. SVT represents the estimated cost of shares issued under a company's equity incentive plans, taking into account full value shares and stock options, if applicable. ISS's model measures SVT relative to two benchmarks: (1) new shares requested, combined with shares remaining for future grants and outstanding unvested/unexercised grants and (2) only new shares requested plus shares remaining for future grants. The relationship of these two SVT measures is weighed against the company's benchmark SVT, as determined by ISS using the company's GICS industry group, market cap size and operational and financial metrics that ISS identified as correlated with total shareholder return ("TSR") performance in the industry.
 - Plan Features: The Plan Features pillar considers the following factors, the presence of which may have a negative impact on the EPSC score, depending on the company's size and circumstances: (1) automatic single-triggered award vesting upon a change in control; (2) broad discretionary

- For 2015, ISS has added new governance, board leadership and performance factors to the list of criteria considered when evaluating shareholder proposals for independent chairs, including (1) absence/presence of an executive chair; (2) recent board and executive leadership transitions at the company; (3) director and CEO tenure; and (4) a longer (five year) TSR performance period.
- ISS's new policy is to vote "For" shareholder proposals requiring that the chairman's position be filled by an independent director, taking into consideration (1) the scope of the proposal; (2) the company's current board leadership structure; (3) the company's governance structure and practices; and (4) any other relevant factors that may be applicable.
- As noted above, ISS has adopted a more holistic approach in evaluating these types of proposals. Therefore, a "For" or "Against" recommendation will not be determined by any single factor. Rather, ISS will consider all positive and negative aspects of the company based on the new expanded list of factors when assessing these shareholder proposals.
- **Litigation Rights**
 - For 2015, ISS has expanded its policy on exclusive venue provisions to cover other types of bylaws that have a material impact on shareholders' litigation rights, including bylaws that mandate fee-shifting or arbitration. ISS will evaluate these bylaws on a case-by-case basis, taking into account factors such as (1) the company's stated rationale for adopting such a provision; (2) disclosure of past harm from shareholder lawsuits in which plaintiffs were unsuccessful or shareholder lawsuits outside the jurisdiction of incorporation; (3) the breadth of application of the bylaw, including the types of lawsuits to which it would apply and the definition of key terms; and (4) governance features such as shareholders' ability to repeal the provision at a later date (including the vote standard applied when shareholders attempt to amend the bylaws) and their ability to hold directors accountable through annual director elections and a majority vote standard in uncontested elections.
- **Political Contributions**
 - ISS has refined its policies relating to political contributions shareholder proposals. ISS will vote for proposals requesting greater disclosure of a company's political contributions and trade association spending policies and activities, considering (1) the company's policies and management and board oversight related to its direct political contributions and payments to trade associations or other groups that may be used for political purposes; (2) the company's disclosure regarding its support of, and participation in, trade associations or other groups that may make political contributions; and (3) recent significant controversies, fines or litigation related to the company's political contributions or political activities.
 - When reviewing disclosures of trade association support or participation, ISS will look at the comprehensiveness of a company's trade association membership disclosure, the nature of a company's trade association participation, the level of transparency provided regarding a company's trade association expenditures and other relevant factors.
- **Greenhouse Gas Emissions**
 - ISS noted that during the 2014 proxy season, the most prevalent resolutions on climate change requested companies to adopt goals to reduce their greenhouse gas emissions ("GHG"). In this regard, ISS has updated its policies to provide greater clarity on the factors that are considered in its analysis of GHG-related proposals. Under the 2015 policy, ISS will make recommendations on a case-by-case basis on proposals that call for the adoption of GHG reduction goals from products and operations, taking into account the following considerations: (1) whether the company provides disclosure of year-over-year GHG emissions performance

data; (2) whether company disclosure lags behind industry peers; (3) the company's actual GHG emissions performance; (4) the company's current GHG emission policies, oversight mechanisms and related initiatives; and (5) whether the company has been the subject of recent, significant violations, fines, litigation or controversy related to GHG emissions.

Glass Lewis 2015 Updates

The Glass Lewis updates for the 2015 proxy season do not provide for sweeping changes to prior policies, but instead generally attempt to clarify Glass Lewis's policies. The Glass Lewis 2015 updates are in the following areas:

- **Governance Committee Performance**
 - Glass Lewis adopted a new policy regarding instances where the board of directors, without seeking shareholder approval, has amended the company's governing documents to reduce, remove or otherwise impede the ability of shareholders to exercise shareholder rights that Glass Lewis deems important (e.g., the elimination of the ability of shareholders to call a special meeting or to act by written consent, an increase to the ownership threshold required for shareholders to call a special meeting or the adoption of a classified board structure). In these instances, Glass Lewis may recommend "Against" the chairman of the governance committee or the entire committee.
- **Board Responsiveness to Majority-Approved Shareholder Proposals**
 - Under its 2014 policies, Glass Lewis would recommend "Against" all members of the governance committee during whose tenure a shareholder proposal relating to shareholder rights that Glass Lewis deems important received support from a majority of the votes cast if the board has not begun to implement or enact the proposal's subject matter.
 - In its 2015 policies, Glass Lewis applies a more nuanced approach to evaluating the adequacy of a board's response to these types of proposals. Glass Lewis will not only consider whether the board has enacted the proposal's subject matter, but it will now examine the quality of the right enacted or proffered for any conditions that may unreasonably interfere with a shareholder's ability to actually exercise the right (e.g., overly restrictive procedural requirements).
- **Vote Recommendations Following an IPO**
 - While Glass Lewis generally refrains from issuing voting recommendations on the basis of most corporate governance best practices during the one-year period following an IPO, its 2015 policies provide for increased scrutiny of certain provisions. These include anti-takeover provisions adopted in a company's charter or bylaws prior to an IPO that are not later put up for a shareholder vote following the IPO. The 2015 policies specifically provide that the adoption of an anti-takeover provision and the adoption of an exclusive forum provision or fee shifting bylaw warrant strong shareholder action against the board of a company that completed an IPO within the past year.
- **"Material" Transactions with Directors**
 - In the context of determining director independence, Glass Lewis deems a "material" relationship to exist between the company and a director where such director is employed by a professional services firm (such as a law firm, investment bank or consulting firm) and the company has paid such firm \$120,000 or more during the past three or five years, depending on the specific circumstances. For this category of "material" relationships, Glass Lewis has clarified in its 2015 policies that it may deem such a transaction to be

immaterial where (1) the amount represents less than 1% of the firm's annual revenues and (2) the board provides a compelling rationale as to why the director's independence is not affected by the relationship.

- Advisory Vote on Executive Compensation (“say-on-pay”)
 - Glass Lewis applies a highly nuanced approach when evaluating say-on-pay proposals. This approach is less formulaic than the methodology used by ISS, allowing for more flexibility (and potentially, unpredictability). Glass Lewis reviews executive compensation on a case-by-case basis based on the company's industry, size, maturity, performance, financial condition, historic pay-for-performance practices and any other relevant internal or external factors.
 - Under its 2014 policies, Glass Lewis reviewed say-on-pay proposals on both a qualitative and quantitative basis, focusing on (1) overall design and structure of the company's executive compensation program, including the selection and challenging nature of performance metrics; (2) the quality and content of the company's disclosure; (3) the quantum paid to executives; and (4) the link between compensation and performance as indicated by the company's current and past pay-for-performance grades.
 - The 2015 policies add a fifth factor: the implementation and effectiveness of the company's executive compensation programs, including pay mix and use of performance metrics in determining pay levels.
 - Glass Lewis will recommend “Against” a say-on-pay proposal if it finds deficiencies in the design, implementation or management of a company's compensation program, including (1) a pattern of poor pay-for-performance practices, (2) unclear disclosures regarding the overall compensation structure, (3) questionable adjustments to certain aspects of the overall compensation structure or (4) other egregious compensation practices.
 - Glass Lewis's 2015 policies also include revised guidance on one-off compensation awards granted outside of a company's standard incentive scheme, clawback policies and compensation consultant independence.
- Employee Stock Purchase Plans
 - The 2015 policies add a description of Glass Lewis's approach to evaluating proposals to adopt or amend employee stock purchase plans (“ESPPs”). Previously, Glass Lewis did not disclose its approach to ESPPs. For 2015, Glass Lewis maintains a quantitative model that estimates the cost of an ESPP by measuring the expected discount, purchase period, expected purchase activity and whether the ESPP has a “lookback” feature (e.g., the plan bases the purchase price on the stock price at either the beginning or end of the purchase period, whichever is lower). The model compares this data to ESPPs at similar companies. Glass Lewis will also analyse the potential shareholder dilution and whether shareholders will not have a chance to approve the program for an excessive period of time. In addition, ESPPs that contain evergreen provisions (that automatically increase the number of shares available under the ESPP each year) will generally receive a negative recommendation.

Our client publication discussing ISS's updates to its proxy voting guidelines is available at:

<http://www.shearman.com/en/newsinsights/publications/2014/11/iss-publishes-2015-proxy-voting-guideline-updates>.

Our client publication discussing ISS's frequently asked questions regarding its EPSC program is available at:

<http://www.shearman.com/en/newsinsights/publications/2015/01/iss-publishes-faqs-on-equity-plan-scorecard>.

Our client publication discussing Glass Lewis's updates to its proxy voting guidelines is available at:

<http://www.shearman.com/en/newsinsights/publications/2014/11/2015-proxy-paper-guidelines>.

ASIAN DEVELOPMENTS

Japan Releases Exposure Draft of New Corporate Governance Code

On 12 December 2014, Japan's Financial Services Agency released and solicited comments on an exposure draft of a new corporate governance code to be made applicable to listed companies in Japan. The draft was prepared by a cabinet-appointed council of experts, with the Financial Services Agency and the Tokyo Stock Exchange serving as joint secretariat.

The draft code will be of significant interest to current and prospective investors in Japanese listed companies. The draft code enumerates principles of governance with respect to which each listed company must either comply or explain its non-compliance. These principles include significant new additions, including recommendations that each listed company appoint at least two independent outside directors and obtain the appropriate participation and advice of the independent directors in respect of important decisions where the independence and objectivity of the board is of great importance, such as the selection and compensation of management or board nominees. The draft code also recommends training for all directors and statutory auditors, ongoing updates and training for continuing board members and evaluation of directors and the board as a whole.

The draft code is open for comment until 31 January 2015 and is available at:

<http://www.fsa.go.jp/en/refer/councils/corporategovernance/20141226-1.html>.

Launch of Shanghai-Hong Kong Stock Connect

On 17 November 2014, Shanghai-Hong Kong Stock Connect (the "Stock Connect"), a pilot programme for establishing stock market trading links between Shanghai and Hong Kong, was launched following its in-principle approval by the China Securities Regulatory Commission ("CSRC") and the Securities and Futures Commission of Hong Kong ("SFC") on 10 April 2014. The programme marks an important two-way opening up of the Shanghai and Hong Kong capital markets. Further, it aims to enhance the competitiveness of Shanghai and Hong Kong and paves the way to internationalization of RMB.

The Stock Connect comprises a Northbound Trading Link and a Southbound Trading Link. For the first time, Hong Kong and overseas investors may trade shares listed on a Mainland exchange, while Mainland investors are allowed to trade foreign-listed shares. Some of the key features of the programme are set out below:

Trading Links and Clearing Links

The Stock Connect is jointly operated by the Shanghai Stock Exchange ("SSE"), The Stock Exchange of Hong Kong Limited ("SEHK"), China Securities Depository and Clearing Corporation Limited ("ChinaClear") and Hong Kong Securities Clearing Company Limited ("HKSCC") under a four-party agreement signed on 4 September 2014. Pursuant to the agreement:

- SSE and SEHK will provide mutual order-routing connectivity and related technical infrastructure to enable investors in their respective markets to trade shares listed on the other's market; and
- ChinaClear and HKSCC will provide arrangements for the clearing and settlement of trades and the provision of depository, nominee and other related services to investors in Mainland China and Hong Kong.

Applicable Trading, Clearing and Listing Rules

Listed issuers in Shanghai and Hong Kong will continue to be subject only to the listing and other rules and regulations of the market where their shares are listed. Trading and clearing arrangements will also be subject to the regulations and operational rules of the market where trading and clearing take place.

Eligible Shares

Only eligible shares are accepted for trading through the Stock Connect:

	Northbound Trading Link	Southbound Trading Link
Eligible shares	<ul style="list-style-type: none"> ▪ Constituent stocks of SSE 180 Index ▪ Constituent stocks of SSE 380 Index ▪ SSE-listed A shares which have corresponding shares listed on SEHK 	<ul style="list-style-type: none"> ▪ Constituent stocks of Hang Seng Composite LargeCap Index ▪ Constituent stocks of Hang Seng Composite MidCap Index ▪ SEHK-listed H shares which have corresponding shares listed on SSE
Exceptions	<ul style="list-style-type: none"> ▪ SSE-listed shares which are not traded in RMB ▪ SSE-listed shares under “risk alert” 	<ul style="list-style-type: none"> ▪ SEHK-listed shares that are not traded in Hong Kong dollars ▪ H shares which have corresponding shares traded on any exchange in Mainland China other than SSE

As at 31 December 2014, a total of 273 SEHK-listed shares were eligible for trading through the Southbound Trading Link and a total of 569 SSE-listed shares were eligible for trading through the Northbound Trading Link.

Investor Eligibility

Northbound trading of SSE-listed shares is open to all Hong Kong and overseas investors including institutional and individual investors. For Southbound trading, only institutional investors and those individual investors who hold an aggregate balance of not less than RMB 500,000 in their securities and cash accounts will be accepted for Southbound trading.

Quotas

As a pilot programme, quota controls have been set up for the initial phase of operation of the Stock Connect:

	Maximum cross-boundary investment quota	Daily quota
Northbound Trading Link	RMB 300 billion	RMB 13 billion
Southbound Trading Link	RMB 250 billion	RMB 10.5 billion

The above quotas are applied on a “net buy” basis. Under this principle, no new buy orders will be accepted once the quota is used up but investors will always be allowed to sell their shares regardless of the quota balance.

Currencies

Hong Kong and overseas investors will trade and settle SSE-listed shares in RMB only. Mainland investors will trade SEHK-listed shares quoted in Hong Kong dollars only and settle the trades with ChinaClear or its clearing participants in RMB.

Enforcement Cooperation

The CSRC and the SFC have strengthened their cross-boundary cooperation regarding any misconduct in connection with trades under the Stock Connect. On 17 October 2014, the CSRC and the SFC signed a “Memorandum of Understanding between the CSRC and the SFC on Strengthening of Regulatory and Enforcement Cooperation under Shanghai-Hong Kong Stock Connect” which sets out enhanced cooperation arrangements on identification, notification and investigation of cross-boundary market misconduct, including disclosure of misleading information, insider dealing, market manipulation and other fraudulent activities.

According to statistics released by SEHK, the average daily turnover in Northbound trading was RMB 5.84 billion and the average daily turnover in Southbound trading was RMB 757 million for the first 20 trading days from 17 November 2014. On average, 25.3% of the Northbound daily quota and 4.5% of the Southbound daily quota were used during the same period. While some market participants have commented that the trading volumes have failed to live up to market expectation, the Stock Connect represents a major move in the opening up of capital markets in China. The infrastructure linking the two markets is likely to add momentum to the long-term development of the Hong Kong capital market, and increase the attractiveness of Hong Kong as a listing venue of choice for international companies targeting the Mainland market.

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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