SHEARMAN & STERLING LLP

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

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EU DEVELOPMENTS

Reform of Market Abuse Regime

As part of the ongoing review of the Market Abuse Regime, the Cyprus EU Council Presidency has published a new compromise text for the Market Abuse Regulation ("MAR"), which deals with insider dealing and market manipulation.

- We reported on the review of the Market Abuse Regime, which comprises MAR and a proposed new directive, in our April 2012 Newsletter.

The new compromise text is available at: http://register.consilium.europa.eu/pdf/en/12/st13/st13313.en12.pdf.

Update on MiFID Reform

As part of the ongoing reform of the Markets in Financial Instruments Directive ("MiFID"), the Cyprus EU Council Presidency has published new compromise texts for each of the proposed regulation (known as "MiFIR") and the proposed directive ("MiFID II").

The changes to the proposals are substantive and identified with bold underlined text.

The new compromise text of MIFIR is available at: http://register.consilium.europa.eu/pdf/en/12/st13/st13287.en12.pdf.

The new compromise text of MIFID II is available at: http://register.consilium.europa.eu/pdf/en/12/st13/st13286.en12.pdf.

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

Remuneration Policies and Practices under MiFID

On 17 September 2012, the European Securities and Markets Authority ("ESMA") published a consultation paper on proposed guidelines on remuneration policies and practices under MiFID.

The guidelines aim to strengthen investor protection, by seeking to improve the implementation of the existing MiFID conflicts of interest requirements, and thereby preventing mis-selling of products.

The guidelines will apply to investment firms, credit institutions, fund management companies when providing investment services, and to competent authorities. Firms must ensure that they have appropriate remuneration policies and practices in place, bearing in mind the obligation on firms to act honestly, fairly and professionally in the best interests of their clients.

For the purpose of the guidelines, remuneration consists of all forms of payments or benefits, provided directly or indirectly, by firms to relevant persons involved in the provision of investment and ancillary services. This focus of the guidelines is on the remuneration of all staff in the provision of investment and/or ancillary services, in particular, staff who can have a material impact on the service provided, on the conduct of business risk profile, and who can influence corporate behaviour. This includes:

- client-facing front-line staff;
- sales force staff, and/or;
- other staff indirectly involved in the provision of investment services whose remuneration may create inappropriate incentives to act against the best interests of their clients.

The guidelines focus on:

- the governance and design of remuneration policies and practices in the context of the MiFID conduct of business and conflicts of interest requirements;
- the control of any risks that remuneration policies and practices create; and
- examples of good and poor practices.

Comments on the consultation paper are due on 7 December 2012. ESMA expects to publish a final report, and final guidelines, by the second quarter of 2013.

ESMA's consultation paper is available at: http://www.esma.europa.eu/consultation/Consultation-Guidelines-remuneration-policies-and-practices-MiFID.

Prospectus Regulation: Updated ESMA Q&A

On 23 July 2012 and 28 September 2012, ESMA published the 16th and 17th versions of its Prospectuses: Questions and Answers. The Q&A's were first published in July 2006 and have been updated numerous times. The updates are intended to give market participants responses to common questions on the Prospectus Directive and the Prospectus Regulation.

The new 17th version includes the insertion of a new question 82 regarding summaries in relation to proportionate disclosure regimes. ESMA notes that Article 24 and Annex XXII of the Prospectus Regulation as amended by the European Commission Delegated Regulation 486/2012, which determines the disclosure requirements in summaries, contain no explicit reference to the proportionate schedules set out in Annexes XXIII to XXIX. ESMA states that in its view there was no intention to exclude the proportionate disclosure regime from the requirements for summaries, and that European Commission Services confirms the view. ESMA expects Annex XXII regarding disclosure requirements in summaries should also be applicable to issuers, offerors or the persons asking for admission, using proportionate disclosure regimes, and that elements in Annex XXII not required by the relevant proportionate schedules could be left out in the summary of a prospectus which complies with the proportionate disclosure regime.

The 16th version added question 81 (the consent given in "retail cascades") and deleted question 56 (retail cascade offers).

The 17th updated edition of ESMA's Prospectuses: Questions and Answers is available at: http://www.esma.europa.eu/page/prospectus.

In our July 2012 Newsletter, we also reported on the European Commission's publication of a draft Delegated Regulation to amend the Prospectus

Regulation (809/2004/EC) as regards the consent to use of the prospectus by financial intermediaries, information on underlying indices and the requirement for an independent accountant or auditor report in relation to profit forecasts and estimates. The draft Delegated Regulation was due to come into force on 1 July 2012; it was, however, not published in the Official Journal until 22 September 2012 and so has only taken effect as from that date.

Takeover Directive: EC Review

On 28 June 2012, the European Commission published a review on the application of the Takeover Directive (2004/25/EC)(the "Directive") on takeover bids in accordance with Article 20 of the Directive. The Directive contains minimum guidelines for the conduct of takeover bids, including disclosure, involving securities with voting rights of companies governed by member states, where all or some of these shares are admitted to trading on a regulated market.

Following the external study on the application of the Directive conducted on behalf of the European Commission, the review considers that generally, the regime created by the Directive is working satisfactorily. However, there are areas where the rules of the Directive could merit some clarification in order to improve legal certainty for the parties concerned and the effective exercise of (minority) shareholder rights.

The European Commission proposes to clarify the concept of "acting in concert," in order to provide legal certainty to international investors as to the extent to which they can cooperate with each other without being regarded as "acting in concert" with the risk of having to launch a mandatory bid. Clarification could come in the form of guidelines from the European Commission and/or ESMA and the European Commission plans to announce what measures it intends to take in this area in October 2012.

The European Commission intends to carry out further investigations on how minority shareholders are protected when a national derogation to the mandatory bid rule applies. If, following the investigation, the protection of minority shareholders proves to be inadequate, the European Commission will take the necessary steps (e.g., through infringement procedures) to restore the effective application of this general principle of the Directive.

The European Commission will also take the appropriate steps, such as bilateral discussions with concerned member states or through commission recommendations, to discourage the use of a technique, whereby offerors can get around the mandatory bid rule, by acquiring a stake close to the mandatory bid threshold and then launching a voluntary bid for a low price.

The European Commission will additionally pursue dialogue with employee representatives with a view to possible future improvements in how the rights of employees are protected in a takeover situation. It will also investigate further the experience with provisions that require disclosure of the offeror's intentions on the future business of the company and its employment conditions, and the view of the offeree's board, as well as disclosure concerning the financing of the bid and identity of the offeror.

Interested parties have been invited to submit their views on the review, which is available at: http://ec.europa.eu/internal_market/company/docs/takeoverbids/COM2012_347_en.pdf.

Disclosure Framework for Notes to Financial Statements

On 12 July 2012, the European Financial Reporting Advisory Group ("EFRAG"), the Autorité des Normes Comptables ("ANC") in France, and the Financial Reporting Council ("FRC") in the United Kingdom published a discussion paper 'Towards a Disclosure Framework for the Notes' that sets out key principles that are required for an effective disclosure framework with respect to financial statements.

The discussion paper lists five points that need to be considered when developing the framework:

- clarification of the purpose of the notes; this will determine what information should be included in the notes. The discussion paper proposes a definition of the notes stating that their purpose is to provide a relevant description of the items presented in the primary financial statements and of unrecognised arrangements, claims against and rights of the entity that exist at the reporting date;
- principles for identifying the information to be included in the notes;

- consideration of the form of disclosure requirements, i.e., detailed disclosure requirements that require specific items to be disclosed or more principle based requirements that require greater judgment and consideration of an entity's circumstances;
- strengthening of the materiality considerations so that the only information disclosed is what is necessary to an understanding of an entity's financial performance and position; and
- need to set out the key features of effective communication that deal with the way disclosures are organised and presented.

Comments on the discussion paper are requested by 31 December 2012. The discussion paper is available at: http://www.frc.org.uk/Our-Work/Publications.aspx?page=4.

Update on Central Securities Depositories

The Economic and Monetary Affairs Committee ("ECON") of the European Parliament has published a draft report (the "ECON Report") in July 2012 on the proposal for a regulation to govern Central Securities Depositaries ("CSD").

- The proposal was published by the European Commission on 7 March 2012 and is available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52012PC0073:EN:PDF.

The ECON Report makes several changes to the proposal:

- it highlights that market participants and ESMA should abide by the 12 April 2012 CPSS-IOSCO principles for financial market infrastructure when abiding by the CSD regulation;
- it suggests that ESMA should be responsible for the review of the cooperation between the competent authorities within the EU, ensuring that all relevant information concerning the European CSDs is exchanged;
- it proposes CSDs should be allowed to offer multiple account structures, including omnibus accounts and segregated accounts, as investors will then be able to choose the degree of segregation which they believe is appropriate for them; and
- it proposes a change, that if a CSD wants to provide banking services, it would have to establish a separate legal entity to do so. As it stands, the current proposal allows CSDs to derogate from the obligation to separate banking services ancillary to settlement from core CSD services, provided that the CSD has received European Commission approval to do so.

The report is available at: http://www.europarl.europa.eu/sides/getDoc.do?type=COMPARL&reference=PE-492.931&format=PDF&language=EN&secondRef=01.

Short Selling and CDSs: EU Commission's Impact Assessment

The European Commission has published an impact assessment on the delegated act which was adopted on 5 July 2012. The delegated act details the rules on the ban on uncovered sovereign credit default swaps ("CDS") and short sales of shares and sovereign debt under the regulation on short selling and CDS.

The delegated act specifies the cases in which sovereign CDS are considered covered, and therefore not banned in accordance with the short selling regulation. The delegated act is part of a package of four implementing measures adopted by the European Commission to specify technical aspects of the short selling regulation.

The impact assessment is available at: http://ec.europa.eu/governance/impact/ia_carried_out/docs/ia_2012/swd_2012_0198_en.pdf.

The delegated act is available at: http://ec.europa.eu/governance/impact/ia_carried_out/docs/ia_2012/c_2012_4529_en.pdf.

Update on EMIR

The European Market Infrastructure Regulation ("EMIR") was published in the Official Journal as Regulation 648/2012 on 27 July 2012, and entered into force in the EU on 16 August 2012, with the clearing obligation expected to take effect by the end of the year.

Our related client publication is available at: http://www.shearman.com/files/Publication/31a1f6ab-c0cb-473c-889b-df9156ee35f9/Presentation/PublicationAttachment/b94ba4c9-438e-488a-83ea-37191afe83bf/OTC-

Derivatives-Regulation-and-Extraterritoriality-II-FIA-090512.pdf.

EMIR Draft Technical Standards

ESMA has published the final draft of its Level 2 technical standards for EMIR. These include a number of changes from the consultation standards, following comments from market participants during the two-stage consultation, in February and June 2012.

The key changes from the consultation paper include:

- definitions of the details of derivatives transactions that need to be reported to trade repositories, including the information to be provided to ESMA for the authorisation and supervision of trade repositories and the data to be made available to relevant authorities and the public. The calculation of non-hedging positions and thresholds have remained unchanged from the consultation paper, at EUR 1 billion to EUR 3 billion, depending on asset class; and
- counterparty risk is intended to be reduced through the setting of permitted risk mitigation techniques, such as timely confirmation, portfolio compression and reconciliation, for non-centrally cleared OTC derivatives.

The next stage is for the European Commission to decide whether to endorse the draft standards, and then they must be approved by the European Council and the European Parliament before entering into force.

The Level 2 standards are available at: http://www.esma.europa.eu/content/Draft-technical-standards-under-Regulation-EU-No-6482012-European-Parliament-and-Council-4-J.

ESMA Consultation on Amendments to CESR Recommendations for Mineral Companies

ESMA has launched a consultation on its proposals to amend paragraphs 131-133 of the 'CESR Recommendations on the consistent implementation of the Prospectus Regulation'. Paragraphs 131-133 govern the content of mineral company prospectus disclosure. The key proposals are:

- an exemption for debt prospectuses from the requirement to contain an expert's report on an issuer's reserves and resources (known as a Competent Persons Report or CPR);
- amendments to an exemption from CPR publication for equity issuers;
- further guidance on what constitutes a mineral company falling within the ambit of paragraphs 131-133; and
- to allow CPRs and annual reserves and resources reporting to be compiled in accordance with the Russian NAEN mining code.

Our related client publication is available at: http://www.shearman.com/esma-launches-consultation-on-amendments-to-cesr-recommendations-for-mineral-companies-10-05-2012/.

GERMAN DEVELOPMENTS

German Federal Constitutional Court Enables Germany to Ratify ESM Treaty

On 12 September 2012, the German Federal Constitutional Court (*Bundesverfassungsgericht*) cleared the way for Germany's accession to the European Stability Mechanism ("ESM"), the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (the "Fiscal Compact") and amendments to the Treaty on the Functioning of the European Union ("TFEU"). However, a condition to the ratification of the treaties is that any increase of Germany's overall liability under the ESM (threshold of EUR190 billion, based on Germany's share in the capital stock of the ESM) must have the further approval of the German parliament. Once again the German Federal Constitutional Court has reinforced the position of the German Federal Parliament (*Bundestag*) vis-à-vis the German Federal Government (*Bundesregierung*) in matters of European monetary and economic integration. The German Federal Constitutional Court did not examine the legality of unlimited government bond purchases by the European Central Bank in the secondary market. However, it is expected that it will address this question in the near future as part of related proceedings.

The German Federal Constitutional Court's decisions of 12 September 2012 as well as extracts from the decision in English (press release no. 67/2012 of 12 September 2012) are available at: http://www.bverfg.de.

German Government Publishes Draft High Frequency Trading Act

On 26 September 2012, German Federal Government approved draft legislation in the form of the Act for the Prevention of Risks and the Abuse of High Frequency Trading (*Entwurf eines Gesetzes zur Vermeidung von Gefahren und Missbräuchen im Hochfrequenzhandel*). The new draft legislation targets the specific risks in connection with computer based algorithmic high frequency trading at German trading venues. In particular, the draft bill would make high-frequency trades easier to track, require its traders to be more accountable and take steps to limit the negative consequences in case of a system failure.

Currently, in Germany there are no specific rules applying to high frequency traders and trading strategies ("HFT") nor, broadly, to algorithmic trading, despite the fact that algorithmic trading accounts for approximately 50 percent of the trading volume at Deutsche Börse. Over the last few years in Germany and elsewhere various instances of market glitches and disruptions have been blamed on HFT.

Some of these concerns are already addressed by the proposed reform of the Markets in Financial Instruments Directive (MiFID II), which introduces a licensing requirement for HFT firms and a specific regulatory framework for algorithmic trading activities. However, Germany is acting ahead of MiFID II. On 28 June 2012, the German Federal Government decided on certain cornerstones for new national legislation targeting HFT and the Ministry of Finance published a draft bill only one month later.

The German draft legislation plans to introduce, among others, the following: (i) a license requirement for HFT firms; (ii) supervision of HFT firms as financial services institutions under the German Banking Act (*Kreditwesengesetz*); (iii) specific organisational requirements for firms engaged in algorithmic trading; (iv) an adequate ratio between sale and purchase orders and executed transactions; and (v) increased enforcement powers of stock exchange supervisory authorities and the German Federal Financial Services Authority ("BaFin") vis-à-vis firms engaged in algorithmic trading, including a right to request further information on the algorithms and the trading strategies.

On 26 September 2012 the German Federal Government adopted the original discussion draft in a slightly amended form. Compared to the earlier discussion draft, the adopted draft (i) further expands the license requirement for firms using algorithms for trading at German trading venues; and (ii) introduces a new obligation to "earmark" every order generated by algorithms.

The new rules will now be discussed in both houses of parliament before they are approved and could be finalised and come into force as early as the end of this year.

The draft bill is available at:
http://www.bundesfinanzministerium.de/Content/DE/Downloads/Abt_7/2012-09-26-PM56-Hochfrequenzhandel.pdf?__blob=publicationFile&v=3.

Our related client publication is available at:
http://www.shearman.com/files/Uploads/Documents/Speed_limit_for_HFT.pdf.

BaFin Guidance on Short Selling

Regulation (EU) No 236/2012 on short selling and certain aspects of credit default swaps (EU Short Selling Regulation) will be applicable from 1 November 2012. As a consequence, the German rules concerning notification of market-making activities pursuant to the German Securities Trading Act (*Wertpapierhandelsgesetz*) in conjunction with the provisions of the Short-Selling Notification Regulation (*Leerverkaufs-Anzeigenverordnung – LanzV*), established in May 2010 by means of a BaFin regulation, will no longer be applicable after 31 October 2012. BaFin has published a Guidance Notice dealing with the form of the notification of intent for market-making activities and primary market operations under the EU Short Selling Regulation. The Guidance Notice provides information on how to deal with notifications under applicable national law that will coincide in time with the notifications of intent to be submitted pursuant to the EU Short Selling Regulation.

The Guidance Note is available at:
http://www.bafin.de/EN/Supervision/StockExchangesMarkets/ShortSelling/Exemptions/exemptionsfromtheban_node.html.

The German Implementing Act for EMIR

On 10 October 2012, the German Federal Government approved the draft implementation act for consultation regarding the regulations on OTC derivatives, central counterparties and trade repositories under EMIR. The Act is intended to implement the applicable provisions of the regulation in Germany, but modifies some of the measures of EMIR. It also contains rules on the supervision of the implementation by the Federal Financial Services Authority (BaFin) and regarding fines pursuant to the German Banking Act.

The draft bill is available at: http://www.bundesfinanzministerium.de/Content/DE/Gesetzestexte/Referentenentwuerfe/2012-09-11-diskussionsentwurf-des-EMIR-ausfuehrungsgesetzes.html.

The German Implementing Act for AIFMD

On 20 July 2012, the German Ministry of Finance (*Bundesfinanzministerium*) published a draft bill to implement the Directive on Alternative Investment Fund Managers (EU Directive 2011/61) ("AIFMD") into German law. Alternative Investment Funds ("AIF") are investment funds that do not constitute Undertakings for Collective Investment in Transferable Securities (UCITS) in the sense of Directive 2009/65/EG (UCITS Directive), e.g., closed-end funds, hedge funds, or special funds. The draft bill establishes a uniform set of rules for UCITS und AIF in the form of a Capital Investment Act, which will comprise the future legal framework for all investment funds. As a consequence of the implementation of the AIFMD, the current German Investment Act (*Investmentgesetz*) will be repealed.

The draft stipulates requirements for and the supervision over the managers of AIFs and aims at an exact adoption of the AIFMD into German law. However, on several points, the German Ministry of Finance has gone beyond the minimum requirements of the AIFMD and imposed a more stringent framework on the German investment fund sector than that stipulated by the AIFMD. For example, the AIFMD only provides for registration and reporting requirement for funds of small volume. According to the draft bill, the Capital Investment Act will also apply to these 'small' funds in full.

A considerable number of the existing types of investment funds under the current rules will be retained. However, changes will be made to open-ended special real estate funds (*Immobilien-Sondervermögen*) and infrastructure funds (*Infrastruktur-Sondervermögen*). According to the draft bill, both fund types will only be permitted as closed-end funds. Furthermore, employee participation funds (*Mitarbeiterbeteiligungs-Sondervermögen*) and old-age pension funds (*Altersvorsorge-Sondervermögen*) are being abolished entirely.

The draft bill is available at: http://www.bundesfinanzministerium.de/Content/DE/Gesetzestexte/Referentenentwuerfe/2012-07-20-aifm.html.

Revised BaFin Guidance on Minimum Requirements for Compliance in ISEs

On 31 August 2012, BaFin published a revised version of its Circular 4/2010 (WA) – Minimum requirements for the compliance function and additional rules of conduct, organisational and transparency obligations applicable to investment services enterprises ("ISEs") pursuant to Sec. 31 et seqq. of the German Securities Trading Act ("MaComp") (4/2010 (WA)). Among others, the revised Circular contains more stringent rules for documentation requirements relating to inducements from third parties pursuant to Section 31d Para. 1 S. 1 No. 1 of the German Securities Trading Act. ISEs have to implement and apply such changes for the financial year 2013.

The revised Circular is available at: http://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Rundschreiben/rs_1004_wa_macomp.html.

ITALIAN DEVELOPMENTS

New Rules on Issuance of Bonds by Non-Listed Companies

Law decree No. 83 of 22 June 2012, which introduced rules aimed at eliminating size restrictions and decreasing the tax cost of bond issuances by Italian non-listed companies, has been converted by the Italian Parliament into law No. 134 of 7 August 2012 ("Law 134"). Law 134 came into force on 12 August 2012 and, among others, established the following changes to the provisions of the law decree:

- the bonds issued by non-listed companies no longer need to be placed exclusively with "qualified investors" that are not (either directly or indirectly) shareholders of the issuer. However, the bonds still need to be subscribed only by non-shareholder qualified investors in order for the issuer to benefit from the new tax regime on deductibility of interest payments;
- the scope of the definition of "non-listed companies" has been clarified in that a company is considered to be "non-listed" if it is not an issuer of "equity financial instruments" listed on a regulated market or a multilateral trading facility; and
- the minimum maturity of subordinated and/or participating bonds that can be issued by non-listed companies has been decreased from 60 months to 36 months.

Our related client publication is available at: http://www.shearman.com/update--new-rules-opening-the-bond-market-to-italian-non-listed-companies-08-24-2012/.

UK DEVELOPMENTS

Short Selling Regulation Update

The UK's Financial Services Authority ("FSA") has provided advance notice of its approach to the transposition of the EU Short Selling Regulation (No 236/2012) in the UK in a special edition of its Market Watch newsletter.

While there is no need for domestic implementing legislation for the Regulation, various issues associated with implementation have been left to the discretion of member states

In particular, the newsletter discusses:

- the removal of the domestic short position disclosure regime;
- the penalties policy requirement;
- the FSA's approach to using temporary suspension powers;
- public disclosures of significant short positions;
- notifications to the FSA of short positions in shares and sovereign debt; and
- the market maker and authorised primary dealer exemption process.

The newsletter is available at: http://www.fsa.gov.uk/static/pubs/newsletters/mw_newsletter42.pdf.

Update on Regulatory Reform of the FSA

The Financial Services Bill provides for the creation of a new framework for financial regulation in the UK, including the split of the FSA into two new authorities, the Prudential Regulation Authority ("PRA") and the Financial Conduct Authority ("FCA") with effect from January 2013.

In this context, the FSA is undertaking work to help the PRA and FCA create their new rulebooks, which will come into effect when the new regulators acquire their legal powers, by splitting the existing FSA Handbook. In September 2012, the FSA issued a consultation paper that details a set of changes to existing regulatory rules and guidance that are required in light of the new regime introduced by the Financial Services Bill.

The key topics covered in the consultation paper are:

- the prescribed wording that firms must use to identify their regulator, e.g., 'authorised and regulated by the FCA';
- withdrawing the right for firms to use the FCA or PRA logos in communications;
- changes to the FCA and PRA's 'Skilled Persons' regime, namely:
  - extending the FCA's powers to allow Skilled Persons reports to be used for recognised investment exchanges;
  - giving the FCA and PRA the power to appoint and contract directly with the Skilled Person; and
  - new rules allowing the costs of a Skilled Person report to be payable as a fee by the firm concerned;
- changes to how firms apply to vary or cancel authorisations or permissions, or to vary or cancel requirements imposed by the regulator;
- changes to how firms will apply for waivers of rules or modifications of rules, including

submitting applications electronically, rather than via the current ONA system;

- changes to how firms must notify the PRA and/or FCA if they wish to exercise a right under an EU Directive to 'passport' out of the UK or into the UK; and
- changes to the explanation of the future roles of the FCA.

The Consultation Paper is available at: http://www.fsa.gov.uk/static/pubs/cp/cp12-24.pdf.

FRC Feedback on UK Corporate Governance Code and Stewardship Code

On 28 September 2012, the FRC published a feedback statement on the consultation published in April in relation to changes to the UK Corporate Governance Code and the FRC's Guidance on Audit Committees. It also published, on the same date, new editions of the UK Corporate Governance Code and Guidance on Audit Committees.

Amendments to the changes proposed in the April consultation include the following:

- In April, a key change was requesting FTSE 350 companies to put the external audit contract out to tender at least every 10 years with the aim of ensuring a high quality and effective audit, whether from the incumbent auditor or from a different firm. Minor changes have been made to the proposed wording of this change; in particular, the suggestion that tenders should be conducted on an open book basis has been replaced with a statement that all tendering firms should have such access as is necessary to information and individuals during the tendering process. The feedback noted that the transition arrangements put forward in the April consultation were largely supported; these arrangements are to ensure that the tendering by companies is phased over a suitable period to avoid excess pressure being put on the market in the first year. The transitional arrangements will be set out on the FRC's website and although they are not binding the FRC does hope they will be borne in mind by companies.
- The change suggested in the consultation required the encouragement of more meaningful reporting by audit committees; this is largely unchanged, although the wording has been changed to clarify that committees are encouraged to report the process by which they have assessed the effectiveness of the external audit, rather than whether they believe the audit to have been effective.
- The proposed requirement whereby the board has to confirm that the annual report and accounts taken as a whole are fair, balanced and understandable, to ensure that the narrative sections of the report are consistent with the financial statements and accurately reflect the company's performance, business model and strategy has been redrafted. The redraft has removed the reference to setting out the board's belief and instead the board must confirm that the report and accounts, taken as a whole, are fair, balanced and understandable and provide the information needed for shareholders to assess the company's performance, business model and strategy. The board has to establish arrangements that will enable it to make the adequate assessment.
- The wording on explanations in the introductory section of the Code has been redrafted with the intention of removing any inference that deviations from the Code should only be temporary and the wording on other providers of capital has been amended to clarify that the interests of shareholders are primarily the responsibility of the board.

The new editions of the UK Corporate Governance Code and the Guidance on Audit Committees will apply to reporting periods beginning on or after 1 October 2012.

On 28 September 2012, the FRC also published a feedback statement in relation to its April consultation on changes to the UK Stewardship Code as well as a new edition of the UK Stewardship Code. The UK Stewardship Code was originally released in July 2010 to set out good practice for institutional investors on engagement with investee companies.

The amendments to the changes proposed in April's consultation include:

- Proposed references to overseas equities and other asset classes in the introductory sections of

the Code had been interpreted by some as extending the scope of the Code. To clarify the misperception, a new statement has been incorporated into the Code stating that the Code is directed in the first instance to institutional investors with equity holdings in UK-listed companies.

- The wording on the other asset classes, in the introductory section, has been revised to clarify that, where signatories apply a stewardship approach to assets other than equities, they are encouraged but not required to disclose that they do so.
- In the introductory section, there has also been an amendment to clarify the role of service providers. While investors may choose to outsource some of their stewardship activity to service providers, they retain responsibility for ensuring those activities are carried out in a manner consistent with their own approach to stewardship as they cannot delegate their responsibility for stewardship.
- The proposal that investors should indicate whether or not they were willing to be made insiders has been adopted and expanded to suggest that, where they are, they should also indicate the mechanism by which this could be done.
- The proposal to require further disclosure on the use made of proxy voting or other voting advisory services has been implemented. Additionally signatories will be expected to identify the providers of proxy voting or other voting advisory services.

The feedback statement on the UK Corporate Governance Code and Guidance on Audit Committees is available at: http://www.frc.org.uk/getattachment/cb2a31b9-f673-4c52-b02a-75996ab8f202/Feedback-statement-on-UK-Corporate-Governance-Code-and-Guidance-on-Audit-Committees-September-2012.aspx.

The new edition of the UK Corporate Governance Code is available at: http://www.frc.org.uk/getattachment/a7f0aa3a-57dd-4341-b3e8-ffa99899e154/UK-Corporate-Governance-Code-September-2012.aspx.

The new Guidance on Audit Committees is available at: http://www.frc.org.uk/getattachment/6ec23196-28ee-406e-8f56-89ab9d1dc06d/Guidance-on-Audit-Committees-September-2012.aspx.

The feedback statement on the UK Stewardship Code is available at: http://www.frc.org.uk/getattachment/bfa5e0f5-6250-4336-b9ab-9a384a1b83a5/Feedback-Statement-UK-Stewardship-Code-September-2012.aspx.

The new edition of the UK Stewardship Code is available at: http://www.frc.org.uk/getattachment/e2db042e-120b-4e4e-bdc7-d540923533a6/UK-Stewardship-Code-September-2012.aspx.

The updated codes will apply from 1 October 2012.

BIS Proposal on IPO market for High-Growth Companies

The UK Department for Business, Innovation and Skills ("BIS") announced on 20 September 2012, that it has developed a set of proposals with the London Stock Exchange ("LSE") to attract entrepreneurs and high-growth companies.

The proposals include a planned new route to the UK initial public offering ("IPO") market for high growth companies, particularly internet and technology companies, which is likely to feature reformed (and relaxed) rules on free float, eligibility criteria and reporting requirements. The route is intended to act as a launch pad for companies seeking a full premium listing and to complement the UK's existing markets, including the LSE and AIM. The route is targeted towards European mid-sized high growth businesses.

There are no detailed proposals at this stage, but BIS expects that further details on the eligibility criteria and benefits of the new route to market will be published before the end of 2012.

Publication of the Accounting Standards Regulations 2012

On 20 September 2012, the Accounting Standards (Prescribed Bodies) (United States of America and Japan) Regulations 2012 were published.

Under current rules, companies in the UK use either UK Generally Accepted Accounting Principles ("UK GAAP") or International Accounting Standards ("IAS") in preparing their accounts. Companies choosing to

redomicile to the UK may use other accounting systems and then must change to UK GAAP or IAS in time for the preparation of their first set of annual accounts.

These regulations aim to reduce the associated costs that arise for a company when converting its accounts in a short time frame by extending the transition period in which companies can change to using UK GAAP or IAS to three years. The regulations are applicable to companies whose securities are registered with the SEC in the US or are admitted to trading on Japanese stock exchanges.

The Regulations recognise the following as prescribed bodies for the purposes of section 464 of the Companies Act 2006:

- The Financial Accounting Standards Board, in respect of the group accounts of parent companies with securities registered with the SEC in the US.
- The Accounting Standards Board of Japan, in respect of the group accounts of parent companies with securities admitted to trading on stock exchanges in Japan.

These bodies will only be prescribed bodies for financial years ending on or before 31 December 2014. The Regulations come into force on 1 October 2012 and will cease to have effect on 31 December 2015.

The Accounting Standards (Prescribed Bodies) (United States of America and Japan) Regulations 2012 are available at: http://www.legislation.gov.uk/uksi/2012/2405/made.

Audit Exemptions and Change of Accounting Framework

On 11 September 2012, BIS published the Companies and Limited Liability Partnerships (Accounts and Audit Exemptions and Change of Accounting Framework) Regulations 2012 (SI 2012/2301).

The Regulations widen certain existing exemptions in relation to requirements to prepare, file and audit annual accounts for small companies and limited liability partnerships ("LLPs") under Part 15 of the Companies Act 2006 (CA 2006). They also create some new exemptions from the audit, preparation and filing of the individual accounts of subsidiary companies and LLPs for a given financial year, provided certain qualifying conditions are met.

The key changes provided by the Regulations are:

- The Regulations relax the existing conditions under which a small company (or group) is exempt from audit. Provided a company (or group) meets the requirements for a small company under section 382 CA 2006 then section 477(2) (b) CA 2006 will no longer impose the separate turnover and balance sheet thresholds in order to qualify for audit exemption.
- Provided certain criteria are met, such as having a parent undertaking established in a European Economic Area ("EEA") state and a guarantee from the parent undertaking for the subsidiary's liabilities that are outstanding at the end of the financial year, then subsidiary undertakings will also be exempt from the audit requirement.
- Dormant subsidiaries will also be exempt from the obligations to both prepare and file individual accounts in respect of a financial year provided that the same criteria as with subsidiary companies has been met.
- The Regulations also relax the rules in which a company (or group) that prepares accounts under IAS may switch to accounts prepared under UK GAAP. Provided a company (or group) has not, at any time in the preceding five years before the day of the relevant financial year, prepared UK GAAP accounts, it may change to UK GAAP accounts. Any change during the preceding five years due to a relevant change of circumstance is to be ignored.

These regulations also extend to LLPs, through largely identical amendments to the Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008 (SI 2008/1911) and the Limited Liability Partnerships (Application of Companies Act 2006) Regulations 2009 (SI 2009/1804).

The Regulations are available at: http://www.legislation.gov.uk/uksi/2012/2301/contents/made.

The Regulations will come into force from 1 October 2012.

Commons Committee Inquiry into Women in the Workplace

On 4 September 2012, the Business, Innovation and Skills Committee announced a new inquiry into women in the workplace. The committee is considering topics on pay and job segregation inequalities, the impact of the current economic crisis on female employment, gender stereotyping in particular occupations (for example in engineering, banking, construction and the beauty industry) and the promotion of part-time working at all levels of the workplace.

The committee is also considering the extent to which Lord Davies' recommendations, set out in his "Women on Boards" review, have been acted upon, and asks for submissions on:

- To what extent should investors take into account the percentage of women on boards when considering company reporting and appointments to the board?
- Why are there still so few women in senior positions on boards, and what are the benefits of having a greater number?
- How successful is the headhunters' voluntary code of conduct (a recommendation of Lord Davies) which considers gender diversity and best practice in relation to search criteria and processes in connection with FTSE board appointments?

The closing date for submissions was 5 October 2012.

Updated ICSA Guidance on Induction of Directors

The Institute of Chartered Secretaries and Administrators ("ICSA") has published an updated version of its guidance note on designing an induction programme for newly appointed directors.

The guidance reaffirms the three aims of the induction process stated in the Suggestions for Good Practice in the Higgs Report published in 2003, namely to build:

- an understanding of the nature of the company, its business and the nature of the market in which it operates;
- a link with the company's people; and
- an understanding of the company's main relationships.

The guidance introduces two further aims of the induction process for a new director, that is, to ensure an understanding of the role of a director and the framework within which the board operates.

The guidance highlights best practice points and checklists for those putting an induction process together.

The best practice points are practical steps which include:

- planning the timing of the induction to avoid overloading a new director;
- varying the delivery of induction information – ICSA advises setting up meetings with executives, making use of advisors and organising site visits;
- planning the induction so it transitions smoothly into the director training programme; and
- reviewing the induction with the director mid-way through the process.

The checklist operates as an "aide-memoire" when devising an induction programme. The checklist is not exhaustive and care must be taken to tailor the programme to each particular director.

Kay Review Publishes Final Report

On 23 July 2012, the Final Report by the Kay Review into equity markets and long-term decision making was published. The final report identified short termism in the equity markets as a major issue with the principal causes of the problem being a decline of trust and misalignment of incentives through the equity investment chain. The report sets out a series of principles and recommendations that are designed to provide a foundation for the taking of a long term perspective in the equity markets.

Specific recommendations outlined in the report which the review believes are necessary to ensure that the equity markets support long-term corporate performance, include:

- amendments to the UK Stewardship Code so it includes a more expansive form of stewardship, which focuses on strategic issues as well as corporate governance;
- directors, asset managers and asset holders should adopt the Good Practice Statements set out in the final report;

- directors should consult major long-term investors over significant board appointments;
- the removal of the obligations to produce interim management statements;
- remuneration should be aligned with long-term performance. In particular, long-term performance incentives should only be provided in the form of shares to be held at least until the director has retired;
- the Law Commission should review the legal concept of fiduciary duty as it applies to investment, as there is currently uncertainty and misunderstanding on the part of trustees and their advisers;
- the government should consider ways for individual investors to hold shares directly through CREST;
- the establishment of an independent investors' forum; and
- the government and companies should keep under review the scale and effectiveness of merger activity carried out by, and in relation to, UK companies.

The report is available at: http://www.bis.gov.uk/kayreview.

FSA Handbook Notices

On 27 July 2012 and 28 September 2012, the FSA published changes to its rules by the publication of Handbook Notices 122 and 123.

Handbook Notice 122

The changes made by Handbook Notice 122 include the UK Listing Authority helpdesk no longer responding to no-name queries and requesting that all queries must be in writing, except in limited circumstances. There has also been a change to the related party transaction rules in Chapter 11 of the Listing Rule to facilitate block trades and other large transactions on a principal basis.

UKLA Helpdesk

- the UKLA will no longer respond to no-name queries. The UKLA has already instructed the helpdesk to act on this basis since March 2012;
- requests for guidance may be made by telephone only in cases of "exceptional urgency" or in the case of a request from a sponsor in relation to the provision of a sponsor service; and
- all other queries must be submitted in writing, on a named basis. The UKLA has indicated that it will respond to written queries within the current turnaround times, which are an initial response within 5 days of receiving the query.

These changes took effect from 30 September 2012.

Related Party Transactions

Currently Chapter 11 of the Listing Rules contains provisions relating to transactions between listed companies or their subsidiaries and related parties. A related party includes a substantial shareholder, which is any person who has at any point in the last 12 months been entitled to exercise, or control the exercise of, 10 percent or more of the voting rights in the company.

The definition of substantial shareholder is being amended to disregard voting rights which a person may hold (or control the exercise of) solely in relation to the direct performance, by way of business and in the ordinary course of business, of (a) underwriting the issue or sale of securities; or (b) placing securities, where the person provides a commitment to acquire any securities which it does not place; or (c) acquiring securities from existing shareholders or the issuer pursuant to an agreement to procure third-party purchase of securities; if (in any such case):

- the corresponding securities are held for a consecutive period of five trading days or less;
- no voting rights are exercised; and
- no attempt is made directly or indirectly by that person to intervene or exert influence on the management of the issuer.

These changes came into effect on 1 August 2012.

Handbook Notice 123

The changes under Handbook Notice 123 include:

- clarification that the new rules relating to externally managed companies will not apply to closed-end investment funds and collective investment undertakings;
- the deletion of the proposed amendments to the Listing Rules in respect of the treatment of

holdings of individual fund managers for the purposes of calculating a company's free float;

- clarification that nothing in the new definition of sponsor service is intended to indicate that a sponsor is obliged to act for a company or in relation to a transaction when a sponsor is required, but had not yet agreed or been appointed to do so. Clarification has also been provided on a sponsor's record keeping requirements; and
- the definition of what constitutes a "reverse takeover" has been clarified to include a change in board control.

The amendments in Handbook Notice 123 come into force on 1 October 2012.

UKLA Consultation Technical and Procedural Notes

On 13 July 2012 the UK Listing Authority ("UKLA") published its second Primary Market Bulletin in which it announced that the FSA is planning to completely re-launch its technical and procedural notes which provide guidance on the Listing Rules, Prospectus Rules and Disclosure and Transparency Rules.

The UKLA has reviewed and revised the existing Technical and Procedural Notes to reflect legal and regulatory amendments and changes in market practice since the notes were first published in October 2010. The UKLA proposes to split or consolidate (as applicable) those notes into short notes organised on a topic-specific basis.

The new notes comprise eight Technical Notes and three Procedural Notes, including guidance on the approval of circulars, certain aspects of related party transactions and block listings.

The UKLA proposes that the notes published following the consultation process will constitute FSA guidance.

Corporate Reporting on Anti-Corruption Measures

On 10 July 2012, Transparency International published a report: "Transparency in corporate reporting: assessing the world's largest companies", in which it sets out a number of policy recommendations for multinational companies on reporting anti-corruption measures. Following its analysis of the 105 largest publicly listed multinational companies, Transparency International recommends that:

- anti-corruption programmes should be publicly available;
- companies should publish exhaustive lists of their subsidiaries, affiliates, joint ventures and other related entities;
- companies should publish separate financial accounts for each country of operations;
- a transparent and informative corporate website, in at least one international language, should be the standard communication tool for all multinational companies; and
- as a result of their significant impact, financial companies should considerably improve their reporting on all transparency-related issues. In particular, financial companies should extend their anti-corruption programmes to cover agents and intermediaries acting on their behalf and prohibit facilitation payments.

Further Consultations on Takeover Code Rule Changes

The Code Committee of the UK Takeover Panel published three consultation documents on proposed changes to the rules of the Takeover Code, covering three areas:

- target companies subject to the Takeover Code;
- information rights, etc. relating to a target's pension scheme trustees in connection with offers governed by the Takeover Code; and
- rules relating to profit forecasts and statements of the benefits expected to arise from the takeover.

Companies Subject to the Takeover Code

The Takeover Panel is proposing to widen the categories of companies that will be subject to the Takeover Code by firstly removing the residency test for companies which have their registered offices in the UK, the Channel IslaFnds or the Isle of Man but are not listed on a regulated market in the UK or a stock exchange in the Channel Islands or Isle of Man and secondly by clarifying and simplifying the Takeover Code's applicability to private companies.

Residency Test

The Takeover Code currently allows some companies who have their registered offices in the UK, the Channel Islands or the Isle of Man ("UK registered companies") to fall outside the reach of the Takeover Code.

Currently, UK registered companies which are listed on a regulated market in the UK are automatically subject to the Takeover Code. However the Takeover Code only applies to other UK registered companies if they are considered by the Takeover Panel to have their place of central management and control in the UK. This residency test is judged primarily by assessing whether a majority of the directors are resident in the UK.

The current test leaves an element of uncertainty about whether a target company is deemed resident with shareholders also at risk from losing Takeover Code protection should a majority of the directors relocate abroad.

The Takeover Panel is proposing the removal of the residency test which will have the effect of the Takeover Panel being able to regulate the takeovers of public and private companies which have their registered offices in the UK, the Channel Islands or the Isle of Man.

Proposed Changes for Private Companies

The Takeover Panel also proposes making changes to the Takeover Code relating to its application to private companies by firstly simplifying the circumstances in which the Takeover Code will apply to offers for private companies into a single requirement that the company's securities have been admitted to trading on a regulated market or any multilateral trading facility in the UK, or any stock exchange in the Channel Islands or the Isle of Man at any time during the relevant period of 10 years.

Secondly, amending the existing rules so that the Takeover Code applies to private companies which have filed a prospectus for the issue of securities, or had a prospectus approved by the UKLA during the relevant 10 years.

The consultation closed on 28 September 2012.

Consultation on Pension Scheme Trust Issues

This consultation seeks views on proposals to extend the framework currently provided in the Code for the benefit of the offeree or target company's employee representatives to apply to trustees of the offeree company's pension schemes.

The consultation closed on 28 September 2012.

Proposed Changes to Profit Forecasts and Merger Benefit Statements

This consultation proposes amendments to the provisions of the Takeover Code in relation to reporting on profit forecasts, merger benefit statements and material changes in information previously published during an offer period.

Currently, Rule 28 requires profit forecasts to be compiled with due care and consideration and when an offeree company or offeror publishes a profit forecast during an offer period, the assumptions upon which the profit forecast is based must be stated and except for when an offeror is offering cash only, the party concerned must obtain and publish reports on the profit forecast from both its reporting accountants and financial advisers. Where a profit forecast has been published prior to the offer period then this will need to be repeated in the offer document or offeree circular in the same manner and treated as if it had been made during the offer period.

The Code committee has recommended that Rule 28 should be restructured into a more logical framework. The committee has proposed the following amendments:

- the existing requirements of Rule 28 should generally continue to apply to profit forecasts published during an offer period and to profit forecasts published following an approach with regard to a possible offer being made;
- Rule 28 should no longer require reports to be obtained from reporting accountants and financial advisers where a profit forecast was published before an approach with regard to a possible offer was made;
- Rule 28 should provide the Panel with the explicit ability to grant a dispensation from its requirements in circumstances where:
  - a profit forecast is published by a party to an offer in the ordinary course of its communications with its shareholders and the market and in accordance with an established practice; or
  - the profit forecast published by a party to the offer relates to a period ending more than

15 months from the date on which it is first published; or

  - the offer could not result in the issue of securities representing 10 percent or more of the enlarged equity share capital of the offeror and, in addition, the application of the Rule would be disproportionate; or
  - a profit forecast states a maximum figure for the likely level of profits for a particular period;

- if, during an offer period, a party to an offer publishes or repeats a profit forecast for a future financial year, Rule 28 should provide that it must also publish corresponding profit forecasts for the current financial year and any intervening financial years. Where, during an offer period, this leads to the publication for the first time of a new profit forecast for the current financial year or any intervening financial year, the Code Committee believes that Rule 28 should apply as usual to that new profit forecast. However, as a result of the proposed ability for the Panel to grant a dispensation for profit forecasts for periods ending more than 15 months from the date on which the forecast is first published, a party to the offer would be able to publish long term profit forecasts without triggering the reporting requirements of Rule 28;
- except with the consent of the Panel, the reporting requirements of Rule 28 should always apply where the offer is a management buy-out or similar transaction or is being made by the existing controller or group of controllers;
- Rule 28 should incorporate more detailed requirements than at present in relation to "quantified financial benefits statements"; and
- Rule 28 should apply to a profit forecast which relates to a part of a business of a party to an offer.

The Takeover Panel is also proposing that any material changes in information are published promptly by way of announcement, and not only when a subsequent document is published.

The Takeover Panel has for the time being deferred making any corresponding amendments to Rule 29 dealing with asset valuations (on which it consulted in 2010).

The Consultation Paper is available at: http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/PCP201201.pdf.

FSA Consultation on Listing Regime

On 2 October 2012, the FSA published a Consultation Paper (CP12/25**) which:

- provided the feedback on the consultation on the Listing Rules changes, launched in January 2012 (and which we discussed in our April 2012 Newsletter) – covering, among others, reverse takeovers, externally-managed companies, sponsors and transactions. It said that it would be largely implementing the changes it had proposed and that the Listing Rules changes would take effect as from 1 October 2012, except for those relating to sponsors, where the amended rules will take effect on 31 December 2012;
- launched a supplementary consultation on Listing Rules arising from implementation of AIFMD;
- proposed further Listing Rules changes, primarily concerned with the premium segment and intended to enhance the effectiveness of the UK Listing Regime. A number of various changes are proposed, particularly in the area of corporate governance as it affects premium listed companies. Key proposals include:
  - the re-introduction of a requirement for a relationship agreement (with mandatory content) to be put in place between a listed issuer and its controlling shareholder (defined as a 30 percent shareholder);
  - the introduction of a new premium Listing Principle that the aggregate voting power of each premium listed equity share class must be proportionate to its relative interest in the equity of the issuer;
  - dual voting on the election of independent directors where there is a controlling shareholder. This would involve such directors being voted on by a vote of all the shareholders and of all shareholders other than the controlling shareholder with a further, simple majority vote of all

shareholders within 90 days if the two earlier votes were in conflict; and

- guidance as to when less than 25 percent may be acceptable as a free float (but not less than 20 percent for a premium listing) for listing purposes.

The consultation will close on 2 January 2013. A copy of the consultation paper is available at: http://www.fsa.gov.uk/static/pubs/cp/cp12-25.pdf.

LIBOR and the Wheatley Report

On 27 June 2012, the UK FSA published the final notice it has issued to Barclays Bank plc, fining it £59.5 million for breaching Principles 2, 3 and 5 of the FSA's Principles for Businesses through misconduct relating to its submission of rates that formed part of the London Interbank Offered Rate ("LIBOR") and Euro Interbank Offered Rate ("EURIBOR") setting processes.

The effect of this decision has led the UK Government to launch a full scale review of the current framework for setting and governing LIBOR. The UK Chancellor appointed Martin Wheatley, the Chief Executive designate of the FCA to lead the review.

- HM Treasury set out the terms of reference of the review which are available at: http://www.hm-treasury.gov.uk/press_68_12.htm.

An initial discussion paper was published in July 2012. This sets out the initial analysis on the role that LIBOR plays in financial markets, the flaws in the current structure of setting LIBOR, its governance and oversight, and a range of options for reform, including the issue of transition.

- The text of the initial discussion paper is available at: http://www.hm-treasury.gov.uk/d/condoc_wheatley_review.pdf.

The final report was published on 28 September 2012. The report is highly critical of the British Bankers' Association ("BBA"), the association which currently supervises LIBOR and stated that it should have "no further role" in the setting of LIBOR.

The three main overarching conclusions of the report are:

- LIBOR should be comprehensively reformed, rather than replaced;
- transaction data should be explicitly used to support LIBOR submissions; and
- market participants should continue to play a significant role in the production and oversight of LIBOR.

The report makes the following three recommendations to the UK Government:

- the submission and administration of LIBOR become FSA regulated activities;
- the key individuals involved should be approved persons and subject to the FSA approved persons regime; and
- the Financial Services and Markets Act 2000 should be amended to introduce criminal sanctions for the manipulation or attempted manipulation of LIBOR.

The report is available at: http://cdn.hm-treasury.gov.uk/wheatley_review_libor_finalreport_280912.pdf.

US DEVELOPMENTS

SEC Developments

In this section, we are covering developments relating to the implementation of provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Reform Act") and the Jumpstart Our Business Startups Act ("JOBS Act") through rulemaking by the US Securities and Exchange Commission ("SEC") as well as other SEC developments.

SEC Adopts Conflict Minerals and Government Payment Rules

On 22 August 2012, the SEC adopted rules implementing Sections 1502 and 1504 of the Reform Act. The rules implementing Section 1502 (the "Conflict Minerals Rules") relate to reporting requirements regarding conflict minerals originating in the Democratic Republic of the Congo ("DRC") and adjoining countries (the "Covered Countries"). The rules implementing Section 1504 (the "Government Payments Rules") relate to reporting requirements regarding certain payments made by oil and gas and mining issuers to foreign governments and the US Federal Government.

- Both the Conflict Minerals Rules and the Government Payments Rules apply to issuers that file reports under Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), including foreign private issuers that file annual reports with the SEC on Form 20-F.

Conflict Minerals Rules. The new rules impose additional disclosure obligations on issuers that use "conflict minerals" in their products. While the Conflict Minerals Rules adopt the framework of the proposed rules issued in December 2010, the SEC modified certain key provisions to address concerns raised in the stakeholder consultation process.

- We reported on the proposed rules in our 2011 and 2012 Newsletters.

The disclosure an issuer is required to make under the Conflict Minerals Rules is determined by a three-step analysis:

- ***Scope of the Rules***. Each issuer must first determine whether it is subject to the Conflict Minerals Rules. The Conflict Minerals Rules apply if conflict minerals are necessary to the functionality or production of products manufactured or contracted to be manufactured by an issuer. Issuers whose products do not contain conflict minerals are not subject to the Conflict Minerals Rules and are not required to make any conflict minerals disclosures.
  - "Manufacture or Contract to Manufacture". Generally, an issuer manufactures or contracts to manufacture a product if the issuer has control or influence over the manufacturing process. An issuer that only services, maintains or repairs a product would not be considered to "manufacture" that product. An issuer that contracts the manufacture of components used in the issuer's products is subject to the Conflict Minerals Rules if those components contain conflict minerals.
  - The Conflict Minerals Rules also clarify that mining companies whose operations are limited to mining conflict minerals and selling unfinished minerals for upgrading or processing do not "manufacture" "products" and are not subject to conflict minerals reporting.
  - "Necessary to Functionality or Production". The SEC provides some guidance in the final rule release regarding its position with respect to how the "necessary" standard delineates the scope of the Conflict Minerals Rules. If conflict minerals are intentionally used in the production of a product, they will be deemed to be necessary and the Conflict Minerals Rules will apply, regardless of the amount of the conflict minerals involved. That is, where conflict minerals are used intentionally, there is no de minimis exemption for products that contain only trace amounts of conflict minerals. However, in a departure from the proposed rules, a product is subject to conflict minerals disclosure only if the final product actually contains conflict minerals. For example, where a conflict mineral is used as a catalyst in the production of a product, but the final product does not contain any of the conflict mineral, the product would not be subject to conflict minerals disclosure. Similarly, the Conflict Minerals Rules would not be triggered if conflict minerals are only used in tools or capital equipment used in the production of an issuer's products.
- The question of whether conflict minerals are necessary to the functionality or production of a product may be academic in most instances. As a practical matter, if an issuer's products contain conflict minerals, or if conflict minerals are used in the production of an issuer's products (other than in tools or capital equipment), it would be prudent to establish controls to diligence the source of those conflict minerals.
- ***Reasonable Country of Origin Inquiry***. If an issuer uses conflict minerals in its products, it must undertake a reasonable country of origin inquiry to determine whether the conflict minerals it uses originated in the Covered Countries or from recycled or scrap sources. If the issuer (i) determines that its conflict minerals did not originate in the Covered Countries or has no reason to believe that such minerals may have

originated in the Covered Countries or (ii) determines, or reasonably believes, that its conflict minerals originated from recycled or scrap sources, it only needs to disclose that determination and describe the inquiry it used in reaching that determination.

- While the nature and extent of the inquiry will necessarily depend on an issuer's particular facts and circumstances, the inquiry must be reasonably designed to determine whether the issuer's conflict minerals did originate in the Covered Countries, or did come from recycled or scrap sources, and it must be performed in good faith.

- The SEC considers an issuer to satisfy the reasonable country of origin inquiry standard if it obtains reasonably reliable representations indicating the smelter or refinery that processed that issuer's conflict minerals and demonstrating that those conflict minerals did not originate in the Covered Countries or came from recycled or scrap sources.

- ***Due Diligence and Conflict Minerals Report***. Finally, if an issuer determines that its conflict minerals did originate, or has reason to believe that such minerals may have originated, in the Covered Countries and are not from recycled or scrap sources, it is required to conduct further due diligence on the source and chain of custody of its conflict minerals. Depending on the findings of the due diligence, the issuer may be required to file a conflict minerals report ("Conflict Minerals Report") containing certain additional disclosures and an independent private sector audit.

Affected issuers are required to comply with the Conflict Minerals Rules beginning with the year ended 31 December 2013 by filing their conflict minerals disclosure and, if required, conflict minerals report on new Form SD by 31 May 2014.

Government Payments Rules. The Government Payments Rules largely adopt the framework proposed in the proposed rules issued by the SEC on 15 December 2010. However, in the final version of the Government Payments Rules, the SEC, after taking into consideration the extensive input received during the comment process, in certain cases either deviated from the proposed rules or opted not to define certain terms in the proposed rules.

- We reported on the proposed rules in our January 2011 Newsletter.

Scope of the Rules. The Government Payments Rules apply to "resource extraction issuers", which includes any US and foreign company that is engaged in the commercial development of oil, natural gas or minerals and that is required to file annual reports with the SEC, regardless of the size of the company, the extent of business operations that constitute commercial development of oil, natural gas or minerals or whether the company is government-owned.

The Government Payments Rules require a resource extraction issuer to provide disclosure of payments made by the issuer, a subsidiary of the issuer, or an entity under the control of the issuer to a foreign government or the US Federal Government for the purpose of the commercial development of oil, natural gas, or minerals.

- The Government Payments Rules define "commercial development of oil, natural gas, or minerals" to include the activities of exploration, extraction, processing and export, or the acquisition of a license for any such activity. This includes both the production of oil and natural gas as well as the extraction of minerals. The term "commercial development" is intended to capture only activities that are directly related to the commercial development of oil, natural gas or minerals, excluding any ancillary or preparatory activities.

Object of Disclosure. Under the Government Payments Rules, the term "payment" includes the following types of payments: (i) taxes; (ii) royalties; (iii) fees; (iv) production entitlements; (v) bonuses; (vi) dividends; and (vi) payments for infrastructure improvements. These payments are subject to disclosure to the extent that they are part of the commonly recognised revenue stream for the commercial development of oil, natural gas or minerals.

The Government Payment Rules define payments that are "*not de minimis*", and, therefore, subject to disclosure, as any single payment or series of related

payments, that equals or exceeds US$100,000 during the most recent fiscal year. In the case of an arrangement providing for periodic payments or instalments (such as rental fees), a resource extraction issuer must consider the aggregate amount of related periodic payments or instalments of related payments in determining whether the US$100,000 threshold has been met for that series of payments and, accordingly, whether disclosure is required.

The Government Payments Rules require a resource extraction issuer to disclose information regarding the type and total amount of payments made to a foreign government or the US Federal Government for each project relating to the commercial development of oil, natural gas or minerals.

The disclosure requirements may not be satisfied by providing the disclosure pursuant to a disclosure regime that the issuer is otherwise subject to, such as domestic laws, listing rules or the Extractive Industries Transparency Initiative (the "EITI"). There is also no exemption for situations where disclosure is prohibited by foreign law or subject to contractual confidentiality provisions.

Form of Disclosure. In a departure from the proposed rules, the Government Payments Rules require the disclosure to be provided in new Form SD, separate from the issuer's existing Exchange Act annual report. The SEC intended that disclosure in a specialised form will facilitate the ability of interested parties to locate the disclosures, as well as address issuers' concerns about providing the disclosure in their Exchange Act annual reports on Forms 10-K, 20-F or 40-F. Form SD requires issuers to include a brief statement in the body of the form, in an item entitled "Disclosure of Payments By Resource Extraction Issuers", directing investors to the detailed payments information to be provided in exhibits to the form.

Affected issuers are required to comply with the Government Payments Rules beginning with the fiscal year ending after 30 September 2013, by filing the required disclosures on Form SD no later than 150 days after the end of the fiscal year.

Our related client publication is available at: http://www.shearman.com/sec-adopts-dodd-frank-conflict-minerals-and-government-payments-rules-08-27-2012/.

SEC Proposes Rules Allowing General Solicitation and Advertising in Rule 144A Offerings and Certain Private Placements

On 29 August 2012, the SEC proposed rule changes allowing general solicitation and advertising in Rule 144A offerings and Rule 506 private placements as mandated by Section 201(a) of the JOBS Act. The proposed rule changes would: (1) eliminate the prohibition on general solicitation in Rule 144A on offers to persons other than qualified institutional buyers ("QIBs") so long as sales are only made to QIBs or persons that the seller and any person acting on behalf of the seller reasonably believe are QIBs; (2) eliminates the restriction in Rule 506 private placements so long as the only purchasers are accredited investors or the issuer reasonably believes they are accredited investors at the time of sale; and (3) require issuers that use general solicitation in Rule 506 offerings to take reasonable steps to verify that the purchasers are accredited investors.

The proposed rules would continue to permit concurrent offshore offerings conducted in reliance on Regulation S under the US Securities Act of 1933, as amended (the "Securities Act"). The proposing rule release provides that unregistered domestic offerings that satisfy the new Rule 144A or Rule 506 registration exemptions will not be integrated with offshore offerings made in compliance with Regulation S. Therefore, assuming the proposed rules are adopted without changes and the conditions to the proposed rules are otherwise satisfied, market participants would be able to conduct concurrent Rule 144A (or Rule 506) and Regulation S offerings and generally solicit investors in the United States without violating the prohibition in Regulation S with respect to "directed selling efforts" in the United States.

The proposed rules have not yet taken effect and the SEC is taking comments from the public until 30 days after publication in the Federal Register. Until final rules are adopted, there will be no change to the prohibition on general solicitation.

General Solicitation in Rule 144A Offerings. Existing Rule 144A provides an exemption from the registration requirements of the Securities Act for offers and sales of securities by persons other than the issuer to QIBs or persons reasonably believed to be QIBs. Although existing Rule 144A does not explicitly prohibit

general solicitation, offers may be made only to QIBs or persons reasonably believed to be QIBs. The proposed rules would amend Rule 144A to eliminate the references to "offer" and "offeree" in Rule 144A(d)(1). As a result, sellers or persons acting on their behalf selling securities pursuant to Rule 144A could offer such securities to non QIBs, including by means of general solicitation, so long as the securities are only sold to QIBs or persons reasonably believed to be QIBs.

General Solicitation in Rule 506 Offerings. Existing Rule 506 is a non-exclusive safe harbor that provides an exemption from the registration requirements of the Securities Act for offers and sales of securities by issuers to an unlimited number of accredited investors and sales to no more than 35 non-accredited investors. Offers and sales made pursuant to existing Rule 506 have long had to satisfy, among other things, the requirements of Rule 502(c) of Regulation D, which prohibits any offer or sale of securities by any form of "general solicitation or general advertising," including newspaper, magazine, television and internet advertisements.

The proposed rules would amend Rule 506 to provide for a new Rule 506(c) that would permit the use of general solicitation in securities offerings under Rule 506 so long as the following conditions are satisfied:

- the issuer takes reasonable steps to verify that the purchasers are accredited investors;
- all purchasers are accredited investors or the issuer reasonably believes that the purchasers are accredited investors at the time of sale; and
- the issuer complies with all other applicable requirements of Regulation D.

"Reasonable Steps to Verify" Accredited Investor Status. The SEC did not propose a uniform or standard verification process. Rather, it stated that the reasonableness of the steps an issuer takes to identify a purchaser's accredited investor status would be subject to "an objective determination, based on the particular facts and circumstances of the transaction". The proposing release suggests a number of factors that may be relevant when determining whether an issuer's verification was "reasonable", including:

- the nature of purchaser;
- information about the purchaser; and
- the nature and terms of the offering, in particular the type of general solicitation used, and the existence of a minimum investment amount.

Our related client publication is available at: http://www.shearman.com/jobs-act-sec-proposes-rules-allowing-general-solicitation-and-advertising-in-private-placements-under-rule-506-of-regulation-d-and-rule-144a-09-05-2012/.

US Exchanges Issues Proposed Rules to Implement SEC's Compensation Committee Independence and Adviser Rules

On 25 September 2012, each of the New York Stock Exchange (the "NYSE") and the NASDAQ Stock Market ("Nasdaq") filed proposed changes to their listing standards. The proposed changes are in response to the SEC's final rules issued on 20 June 2012 (the "Final Rules"), on which we reported in our July 2012 Newsletter, directing the national securities exchanges to adopt listing standards (i) that require each member of a company's compensation committee to be an "independent" member of the board of directors under the applicable exchanges' independence standards and (ii) relating to the selection, including independence, of compensation advisers. The following is a summary of notable provisions in the NYSE and Nasdaq proposals.

Compensation Committee Requirements.

- *Nasdaq*. Although this modification was not required pursuant to the Final Rules, Nasdaq's proposal will require listed companies to have a compensation committee consisting of at least two "independent" members (as determined in accordance with the rules described below).
- *NYSE*. NYSE already requires a standing compensation committee consisting solely of independent directors, but does not dictate a minimum number of members required. NYSE also proposed consideration of the additional independence factors as required under the Final Rules.

Compensation Committee Director Independence Standards. The Final Rules direct the securities exchanges to adopt independence requirements for compensation committee members,

taking into account the following factors: (i) the source of the director's compensation, including any consulting, advisory or other compensatory fees paid by the listed company and (ii) whether the director has an affiliate relationship with the company, a subsidiary of the company or an affiliate of a subsidiary of the company.

- *Nasdaq.* Currently, the Nasdaq rules set forth a two-part test to determine director independence. First, certain categories of directors may not be considered independent and second, the board must make an affirmative determination that the independent director does not have a relationship that would interfere with the exercise of independent judgment in carrying out his or her responsibilities. The proposed rules retain the current provisions but modify one of the categories of directors who will not be considered independent: (i) directors who receive any (rather than, as under current Nasdaq rules, more than a threshold amount of) consulting, advisory or other compensatory fee from the listed company (other than fees for service as a member of the board or any board committee and fixed amounts of compensation under a retirement plan for prior service with the company.
- *NYSE.* Current NYSE rules also provide for a two-part independence determination test. First, if a director has a relationship with a listed company that violates one of five listed "bright line" tests, he or she is deemed not to be independent. Second, no director qualifies as "independent" unless the board of directors affirmatively determines that the director has no material relationship with the listed company (either directly, or as a partner, shareholder or officer of an organisation that has a relationship with the company). The NYSE proposed an additional test that would require the board to consider "all factors specifically relevant to determining whether a director has a relationship" to the listed company that is "material to the director's ability to be independent from management," in addition to the two SEC factors described above.

Interestingly, both the NYSE and Nasdaq refrained from proposing specific standards prohibiting individuals with affiliate relationships from serving on the compensation committee, noting that it may be appropriate for certain affiliates, such as significant shareholders, to serve on compensation committees as their interests are likely to be aligned with those of other shareholders.

Compensation Committee Advisers. Under the Final Rules, listing standards must require that compensation committees have (i) the authority to retain compensation consultants, independent legal advisers and other compensation advisers, (ii) adequate funding to pay the advisers, and (iii) responsibility to consider independence factors when hiring their advisers, other than in-house counsel. The compensation committee is not required to take the advice of any of its advisers and the proposed rules may not be construed to affect the compensation committee's ability to exercise its own judgement. In addition, the Final Rules set forth the following list of six independence factors a compensation committee must consider prior to hiring an adviser, which both the NYSE and Nasdaq have adopted without adding any other factors*:*

- whether the entity employing the compensation adviser provides other services to the issuer;
- the amount of fees received from the issuer by the entity employing the compensation adviser as a percentage of its total revenues;
- the policies and procedures of the entity employing the compensation adviser designed to prevent conflicts of interest;
- any business or personal relationship between the compensation adviser and a member of the compensation committee;
- whether the compensation adviser owns any stock in the issuer; and
- any business or personal relationship between the compensation adviser and the issuer's executive officer.

Compensation Committee Charters.

- *Nasdaq.* Nasdaq does not currently require listed companies to adopt a written compensation committee charter. The proposed rules would require each listed company to certify that it has

adopted a formal written compensation committee charter.

- *NYSE.* The NYSE currently requires compensation committees to have a written charter.

Foreign Private Issuers. The Final Rules exempt a foreign private issuer from the independent compensation committee requirements if it discloses in its annual report the reasons it does not have an independent compensation committee. Foreign private issuers would be subject to the compensation advisor rules unless the exchanges elect to exempt them.

- *Nasdaq.* Nasdaq proposes to expand the Final Rules and to exempt foreign private issuers that follow their home country corporate governance practices from both the compensation committee independence and advisor rules, provided that the foreign private issuer discloses each Nasdaq listing requirement that it does not follow and describes its applicable home country practice. If a foreign private issuer follows its home country practice and does not have an independent compensation committee, it must also disclose the reasons why it does not.

- *NYSE.* The NYSE also proposes to exempt foreign private issuers that follow their home country corporate governance practices from both the compensation committee independence and advisor rules, provided that the foreign private issuer discloses the significant ways in which its corporate governance practices differ from those followed by domestic listed companies. Accordingly, any foreign private issuer seeking to avail itself of the exemption afforded by the proposed rules would need to disclose the differences in its corporate governance practices from the domestic issuer requirements. Disclosure of the reasons for these differences is not required under the proposed rules, however, as the NYSE noted that, most frequently, foreign private issuers would merely be stating that home country law has no similar requirement.

Effective Dates. The proposed rules must be approved by the SEC and in place by 27 June 2013.

- *Nasdaq.* Nasdaq rules relating to the committee's (i) authority to retain advisors, (ii) funding to retain advisors, and (iii) requirement to analyse advisor independence, will be effective immediately upon approval of the proposed rules by the SEC. Compliance with the remaining provisions is required by the earlier of: (i) the listed company's second annual meeting after the date the Nasdaq rules are approved, or (ii) 31 December 2014. Companies must certify compliance with the applicable requirements no later than 30 days after the applicable implementation deadline.

- *NYSE.* The NYSE rules will generally be effective 1 July 2013. However, with respect to the compensation committee independence requirements, listed companies will have until the earlier of: (i) their first annual meeting after 15 January 2014, or (ii) 31 October 2014, to comply.

Conclusion. Listed companies and foreign private issuers that will become subject to the proposed NYSE or Nasdaq rules should begin thinking about whether their current compensation committee membership and committee structure will satisfy the proposed rules. While no action is required until the rules become effective next year, listed companies may also want to start thinking of ways to implement the compensation committee adviser rules.

The Nasdaq's proposed rules are available at: http://nasdaq.cchwallstreet.com/NASDAQ/pdf/nasdaq-filings/2012/SR-NASDAQ-2012-109.pdf.

The NYSE's proposed rules are available at: http://www.nyse.com/nysenotices/nyse/rule-filings/pdf;jsessionid=474035BE3B197D71B5150C5D1911BB0F?file_no=SR-NYSE-2012-49&seqnum=1.

Our related client publication is available at: http://www.shearman.com/the-nyse-and-nasdaq-issue-proposed-rules-to-implement-the-sec-compensation-committee-independence-and-advisor-rules-10-04-2012/.

PCAOB Developments

PCAOB Proposes Auditor Communications Standard

On 15 August 2012, the Public Company Accounting Oversight Board ("PCAOB") adopted Auditing Standard No. 16, Communications with Audit Committees ("AS 16"). This new standard must be approved by the

SEC, which requested comments on 10 September 2012. If approved, the new standard will replace the current interim standards governing communications between auditors and audit committees (AU sec. 380, Communications with Audit Committees and AU sec. 310, Appointment of the Independent Auditor). The new auditing standard is intended to improve audits by enhancing the relevance and quality of communications between auditors and audit committees.

Appointment and Retention of the Auditor. The new standard would require the auditor to establish an understanding of the terms of the audit engagement with the audit committee at the outset, which includes communicating to the audit committee the objective of the audit and the respective responsibilities of the auditor and management. The terms of the audit engagement must be recorded in an engagement letter, provided to the audit committee annually. AS 16 also requires auditors to discuss with the audit committee any significant issues discussed with management in connection with the appointment or retention, for example regarding the application of accounting principles and auditing standards.

Obtaining Information Relevant to the Audit. Under the proposed new standard, the auditor must inquire with the audit committee about whether it is aware of matters relevant to the audit, such as, for example, violations or possible violations of laws and regulations.

Audit Strategy. The auditor would also be required to communicate with the company's audit committee regarding certain matters relating to the conduct of an audit. This includes an overview of the overall audit strategy, including the timing of the audit, and a discussion with the audit committee about the significant risks identified during the auditor's risk assessment procedures.

Audit Results. With respect to the audit results, the new standard requires the communication and evaluation of significant and critical accounting policies and practices and a discussion of critical accounting estimates developed by management and significant unusual transactions that occur outside the normal course of business for the company or that otherwise appear to be unusual due to their timing, size or nature. Other areas of required communications relate to difficult and contentious matters for which the auditor consulted outside the engagement team and that the auditor reasonably determined are relevant to the audit committee's oversight of the financial reporting process and to matters relating to the auditor's evaluation of the company's ability to continue as a going concern.

Interim Financial Statements. AS 16 also amends AU sec. 722, Interim Financial Information, directing an auditor conducting a review of interim financial information to determine whether any of the matters described in AS 16, as they relate to interim information, have been identified and if so, communicate them to the audit committee or its chair in a timely manner and prior to the filing of the company's quarterly report on Form 10-Q.

It is expected that the new standard will be effective for audits and quarterly reviews for fiscal years beginning on or after 15 December 2012.

The SEC release is available at:
http://www.sec.gov/rules/pcaob/2012/34-67807.pdf.

Corporate Governance Trends: Shearman & Sterling's 10th Annual Surveys of Selected Corporate Governance Practices

In September 2012, we published our milestone 10th Annual Surveys of Selected Corporate Governance and Director & Executive Compensation Practices of the top 100 US public companies. The surveys are being published in a continued challenging global economic environment that has intensified the pressure for change in corporate governance practices.

As in previous years, our surveys provide in-depth analyses of practices and trends impacting corporate governance and shed light on how leading US companies are addressing important governance issues in the current environment. For non-US companies, whether listed in the US or not, the practices and trends of the largest US companies provide instructive information in an increasingly convergent global corporate governance environment. More than ever, the governance regimes of global companies are being scrutinised and critiqued by activist shareholders and proxy advisory organisations, with an increasing number of shareholder proposals being submitted across a broad range of corporate and economic issues.

In our general corporate governance practices survey we highlight trends in policies and practices of the top

100 US companies relating to the composition and structure of their boards of directors, including independence of directors, majority voting in the election of directors, board leadership and board committees. We also identify trends in the governance practices of the top 100 US companies that apply more broadly, including risk oversight policies, structural defenses and shareholder and management proposals.

In our executive compensation survey we focus on how pay practices are developing in light of mandatory "say on pay" requirements and disclosure practices regarding the relationship of compensation to risk. We also discuss trends in non-employee director compensation practices over the past decade.

We will host our Seventh Annual Corporate Governance Symposium in New York on 23 October 2012. You may visit http://corpgov.shearman.com for more information.

Recent Trends and Patterns in FCPA Enforcement

In September 2012, we published our bi-annual "Recent Trends and Patterns in FCPA Enforcement" report, part of our renowned FCPA Digest, which together provide an insightful analysis of recent trends and pattern and an invaluable compendium of all FCPA enforcement actions and private actions.

The first half of 2012 brought relatively fewer enforcement actions, but several FCPA-related court decisions and sentencings, as well as the beginnings of results from industry sweeps. In this edition of Trends and Patterns, we summarise recent statistics, analyse legal developments, and provide insight into the latest legislative and regulatory trends in anti-bribery enforcement in the US and the UK.

Our July 2012 "Recent Trends and Patterns in FCPA Enforcement" report is available at: http://www.shearman.com/recent-trends-and-patterns-in-the-enforcement-of-the-foreign-corrupt-practices-act-fcpa-07-30-2012/.

Noteworthy US Securities Law Litigation

US Federal Court of Appeals does not require SEC to plead proximate causation in connection with aiding and abetting claim: Securities and Exchange Commission v. Apuzzo. In August 2012, a US federal court of appeals ruled that, in order to state a claim of aiding and abetting a securities law violation, the SEC does not have to plead that the defendant's conduct was the "proximate cause" of the primary violation. In *Apuzzo*, the SEC alleged that a chief financial officer of an equipment manufacturer aided and abetted a scheme by an equipment rental company to inflate and prematurely recognise revenue from a sale-lease-back transaction. The district court dismissed the SEC's complaint and ruled that, even if Apuzzo knew about the scheme, the SEC failed to allege adequately that he proximately caused the primary violation. Specifically, the court stated that Apuzzo did not structure the transaction, modify the transaction documents in order to conceal the fraud, or make the equipment company's fraudulent accounting decisions.

The federal appeals court reversed and held that the SEC does not need to plead facts that the aider and abettor's conduct was the proximate cause of the primary securities law violation. The court explained that, in pleading an aiding and abetting claim, the SEC has to allege sufficient facts from which to infer that the aider and abettor associated himself with the fraudulent scheme, participated in it, and sought by his actions to make it succeed.

This case is significant because it effectively lowers the bar for what the SEC needs to plead and prove against individuals it alleges aided and abetted violations of the securities law.

Our related client publication is available at: http://www.shearman.com/second-circuit-clarifies-the-secs-pleading-threshold-in-bringing-claims-against-aiders-and-abettors-08-20-2012/.

New York state court allows plaintiffs to bring fraud claims against foreign corporations in spite of Morrison: Viking Global Equities, LP v. Porsche Automobil Holding SE. In August 2012, a New York state court denied a motion to dismiss filed by Porsche Automobil Holding SE, even though Porsche had previously succeeded in having the case dismissed in federal court based on the US Supreme Court's landmark decision in *Morrison v. National Australia Bank*. As noted in our April 2012 update, a federal court in New York, relying on the Morrison decision, dismissed a federal securities fraud lawsuit against Porsche on the grounds that the securities transactions at issue in that case were foreign

transactions that were not entitled to the protection of Section 10(b) of the Exchange Act.

Some of the plaintiffs that lost in federal court initiated a separate action in New York state court alleging claims of common law fraud and unjust enrichment. Porsche moved to dismiss the state court complaint based on forum non conveniens and the failure to state a claim. The court denied the motion to dismiss and held, among other things, that Porsche had not met its heavy burden of demonstrating that the forum was not convenient. In fact, the court identified a number of factors that weighed in favor of hearing the case in New York, including the presence of the plaintiffs' critical witnesses and documents in New York, Porsche's history of regularly doing business in New York, and Porsche's having allegedly made misrepresentations directly to the plaintiffs in New York. The court held that, even though Porsche's witnesses reside in Germany, a large corporation such as Porsche has ample resources to transport witnesses and documents to New York.

For plaintiffs (in cases other than class actions), this case could provide a road map for circumventing *Morrison*. Whether others will follow this strategy – pursuing fraud claims against foreign corporations in state court– remains to be seen.

Recent SEC/DOJ Enforcement Matters

SEC issues first payment under Whistleblower programme. In August 2012, the SEC issued its first payment under the new whistleblower programme that was created as part of the Reform Act. Under the programme, the SEC is authorised to reward individuals who offer high-quality original information about securities fraud that leads to an SEC enforcement action in which more than US$1 million in sanctions is ordered. Awards can range from 10 percent to 30 percent of the money collected. The law specifies that the SEC cannot disclose any information, including information the whistleblower provided to the SEC that could reasonably be expected to directly or indirectly reveal a whistleblower's identity.

- We reported on the final whistleblower programme in our June 2011 Newsletter.

In the first payment under the programme, the whistleblower received US$50,000, which represented 30 percent of the amount the SEC collected in an SEC enforcement action against the perpetrators of a securities fraud scheme. The SEC did not disclose any details about the whistleblower or the information he or she provided because the law prohibits such disclosure. The SEC did, however, state that the whistleblower provided documents and other significant information that allowed the SEC's investigation to move at an accelerated pace and prevent the securities fraud from ensnaring additional victims.

The SEC has indicated that, since the programme was established in August 2011, the SEC has received approximately eight tips a day. This programme is different than an older whistleblower programme established by the US Internal Revenue Service that recently awarded US$104 million to a former UBS banker who provided information about how thousands of US citizens evaded taxes through the use of illegal offshore bank accounts.

ASIAN DEVELOPMENTS

China Securities Regulatory Commission Lowers QFII Threshold

On 27 July 2012, the China Securities Regulatory Commission ("CSRC") published the amended Provisions on Issues concerning the Implementation of the Administrative Measures for Securities Investment Made in China by Qualified Foreign Institutional Investors (the "New QFII Measures"), which replaced the previous regulations relating to the Qualified Foreign Institutional Investor ("QFII") scheme which were issued on August 24, 2006 (the "2006 Circular").

Background

The QFII scheme was introduced by Chinese regulators in 2002 to allow foreign qualified investors to invest in A-shares listed on the Shanghai and Shenzhen stock exchanges (previously open only to mainland China investors) and other financial products as approved by the CSRC. Since the RMB is not freely convertible, the objective of the QFII scheme is to provide a channel for funds from overseas to flow into China's capital markets. As of June 2012, China has awarded QFII licenses to 172 foreign investors, among which 145 have been granted quotas in aggregate of US$27.26 billion. In particular, since Mr. Guo Shuqing, the new president of the CSRC, took office in October 2011, the CSRC and the State Administration of Foreign Exchange

("SAFE"), the other major QFII regulator, have shortened the timeframe for QFII approvals, granting US$5.62 billion in quotas to 51 QFIIs since December 2011. The New QFII Measures have been seen by many as an ongoing attempt by the CSRC to further liberate the Chinese domestic capital markets.

New QFII Measures

The New QFII Measures include the following major revisions to the 2006 Circular:

- lowering the qualification threshold for a foreign investor to apply for QFII status;
  - *Securities companies.* Minimum years of operations are lowered from 30 years to 5 years; the required capital or assets requirement is changed from paid-in capital of no less then US$1 billion to net assets of no less than US$500 million; and the required assets under management are lowered from US$10 billion to US$ 5 billion.
  - *Commercial banks.* The QFII Measures establish a minimum year of operation requirement of 10 years and a requirement of Tier 1 capital of no less than US$300 million; in addition, the required assets under management are lowered from US$10 billion to US$ 5 billion.
  - *Fund managers; insurance companies and other institutional investors.* Minimum years of operations are lowered from 5 years to 2 years and the required assets under management are lowered from US$5 billion to US$ 500 million.
- widening the investment scope by allowing QFIIs to invest in fixed-return products traded in China's inter-bank bond market. This is a further step after the CSRC permitted QFIIs' participation in stock-index futures in 2011;
- relaxing the shareholding limit of QFIIs. The cap on the combined stake in a listed company held by QFIIs is increased to 30 per cent from the previous 20 per cent. However, the cap on the stake in a listed company held by one single QFII remains unchanged; and
- permitting QFII to set up multiple investment accounts. Under the 2006 Circular, a QFII is permitted to set up only one investment account with China's stock clearance company for trading in each of Shanghai Stock Exchange and Shenzhen Stock Exchange, respectively.

By substantially lowering the qualification requirements for QFII status, the New QFII Measures effectively expand the number of potential qualified applicants for QFII status. In addition, these adjustments with respect to QFII's investment scope and shareholding limit offer QFIIs with more diversified and flexible investment choices. The New QFII Measures also proposes to streamline the administration of QFII investment accounts, which would further facilitate QFII operation and investments in China.

The New QFII Measures (Chinese version) are available at: http://www.csrc.gov.cn/pub/zjhpublic/G00306201/201207/t20120727_213211.htm.

China NDRC Denies the "National Treatment" for RMB Funds with Foreign GPs

China's National Development and Reform Commission ("NDRC"), one of the major regulatory authorities in charge of foreign investments in China, denied in April 2012 the "national treatment" of RMB funds in the form of a limited liability partnership with a foreign-invested company as general partner ("GP") and with only PRC domestic investors as limited partners ("LPs").

Background

Foreign investments in China are subject to certain restrictions as well as various governmental approval procedures, which are often considered to be onerous and time-consuming. In early 2011, to attract the establishment of private equity funds, Shanghai, followed by Beijing and Tianjin, introduced the so-called Qualified Foreign Limited Partners ("QFLP") programme, under which, among others, a private equity fund formed as a limited liability partnership with a foreign-sourced GP and Chinese LPs and no foreign LPs would be deemed to be a Chinese investor for purposes of foreign investment regulations, provided that the GP's capital commitment to the fund does not exceed 5 percent of the total capital commitments (the "5 percent Exception Rule"). Such "national treatment" exempts qualified funds from

complying with China's foreign investment regulation regime when such funds make investments in portfolio companies. The 5 percent Exception Rule is particularly attractive to those foreign fund managers who intend to raise capital only from China's domestic sources while hoping to ensure that such type of funds receive equal treatment with their purely domestic private equity competitors (which are RMB funds with a domestic GP and domestic LPs) in the process of portfolio investments. Therefore, with other merits, the QFLP programme had led to a surge in the number of RMB funds, especially in Shanghai, including, among others, funds managed by Blackstone Group and The Carlyle Group.

Regulation

In response to the Shanghai Development and Reform Commission's request to clarify the "national status" of a fund with a PRC subsidiary of Blackstone Group as its GP, NDRC, however, issued a letter on 23 April 2012 (the "NDRC Letter"), affirming that such type of RMB funds shall still be deemed as foreign investors, and their portfolio investments are therefore subject to the Catalogue for Guiding Foreign Investment, a major PRC regulation specifying the industry restrictions for foreign investments and other applicable PRC laws relating to foreign investments.

Implications

The NDRC Letter denies the applicability of the 5 percent Exception Rule under the QFLP program to the effect that a contribution of even a nominal amount of foreign-sourced capital comprising a small fraction of the total fund size would make the fund "foreign." It would also cause uncertainties as to the legality of the finished portfolio investments made by foreign-invested RMB funds if such investments had enjoyed the "national treatment" according to the 5 percent Exception Rule.

Review of Securities Investment Funds Law

China is undertaking a comprehensive review of its 2004 Securities Investment Funds Law. Following a first round review, the Standing Committee of the National People's Congress (the "NPC"), China's legislation power, published the draft amendments to the Securities Investment Funds Law (the "July Draft") on 11 July 2012 for public comments. It has been reported that an updated draft (which has not yet been published) may be submitted to the Standing Committee of NPC for a second round review either in October or the coming December and as a result of such second review, the proposed amendments set out below may be changed.

Highlights

- ***Privately-raised funds ("Private Fund")***: Among other changes, a heavily debated issue in the July Draft is whether the Private Funds should be included in the regulatory regime. While the July Draft put the Private Funds into its regulatory regime, this proposal have been castigated by PE/VC participants. The July Draft sets forth that:
  - Private Funds can only be raised from no more than 200 qualified investors, who will need to satisfy the income or asset requirements. Accordingly, Private Funds cannot be advertised publicly.
  - The launch of a Private Fund is subject to a post-launch filing requirement with the CSRC or the Fund Sector Association, while the launch of a public fund is subject to prior registration with the CSRC (under existing law, the launch of a public fund is subject to prior approval by the CSRC).
  - Unlike the fund manager of a public fund which is subject to the approval by the CSRC, a fund manager of a private equity fund will only need to register with the CSRC or make a prescribed filing with the Fund Sector Association, depending on the total amount of the capital proposed to be raised and the number of unit holders of the fund (the thresholds have not yet been clarified by further regulations). However, failure to make such registration may trigger restrictions on the opening of securities accounts or the trading of securities by the fund manager or the funds under its management.
- ***New form of funds***: In addition to the contractual form fund available under the existing law, two new forms of funds are proposed – a council form fund and an unlimited liability form fund. Public funds can be either in the contractual

form or the council form. Private Funds can also be in the unlimited liability form.

- ***Permitted scope of investments***: In addition to listed shares and bonds in which the public funds are allowed to invest under current regulatory regime, a public fund will be permitted to invest in other forms of securities and derivatives determined by the CSRC.
- ***Fund manager in form of partnership***: A fund manager will be able to be set up as a partnership, however, the detailed provisions regarding how a partnership can be a fund manager of a public fund need to be further formulated by the CSRC.
- ***Funds service agencies***: Various funds service agencies (such as sales agencies, valuation agencies and registration agencies) will be brought within the regulatory regime and will therefore be required to register or make a filing with the CSRC before they can provide services to public funds.
- ***Practitioners trading in securities***: Directors, supervisors, senior management personnel and other employees of a fund manager (or their respective spouses and interested persons) will now be permitted to engage in securities trading, subject to prior disclosure to the fund manager and prohibition of certain improper acts. This will lift the current prohibition on fund practitioners trading in securities, and will be welcomed by the market. On the other hand, it will increase the challenge faced by regulators seeking to crack down on potential market misconduct activities by fund practitioners.

DEVELOPMENTS SPECIFIC TO FINANCIAL INSTITUTIONS

EU Developments

Regulatory Capital Update

The European Banking Authority ("EBA") has published an update on its draft implementing technical standards on supervisory reporting requirements for institutions, stating that it has been delayed owing to the adoption of the Capital Requirements Regulation ("CRR").

As soon as the final CRR text is available, the EBA will finalise the draft standards, taking into account possible changes in the scope of the CRR reporting requirements, and submit them to the European Commission for endorsement.

The CRR was expected to apply from 1 January 2013; however, it is now unlikely to be effective by then. The European Parliament, European Commission and European Council had originally aimed to finalise an agreed position on the CRR by the end of June 2012, which would have allowed it to be adopted during the plenary session in July 2012. However, as this has not happened, it is unlikely that the CRR will be adopted earlier than during the autumn of 2012, and therefore will not enter into force on 1 January 2013. No updated timeline or dates has been published by any of the EU institutions involved.

The EBA update is available at: http://www.eba.europa.eu/News--Communications/Latest-news.aspx.

In addition, the European Commission has published its second report on the effects of the Capital Requirements Directive on the economic cycle. Under article 156 of the Directive, the European Commission must periodically monitor whether the Directive has significant effects on the economic cycle and, in light of the examination, submit a biennial report to the EU Parliament and EU Council, together with any appropriate remedial measures. In particular, the purpose of the report is to consider whether the CRD contributes to pro-cyclicality.

The report is available at: http://eba.europa.eu/News--Communications/Year/2012/Update-on-the-finalisation-and-implementation-of-t.aspx.

Shearman & Sterling LLP

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

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

EUROPE

Pamela M. Gibson
London
+44.20.7655.5006
pgibson@shearman.com

Apostolos Gkoutzinis
London
+44.20.7655.5532
apostolos.gkoutzinis@shearman.com

Richard Kelly
London
+44.20.7655.5788
richard.kelly@shearman.com

Laurence Levy
London
+44.20.7655.5717
laurence.levy@shearman.com

Jacques B. McChesney
London
+44.20.7655.5791
jacques.mcchesney@shearman.com

Monica McConville
London
+44.20.7655.5904
monica.mcconville@shearman.com

Richard J.B. Price
London
+44.20.7655.5097
rprice@shearman.com

Barnabas W.B. Reynolds
London
+44.20.7655.5528
barney.reynolds@shearman.com

David Dixter
London
+44.20.7655.5633
david.dixter@shearman.com

Babett S. Carrier
London
+44.20.7655.5945
bcarrier@shearman.com

Paul Haut
London
+44.20.7655.5103
paul.haut@shearman.com

Simon Jerrum
London
+44.20.7655.5727
simonjerrum@shearman.com

Michael Scargill
London
+44.20.7655.5161
michael.scargill@shearman.com

Hans Diekmann
Düsseldorf
+49.211.1788.8814
hdiekmann@shearman.com

Martin Neuhaus
Düsseldorf
+49.211.1788.8922
mneuhaus@shearman.com

Roger Kiem
Frankfurt
+49.69.9711.1280
rkiem@shearman.com

Marc O. Plepelits
Frankfurt
+49.69.9711.1299
mplepelits@shearman.com

Markus Rieder
Munich
+49.89.23888.2119
markus.rieder@shearman.com

Tobia Croff
Milan
+39.02.0064.1509
tobia.croff@shearman.com

Fabio Fauceglia
Milan
+39.02.0064.1508
fabio.fauceglia@shearman.com

Domenico Fanuele
Rome
+39.06.697.679.210
dfanuele@shearman.com

Guillaume Isautier
Paris
+33.1.53.89.70.00
gisautier@shearman.com

Hervé Letréguilly
Paris
+33.1.53.89.71.30
hletreguilly@shearman.com

John J. Madden
Paris
+33.1.53.89.71.80
jmadden@shearman.com

Cyrille Niedzielski
Paris
+33.1.53.89.89.30
cniedzielski@shearman.com

Bertrand Sénéchal
Paris
+33.1.53.89.70.95
bsenechal@shearman.com

Sami L. Toutounji
Paris
+33.1.53.89.70.62
stoutounji@shearman.com

AMERICAS

Abigail Arms
Washington, DC
+1.202.508.8025
aarms@shearman.com

Jerome S. Fortinsky
New York
+1.212.848.4900
jfortinsky@shearman.com

Doreen E. Lilienfeld
New York
+1.212.848.7171
dlilienfeld@shearman.com

Manuel A. Orillac
New York
+1.212.848.5351
morillac@shearman.com

Antonia E. Stolper
New York
+1.212.848.5009
astolper@shearman.com

Robert C. Treuhold
New York
+1.212.848.7895
rtreuhold@shearman.com

Jeffrey J. Resetarits
New York
+1.212.848.7116
jeffrey.resetarits@shearman.com

Jennifer Stadler
New York
+1.212.848.5241
jennifer.stadler@shearman.com

ASIA

Alan Seem
Beijing
+86.10.5922.8002
aseem@shearman.com

Matthew Bersani
Hong Kong
+852.2978.8096
mbersani@shearman.com

Peter Chen
Hong Kong
+852.2978.8012
peter.chen@shearman.com

Colin Law
Hong Kong
+852.2978.8090
colin.law@shearman.com

Vanessa Poon
Hong Kong
+852.2978.8057
vanessa.poon@shearman.com

Jayesh Wadhwani
Hong Kong
+852.2978.8086
jayesh.wadhwani@shearman.com

Andrew R. Schleider
Singapore
+65.6230.3882
aschleider@shearman.com

Masahisa Ikeda
Tokyo
+813.5251.1601
mikeda.asahisa.ikeda@shearman.com

BROADGATE WEST | 9 APPOLD STREET | LONDON | EC2A 2AP | WWW.SHEARMAN.COM

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