SHEARMAN & STERLING LLP

# Governance & Securities Law Focus

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Latin America Edition

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

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## 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 August 22, 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.

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

***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 July 2012 Newsletter.

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 December 31, 2013, by filing their conflict minerals disclosure and, if required, conflict minerals report on new Form SD by May 31, 2014.

***Government Payments Rules***. The Government Payments Rules largely adopt the framework proposed in the proposed rules issued by the SEC on December 15, 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.

***Scope of the Rules***. The Government Payments Rules apply to "resource extraction issuers," which include any US or 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 (vii) payments for infrastructure improvements. These payments are subject to disclosure to the extent that they are part of the commonly recognized 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 installments (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 specialized 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 September 30, 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/](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 August 29, 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) eliminate 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 the 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/](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 Issue Proposed Rules to Implement SEC's Compensation Committee Independence and Adviser Rules*

On September 25, 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 June 20, 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 exchange's 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: 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 organization 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 June 27, 2013.

- *Nasdaq*. Nasdaq rules relating to the committee's (i) authority to retain advisors, (ii) funding to retain advisors, and (iii) requirement to analyze 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) December 31, 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 July 1, 2013. However, with respect to the compensation committee independence requirements, listed companies will have until the earlier of: (i) their first annual meeting after January 15, 2014, or (ii) October 31, 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 Proposes Auditor Communications Standard

On August 15, 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 September 10, 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 December 15, 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 scrutinized and critiqued by activist shareholders and proxy advisory organizations, 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 October 23, 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 patterns 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 summarize recent statistics, analyze 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 recognize 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*. In that earlier decision, a federal court in New York, relying on the Morrison decision, had 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 program.*** In August 2012, the SEC issued its first payment under the new whistleblower program that was created as part of the Reform Act. Under the program, the SEC is authorized 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.

In the first payment under the program, 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 program was established in August 2011, the SEC has received approximately eight tips a day. This program is different than an older whistleblower program 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.

# INTERNATIONAL DEVELOPMENTS

## Corporate Reporting on Anti-Corruption Measures

On July 10, 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 programs 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 programs to cover agents and intermediaries acting on their behalf and prohibit facilitation payments.

## LIBOR and the Wheatley Report

On June 27, 2012, the UK Financial Services Authority ("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 Financial Conduct Authority, 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 September 28, 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.

## China Securities Regulatory Commission Lowers QFII Threshold

On July 27, 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 liberalize 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 than 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/newsite/

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

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

**Robert Ellison**
Sao Paulo
+55.11.37022214
robert.ellison@shearman.com

**Stuart K. Fleischmann**
New York
+1.212.848.7527
sfleischmann@shearman.com

**Laura Friedrich**
New York
+1.212.848.7524
laura.friedrich@shearman.com

**Heather L. Kafele**
Washington, DC
+1.202.508.8051
hkafele@shearman.com

**Michael McGuinness**
New York
+1.212.848.7057
michael.mcguinness@shearman.com

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

**Bradley Sabel**
New York
+1.212.848.8077
bsabel@shearman.com

**Russell Sacks**
New York
+1.212.848.7319
russell.sacks@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

**Mathias von Bernuth**
Sao Paulo
+55.11.37022248
mathias.vonbernuth@shearman.com

599 LEXINGTON AVENUE | NEW YORK | NY | 10022-6069 | WWW.SHEARMAN.COM

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