SHEARMAN & STERLING LLP

A QUARTERLY NEWSLETTER FOR CORPORATES

Governance & Securities Law Focus

JULY 2015/EUROPE

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

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Financial regulation developments are available here.

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EU DEVELOPMENTS

Financial Reporting: Commission Delegated Regulations on Equivalence of Certain Third Country National GAAPs to IFRS

On 15 June 2015, the European Commission published the text of a draft delegated regulation to amend the Prospectus Regulation (809/2004). The objective of the delegated regulation is to deal with the expiry on 31 December 2014 of the transitional period during which the Commission allowed issuers to use financial statements prepared in accordance with Indian GAAP under the Transparency Directive. In order to allow India to complete the convergence of Indian GAAP with IFRS, the delegated regulation retrospectively extends this transitional equivalence period to 1 April 2016.

The full text of the regulation is available here:

http://data.consilium.europa.eu/doc/document/ST-9941-2015-INIT/en/pdf

On 15 June 2015, the European Commission also published the text of a further delegated regulation to amend Regulation (EC) No 1569/2007 establishing a mechanism for the determination of equivalence of accounting standards applied by third country issuers, in order to give countries that are still working to converge towards or adopt IFRS in their national systems more time. This further delegated regulation therefore extends the period for accepting relevant third country accounting standards until 31 March 2016.

The full text of the regulation is available here:

http://data.consilium.europa.eu/doc/document/ST-9936-2015-INIT/en/pdf

Proxy Advisers: ESMA Consultation on Best Practise Principles for Voting Research 2014

On 8 June 2015, the European Securities and Markets Authority ("ESMA") published a call for evidence to gather information on how stakeholders perceive the most recent proxy seasons (following the Best Practise Principles for Shareholder Voting Research 2014 ("BPPs")) to have evolved and to assess the extent to which new trends or changes in proxy advisors' approaches have developed.

ESMA's review will examine both how many proxy advisers have signed up to the BPPs and the extent of changes brought about by the BPPs since they were introduced. The extent of changes will be assessed by reference to:

- how far the BPPs address the issues identified by ESMA as needing change;
- the extent to which compliance statements published by signatories to the BPPs comply with ESMA's 2013 report on the role of the proxy advisory industry; and
- the actual practise of signatories following implementation of the BPPs.

The call for evidence sets out a number of questions relevant to all stakeholders, with ensuing sections containing questions for specific groups of shareholders.

The full text of ESMA's call for evidence is available here:

http://www.esma.europa.eu/system/files/2015-920.pdf

Fourth Money Laundering Directive: Publication in Official Journal (Corporate Aspects)

On 5 June 2015, the Fourth Money Laundering Directive was published in the Official Journal. The published text of the directive is in substantially the same form as the text adopted by the European Parliament at the second reading on 20 May 2015.

Under the text, member states must ensure that they adhere to the following in respect of central registers of information on the ultimate beneficial owners:

- Member states must ensure that corporate and other legal entities incorporated within their territory are required to obtain and hold adequate, accurate and current information on their beneficial ownership, including the details of the beneficial interests held.
- The information must be held in a central register in each member state or a public register.
- The information must be available to: (a) competent authorities and financial intelligence units, without any restriction; (b) obliged entities that must do customer due diligence under the directive; and (c) any person or organisation that can demonstrate a legitimate interest.

The directive came into force on 25 June 2015, and must be implemented by member states by 26 June 2017.

The full text of Directive (EU) 2015/849 is available here:

http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:JOL_2015_141_R_0003&from=EN

Single-Member Companies: Council Agrees a General Approach on Replacement Directive

On 28 May 2015, the Competitiveness Council agreed a general approach on a proposal for a new Directive on EU-member private limited liability companies.

The proposed Directive will require member states to provide in their national company law for a form of single-member limited liability company to be established, which will be known as a Societas Unius Personae ("SUP").

The key elements of the proposal include:

- Online registration: the SUP can be registered on-line using templates provided by member states. Online registration is to be as secure and compliant with existing national rules as possible.
- Minimum capital requirement of € 1. Furthermore, in order to ensure adequate protection of creditors and other stakeholders, member states will have to ensure that their national laws provide mechanisms intended to guard against SUPs from being unable to pay their debts.
- Transfer of seat to another member state: provisions relating to the separation of the company's seat from the member state in which the SUP was registered have been removed from the original Commission proposal to respect member states' competences and traditions. Similarly, aspects of labour law will remain covered by existing national laws.

The European Parliament is scheduled to adopt its first-reading position on the proposal on 15 December 2015.

The full text of the proposal is available to download here:

http://www.consilium.europa.eu/en/press/press-releases/2015/05/28-29-compet-single-member-private-companies/

EU Related Party Transaction Rules: The Latest Position

The European Parliament's Legal Affairs Committee has voted to adopt the proposal for a new European Directive on related party transactions at an EU-level which will amend the Shareholder Rights Directive 2007/36/EC. The proposal, as adopted at this stage, contains exemptions for intra-group transactions and ordinary course transactions. There is also a great deal of flexibility for Member States to set the parameters for when related party transactions have to be approved or announced and whether they have to be approved by the shareholders or just the board.

Now both co-legislators (European Parliament and Council) have finalised their negotiation positions, the trilogues (informal negotiations between the European Parliament and the Council, during which the European Commission has a mediation and facilitation role) will start.

Conflict Minerals: The European Parliament Aims to Introduce an EU Mandatory Regime

On 20 May 2015, in a plenary meeting, the European Parliament proposed a mandatory reporting regime for "all Union importers" (downstream companies) of conflict minerals from conflict zones in the world.

The European Parliament's approach therefore substantially departs from the Commission's proposal for a voluntary "self-certification" regime, as well as the text adopted by the Parliament's International Trade committee ("INTA") in April, which included a mandatory certification only at the level of smelters and refiners.

Ultimately, however, the proposed regulations will have to be adopted in co-decision by the Parliament and the Council and the informal negotiation between the two institutions and the European Commission; it is possible, therefore, that a compromise position may be reached.

The press release and adopted text is available here:

http://www.europarl.europa.eu/pdfs/news/expert/infopress/20150513IPR55318/20150513IPR55318_en.pdf

Transparency Directive: Delegated Regulation on Regulatory Technical Standards on Major Holdings Published in Official Journal

On 13 May 2015, the European Commission's delegated regulation setting out regulatory technical standards on major holdings under the amended Transparency Directive was published in the Official Journal.

The delegated regulation is largely concerned with the calculation of voting rights in connection with the operation of market maker and trading book exemptions, for the purposes of major holdings disclosures as well as the calculation of voting rights in relation to certain derivatives.

The regulation will enter into force on 2 June (being 20 days after publication in the Official Journal) and shall apply from 26 November 2015 which is the date prescribed for the transposition of the directive amending the Transparency Directive.

The full text of Commission Delegated Regulation (EU) 2015/761 is available here:

http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:JOL_2015_120_R_0002&from=EN

ITALIAN DEVELOPMENTS

Final Implementation of EU Directive 2011/61/EU on Alternative Investment Fund Managers

On 8 January 2015 the Italian securities and exchange commission (Commissione Nazionale per le Società e la Borsa, "CONSOB") issued resolution no. 19094 (the "Resolution"), which implemented in Italy the EU Directive 2011/61/EU on Alternative Investment Fund Managers (the "AIFMD") and the relevant provisions of Italian Legislative Decree no. 58 of 24 February 1998 ("Italian Securities Act"). Such Resolution became effective starting from 3 April 2015.

The Resolution introduced several changes to CONSOB regulation no. 11971 of 14 May 1999, as amended (the "Regulation on Issuers"), aimed at regulating (i) the marketing in Italy or in another state of the EU, both to institutional investors and to retail investors, of units of alternative investments funds ("AIF"), both closed-end and open, managed by Italian managers, società di investimento a capitale fisso ("SICAF") or società di investimento a capitale variabile ("SICAV"), EU managers or managers that are non-EU, as well as (ii) the authorisation to be

provided by CONSOB and Bank of Italy with respect to such marketing. The new rules also set forth the pass-porting regime to which the marketing of units of an EU-AIF must be subject to, in order to be exempted from the CONSOB and Bank of Italy authorisation procedure.

There is currently an ongoing debate in Italy on the new regime set forth by the Resolution and through the Regulation on Issuers, as well as on the integration of such new regime with the public offerings regime, the consequences and effects of which are, therefore, still uncertain.

UK DEVELOPMENTS

Listing Rules: Financial Conduct Authority Final Notice for Breaches of LR and DTR

On 17 June 2015, the Financial Conduct Authority ("FCA") published a final notice imposing a fine of £4,651,200 on Asia Resource Minerals plc ("ARM") (formerly Bumi plc). The FCA found that between 28 June 2011 and 19 July 2013, ARM had inadequate systems and controls to comply with its obligations as a listed company in breach of Listing Principle 2 (requirement to take reasonable steps to establish and maintain adequate procedures, systems and controls to enable it to comply with its obligations). The FCA also found that during the same period ARM had also committed serious breaches of three Listing Rules concerned with related party transactions:

The discovery of the related party transactions, together with other financial irregularities, meant the company could not publish its annual financial report for 2012 within four months of the financial year end (as required by the UK Listing Authority's Disclosure and Transparency Rules), consequently leading to a suspension of the company's shares.

The penalty is required to be paid in full by ARM to the FCA by 26 June 2015 (14 days from the date of the final notice).

A copy of the report is available here:

http://www.fca.org.uk/static/documents/final-notices/asia-resource-minerals.pdf

Market Abuse: Publication of Fair and Effective Markets Review (Corporate Aspects)

On 10 June 2015, the Fair and Effective Markets Review (set up last year by HM Treasury, the Bank of England and the FCA) published its final report. The majority of the report concerns the fixed income, currency and commodities markets. The report also includes a recommendation that HM Treasury should extend the maximum prison sentence for criminal market abuse from seven to ten years, to align the penalties with those for comparable economic crimes such as fraud.

The report considers that extending the maximum sentence will allow greater headroom for judges to take account of a large number of aggravating factors and to send a message of deterrence; this is despite the fact that no case has, to date, resulted in the maximum seven year sentence being imposed for market abuse.

The chairs of the Review will provide a full implementation report to the Government and to the Bank of England by June 2016.

The Fair and Effective Markets Review is available here:

http://www.bankofengland.co.uk/markets/Documents/femrjun15.pdf

LR and DTR: FCA Quarterly Consultation No. 9 (Corporate Aspects)

On 5 June 2015, the FCA published its ninth quarterly consultation paper, CP 15/19. Chapter 2 of the consultation paper sets out proposals to amend the Listing Rules and Disclosure and Transparency Rules to take account of, among other things, implementation of the revised UK Corporate Governance Code in September 2014.

Key areas of chapter 2 include:

- The going concern requirements for annual financial statements.
- Removing inconsistencies in the application of the concession for the admission to trading of the securities of scientific research based companies.
- Deleting the electronic settlement eligibility requirements for premium-listed equities as this is now in any event required for both premium-listed and standard listed equities by the new EU Central Securities Depositories Regulation (909/2014).
- Updating the headline codes to be used by FCA-approved primary information providers when disseminating regulated information.

The FCA asks for comments on the proposed changes set out in Chapter 2 of the consultation paper by 5 August 2015.

The consultation paper also proposed changes to the Listing Rules relating to the UK Corporate Governance Code.

Following the introduction of a requirement in the 2014 version of the Corporate Governance Code for directors to make a statement about the long term viability of the company, rather significantly, the FCA is proposing to amend the Listing Rules so that it will also be compulsory for premium-listed companies to make a viability statement (rather than simply a statement of compliance or explanation of non-compliance with this requirement of the Code). If companies do not make a viability statement they will be in breach of the Listing Rules.

The FCA's consultation paper is available here:

http://www.fca.org.uk/static/fca/documents/cp1519.pdf

AIM: Guidance on Free Float and Considering Financial Policies and Procedures Under AIM Rule 31

On 1 June 2015, the London Stock Exchange published guidance concerning the free float requirements for admission to trading on Alternative Investment Market ("AIM") and the assessment of a company's financial policies and procedures for the purposes of AIM Rule 31.

AIM Rule 31 requires AIM companies and their directors to have in place sufficient systems, procedures and controls to enable them to comply with the AIM Rules.

The guidance highlights that when considering a company's financial policies and procedures for the purposes of AIM Rule 31, an assessment should be made of whether those policies are capable of working in practise, taking into account its knowledge of the company and its management.

In relation to a company's free float, the guidance provides clarification on some of the factors which must be considered by companies and their nominated advisers when assessing the free float of a company seeking admission to AIM, including:

- How the securities are likely to trade when admitted to AIM.
- The rationale for the applicant to seeking admission to AIM.

- Issues of undue influence, control and ongoing corporate governance arrangements within the company in circumstances where there are concentrated shareholdings.

The AIM guidance is available here:

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

Financial Reporting: FRC Discussion Paper on Improving Reporting by Smaller Listed and AIM Quoted Companies

On 2 June 2015, the Financial Reporting Council ("FRC") published a discussion paper on improving the quality of reporting by smaller listed and AIM quoted companies.

The paper sets out the FRC's findings and proposals from the first phase of the project it began in 2014 to investigate the importance of the quality of reporting to investors in such companies, and to explore how the FRC can support companies in fostering improvements in this area.

The FRC's key findings include that:

- There is a higher incidence of poorer quality annual reports by smaller quoted companies than by their larger counterparts.
- There is a perception gap between smaller quoted companies and investors regarding the value of their annual reports, which has led to a failure in prioritising the production of high quality reports.
- Smaller quoted companies often lack sufficient skilled resources and up to date information on reporting requirements.
- There is strong consensus among stakeholders that International Financial Reporting Standards ("IFRS") should remain the reporting framework for all listed companies. However, the FRC has found evidence of a desire for increased stability in IFRS and reduced disclosure for smaller quoted companies.
- A lack of rigour by some audit teams in applying the audit process, often when there is significant time pressure, is a contributing factor in lower quality reporting.

The paper outlines a number of steps that can be taken to help smaller quoted companies to improve their financial reporting.

The FRC's report is available here:

http://www.frc.org.uk/Our-Work/Publications/FRC-Board/Consultation-Improving-the-Quality-of-Reporting-b-File.pdf

Financial Reporting: FRC Implementation Study on Audit Committee Reporting

On 29 May 2015, the FRC published an implementation study by its Financial Reporting Lab on audit committee reports. The study analyses how well a sample of 34 Financial Times Stock Exchange ("FTSE") 350 companies' audit committee reports responded to the needs of investors highlighted in the Lab's original report in October 2013.

Key findings in the study include that:

- Companies have partially implemented investors' preference for personalisation of the report.
- Investors' preferences in relation to the reporting of significant issues have been implemented to varying degrees - only 59% of companies had made a reasonable attempt.

- Most committees could significantly improve the reporting of their assessment of external auditor effectiveness by including more detail.
- Although most companies have reflected investors' suggestions in relation to the disclosure of auditor appointments, the Lab identifies possible improvements, particularly in relation to the disclosure of audit partner tenure and rotation.
- Nearly all audit committee reports disclosed the company's non-audit services policy.

The FRC's report is available here:

http://www.frc.org.uk/Our-Work/Publications/FRC-Board/Consultation-Improving-the-Quality-of-Reporting-b-File.pdf

Financial Reporting: FRC Practise Aid on Audit Quality for Audit Committees

On 29 May 2015, the FRC issued a practise aid to provide audit committees with guidance on audit quality and best practises for consideration when they prepare or revise their own assessment procedures for a particular audit engagement.

The aid sets out how audit committees should focus more on seeking evidence of quality throughout an audit engagement rather than on the output of the external audit, how this may be achieved and the inputs that could inform the audit committees' assessment.

The FRC's practise aid is available here:

http://frc.org.uk/Our-Work/Publications/Audit-and-Assurance-Team/Audit-Quality-Practice-Aid-for-Audit-Committee-(1).pdf

Small Business, Enterprise and Employment Act: First Commencement Regulations

On 26 May 2015, the Small Business, Enterprise and Employment Act 2015 (Commencement No. 1) Regulations 2015 were published. Among other things, the regulations bring into force the following provisions of the Small Business, Enterprise and Employment Act 2015 for the purposes of enabling the exercise of delegated powers or the power to issue statutory guidance in relation to:

- Requirements for certain companies to keep a register of people with significant control of the company.
- The power of the Registrar to omit the day of the date of birth of directors and persons exercising significant control of a company from the information on the register available for public inspection.
- Amendments to the directors' disqualification regime. This includes allowing for the Secretary of State to apply to the court for a disqualification order on the grounds that a director has been convicted of certain offences overseas, and expanding the matters which the court must have regard to when determining whether a person should be disqualified as a director. There has also been an increase in the period of time for applying to the court for disqualification.

For a summary of the Small Business, Enterprise and Employment Act 2015, please see our Q1 Governance and Securities Newsletter published in April 2015 available here:

http://www.shearman.com/~/media/Files/NewsInsights/Publications/2015/04/Governance-and-Securities-Law-Focus-Asia-Edition-CM-042415.pdf

The full text of the Small Business, Enterprise and Employment Act 2015 (Commencement No. 1) Regulations 2015 (SI 2015/1329) is available here:

http://www.legislation.gov.uk/uksi/2015/1329/pdfs/uksi_20151329_en.pdf

Takeover Code: Consultation on Dividends

On 11 May 2015, the Takeover Panel published a consultation paper (PCP 2015/1: Dividends) on the treatment of dividends paid by an offeree company to its shareholders proposing amendments to the Code, and a new Practise Statement, which are intended to clarify the application of existing provisions of the Code, and to ensure greater alignment of the Code with the existing practise of the Panel Executive.

The proposed amendments to the Code relate to the following areas:

- Reserving the right to reduce the offer consideration if a dividend is paid.
- Effect of a dividend where the offeror has made a "no increase statement."
- Impact of dividends on a minimum offer price established by share purchases.

Appendix C to PCP 2015/1 also contains the Executive's Draft Practice Statement on dividends, which sets out the Executive's practise on:

- Permitting an offeror to reserve the right to reduce the offer consideration if the offeree pays a dividend.
- Requiring the offer consideration to be reduced where a dividend is paid by the offeree after the offeror has made a no increase statement.
- Calculating the maximum price at which an offeror may purchase offeree shares without having to increase its offer under Rules 6, 9.5 or 11.1 where the shares are trading cum dividend or ex dividend.
- The application of Rule 21.2 in prohibiting an offeree (or any person acting in concert with it) from entering into "offer-related arrangements" with an offeror (or any person acting in concert with it) in relation to the payment of dividends by the offeree.

The Takeover Panel's consultation paper is available here:

http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/PCP201501.pdf

Corporate Governance: ICSA Guidance on General Meeting Notice Periods

On 29 April 2015, the Institute of Chartered Secretaries and Administrators ("ICSA") published guidance on the notice requirements for shareholder meetings laid down in the UK Corporate Governance Code and the general meeting notice requirements under the Companies Act 2006.

The guidance is, in part, a response to queries that were raised in respect of the revised wording introduced into the Code in 2014, relating to the notice period for general meetings, other than the annual general meeting. This period is 14 working days under the Code, as opposed to 14 days under the Companies Act 2006.

ICSA states in the guidance, among other things:

- That in its view, while companies will not use the option to provide the shorter 14 days' notice unless it is necessary for them to do so, it is helpful for shareholders to receive as much notice as possible.
- The Code recommends earlier publication dates for notices of meetings than the statutory requirements and where companies are not able to meet the Code recommendations on notices for general meetings; this should be explained in the Annual Report in the same way as any other departure from the Code.

- As a general rule, it expects that a company will only use the reduced notice period where there is a need for urgency. Consequently, an explanation of these circumstances will be required where the company does not comply with the relevant notice period under the Code.

The ICSA guidance note is available here:

http://www.icsa.org.uk/assets/files/free-guidance-notes/uk-corporate-governance-code-provision-e24.pdf

Narrative Reporting: ICSA Guidance on Good Practise for Annual Reports

In April 2015, ICSA published a guidance note of good practise for annual reports. The note briefly summarises what is expected of each part of an annual report, and sets out features of what it considers to be the best annual reports, strategic reports, board disclosures, audit and risk reports, remuneration reports, and sustainability and stakeholder disclosures.

ICSA considers the best annual reports to demonstrate the following:

- An understanding of the links between governance, shareholder value creation and the avoidance of value destruction.
- Responding to the opportunities created by reporting requirements rather than seeing them as obligations.
- Innovative and creative forms of disclosure, which move away from 'boilerplate' reporting that simply repeat the language of the Code and explain how the board and company is run.
- Explanations of the way the board runs itself and its committees, and how decisions are taken.
- A governance report that demonstrates clear ownership by the chairman and a real desire to use governance to enhance the business rather than as a 'box-ticking' exercise.
- Comprehensive explanations of departures from the provisions of the Code.
- A full description, and explanation, of the business model and the strategy, with Key Performance Indicators ("KPIs"), performance against targets, and important information cross referenced to elsewhere in the report.
- Discussion of the principal risks to the strategy, the company's risk appetite and culture, how the risk profile is changing, and how the risks are being managed.
- Joined-up thinking that links strategy, pay, performance and risk.
- Evidence of directors having satisfied their statutory duties, including the duty to promote the success of the company over the longer term.
- Recognition and balancing of the needs and expectations of different shareholder and stakeholder priorities.

The full text of the ICSA guidance is available here:

http://www.icsa.org.uk/assets/files/free-guidance-notes/good-practice-for-annual-reports.pdf

Narrative Reporting: ICSA Guidance on Annual Report Contents

In April 2015, ICSA published its final guidance note, prepared with the assistance of a number of company secretaries from quoted companies, on a contents list for the annual report of a UK company to help those preparing reports. The guidance is more of an indicative framework, rather than a rigid template and it is not intended to be prescriptive. Some of the changes to the consultation draft include:

- Amendments to reflect the new version of the UK Corporate Governance Code published in September 2014.

- The insertion of a new paragraph stating that the strategic report should also include details of strategically important matters on sustainability, ethics, values and/or corporate social responsibility, if applicable.
- An amendment to specify that the audit committee report should include impairment assumptions.

The ICSA final guidance note is available here:

http://www.icsa.org.uk/assets/files/free-guidance-notes/contents-list-for-the-annual-report-of-a-uk-company.pdf

Corporate Governance: PIRC UK Shareowner Voting Guidelines 2015

In April 2015, the Pensions Investment Research Consultants ("PIRC"), the independent research and advisory body that provides services to institutional investors on corporate governance and corporate social responsibility, published its latest UK Shareowner Voting Guidelines.

Some of the key changes and additions which may be of interest to UK listed companies are in respect of the following areas:

- The Board.
- Report and accounts, audit and financial controls.
- Shareowner rights, capital stewardship and corporate actions.
- Directors' remuneration.
- Investment companies.
- Sustainability and corporate responsibility reporting.

Changes from the previous edition of the guidelines include:

- the guidance that, before allocating capital within a company, directors should consider whether it may be more appropriate to return that capital to shareholders; and
- the removal of the statement, included in the 2014 guidelines, that PIRC will normally consider general authorities for share buybacks up to 15% of the issued capital to be acceptable. No replacement figure is included in the guidelines.

The PIRC UK Shareowner Voting Guidelines 2015 are available to order here:

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

Corrupt Asset Recovery: Proposal to Introduce Unexplained Wealth Orders

Transparency International has published a discussion paper on a proposal for the introduction of Unexplained Wealth Orders ("UWOs") and other potential new approaches to assist with the recovery of proceeds of corruption in the UK. UWOs would be intended to increase the effectiveness of Suspicious Activity Reports ("SARs") in the UK, which are issued by certain designated individuals whenever they suspect that a person is engaged in money laundering. Transparency International notes that whilst around 14,000 SARs were issued last year to request consent to proceed with a certain transaction, this led to action being taken in relation to just seven transactions.

Transparency International proposes that law enforcement agencies would have the power to issue a UWO to individuals linked to suspicious UK assets or transactions, who would be required to explain legitimate and legal sources of wealth. If the suspect fails to respond to the UWO, or provides an inadequate response, civil recovery processes could then be used in relation to that asset. The UWO process would also lengthen the investigation period available to the authorities following a SAR, which would be suspended pending the return of the UWO.

As with some other recent UK statutes, Transparency International suggests that UWOs should apply extra territorially wherever there is a sufficient connection to the UK (which may consist of unlawful activity in the UK, assets located in the UK at a relevant time, a British citizen, resident or person domiciled in the UK being involved, or a company linked to the case being incorporated in the UK).

The full text of the discussion paper can be found at:

http://www.transparency.org.uk/our-work/publications/15-publications/1275-empowering-the-uk-to-recover-corrupt-assets

US DEVELOPMENTS

SEC and NYSE/Nasdaq Developments

SEC Chair Speaks on Whistleblower Programme

In April 2015, US Securities and Exchange Commission ("SEC") Chairwoman Mary Jo White delivered a speech on the SEC as the whistleblower's advocate, and in particular, discussing the recent enforcement action against KBR Inc. ("KBR") for improperly restrictive language in a confidentiality agreement that impeded whistleblowers from communicating with the SEC (discussed in further detail below).

Commenting on the success of the SEC's whistleblower programme in the four years since it was implemented as part of the reforms established by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("the Dodd-Frank Act"), Chairwoman White noted that one effect of the programme has been to create a powerful incentive for companies to self-report wrongdoing to the SEC, as companies now know that if they do not, the SEC may hear about the conduct from someone else.

Under the programme, a whistleblower may be entitled to an award where he or she voluntarily provides the SEC with original information that leads to a successful enforcement action or related action with monetary sanctions exceeding $1,000,000. If those criteria are met, the whistleblower may apply for an award, which can range between 10% to 30% of the amounts collected in the case. A total of 17 whistleblowers have thus far received awards. Payouts have totaled nearly $50 million, and the SEC has made individual awards in excess of $1 million three times. The highest award to date is over $30 million. In the last fiscal year, the SEC issued more awards to more people for more money than in any previous year – and that trend is expected to accelerate.

In the context of discussing how confidentiality agreements are affected by the rule prohibiting actions that could impede an individual from communicating directly with the SEC staff about possible securities law violations, Chairwoman White said, "The SEC is not trying to dictate the language of these agreements or warnings – that is the company's responsibility. But a company needs to speak clearly in and about confidentiality provisions, so that employees, most of whom are not lawyers, understand that it is always permissible to report possible securities laws violations to the Commission."

In the SEC's recent enforcement action, the company addressed the issue by changing the violative language to say explicitly that the agreement does not prevent individuals from reporting possible violations of the law to federal law enforcement agencies. And to remedy any potential harm already done, the company also undertook to notify employees who had signed the original agreement that they are not required to seek permission before communicating with any governmental agency concerning possible violations of federal law. Companies would be well-served to review their own agreements and policies to ensure that they are consistent with this and all of the whistleblower rules.

The full text of Chairwoman White's speech The SEC as the Whistleblower's Advocate is available at:

http://www.sec.gov/news/speech/chair-white-remarks-at-garrett-institute.html

Our related client publication is available at:

http://www.shearman.com/en/newsinsights/publications/2015/04/confidentiality-agreements-impede-whistleblowing

NYSE and Nasdaq Revise Guidance on Application of 20% Shareholder Approval Rule to Convertible Bonds

Both the New York Stock Exchange (the "NYSE") and the NASDAQ Stock Market ("Nasdaq") require companies that are listed on their exchanges to obtain shareholder approval for issuances of common stock, or securities convertible into or exercisable for common stock, representing 20% or more of the voting power or number of shares of common stock outstanding before the issuance. This "20% rule" does not apply to public offerings or where the price of the stock to be *issued* is at least the greater of the book or market value of the stock. This rule is intended to protect public shareholders from dilutive transactions.

The NYSE and Nasdaq altered their views about how the 20% shareholder approval rule applies to convertible bonds. The new views remove a potential obstacle to US public companies seeking convertible bond financing. The changes specifically affect companies doing offerings made pursuant to Rule 144A ("Rule 144A") under the Securities Act of 1933 (the "Securities Act") where the number of shares underlying the convertible bonds exceeds 20% of the outstanding shares.

The NYSE and Nasdaq rule changes apply to Rule 144A offerings of convertible bonds that allow for settlement in cash or a combination of cash and shares. Previously, shareholder approval was required if a listed company offered convertible bonds like that under Rule 144A and the number of shares of common stock underlying the convertible bond exceeded 20% of the outstanding shares or voting power. Now, the NYSE and Nasdaq will treat alike convertible bonds with flexible settlement and convertible bonds that only convert into shares of common stock. If the conversion price is at least equal to the greater of the book value and market value per share of common stock, no shareholder approval will be required.

It should be noted, however, that Nasdaq's rules have a separate requirement for a shareholder vote if the use of proceeds of convertible bonds with 20% or more underlying common stock is to acquire the stock or assets of another company. In such a case, the greater than book and market exemption is not available.

The new guidance was published by Nasdaq in March 2015 under FAQ # 1136 on the Frequently Asked Questions section of Nasdaq's website. The NYSE has also changed its interpretation of the greater than book and market exemption in its rules. The new interpretation can be confirmed with NYSE staff members.

An article by Shearman & Sterling partner Robert Evans on this topic is available at:

http://www.shearman.com/en/newsinsights/publications/2015/06/nasdaq-and-nyse-rules-affecting-convertible-bonds

Regulation A+ Comes into Effect, Providing New Capital Raising Alternatives for Non-SEC Reporting Companies

Non-SEC reporting US and Canadian companies may now raise up to $50 million in a 12-month period under an expanded exemption from the registration requirements of the Securities Act under amendments to Regulation A. This expanded exemption, often referred to as Regulation A+, came into effect on 19 June 2015.

Prior to the adoption of the amendments, offerings under Regulation A were limited to $5 million in any 12-month period, required significant disclosure and were subject to compliance with state securities or "Blue Sky" laws. As a result, Regulation A was rarely used.

The amended rule creates two tiers of offerings: Tier 1 for offerings of up to $20 million in any 12-month period, and Tier 2 for offerings of up to $50 million in any 12-month period. These two tiers have different disclosure and ongoing reporting obligations. Under the amended rule, the exemption is available for sales by existing stockholders, though subject to tighter limits. The amended rule provides many of the benefits available to "emerging growth companies," including permitting issuers to make confidential submissions to the SEC for the first offering, engage in certain test-the-waters activities and delay implementation of new accounting rules in certain circumstances. Tier 2 offerings are not subject to registration or qualification requirements under Blue Sky laws, although issuers may still be required to make filings and pay fees in states where securities are sold. Tier 1 offerings remain subject to Blue Sky laws.

Our related client publication, which provides further information on the "Regulation A+" exemption, is available at:

http://www.shearman.com/en/newsinsights/publications/2015/04/non-sec-reporting-companies-regulation-a

The SEC has published compliance and disclosure interpretations, providing guidance on frequently asked questions regarding the new "Regulation A+" rules, which can be found at:

http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm#182.01

Conflict Minerals Reporting Update

1 June 2015 marked the deadline for the second year of reporting under the SEC's conflict minerals rule. Under the SEC's conflict minerals reporting requirements, companies that are subject to reporting under the US Securities Exchange Act of 1934 (the "Exchange Act"), must assess whether they manufacture or contract to manufacture products containing tin, tungsten, tantalum or gold ("Conflict Minerals"). If Conflict Minerals are necessary to the functionality or production of the reporting company's products, the company must undertake a reasonable country of origin inquiry and file with the SEC a specialised disclosure report on Form SD. If the company knows or has reason to believe that the Conflict Minerals used in its products originated in the Democratic Republic of the Congo or one of the countries that borders it, the company must also undertake due diligence on the source and chain of custody of those Conflict Minerals and file a Conflict Minerals Report with the SEC.

In April 2015, two human rights non-governmental organisations, Amnesty International and Global Witness, published a report analysing compliance by US reporting companies with the SEC's conflict minerals rules. The report, which reviewed the conflict minerals disclosures of 100 companies, provides helpful insights for identifying best practises for conflict minerals supply chain due diligence and reporting.

Best practises identified by the report for companies to consider at the reasonable country of origin inquiry and Form Securities and Exchange Commission ("SD") disclosure stage include:

- disclosing information on the number of suppliers surveyed and the supplier response rate;
- adopting a policy for following up with unresponsive or unco-operative suppliers; and
- building conflict minerals-related clauses into existing, new and/or renewed contracts with suppliers that require suppliers to comply with information requests about conflict minerals chain of custody or requiring compliance with the reporting company's conflict minerals policy.

At the due diligence and Conflict Mineral Report stage, the report's recommendations for companies to demonstrate the actions they have taken to meet each step of the due diligence framework are set forth in the Organization for

Economic Co-operation and Development's ("OECD") Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas (the "OECD Guidance") include:

- adopting a conflict minerals policy based on the model supply chain policy in Annex II of the OECD Guidance and implementing internal controls to put the policy into practise;
- implementing a grievance mechanism, or whistleblower policy, to improve risk awareness;
- seeking to identify the specific smelters and refiners from which the conflict minerals in their supply chain were ultimately sourced or, if a company is unable to do so, describing in detail the company's efforts to identify the smelters and refiners; and
- reporting on how they defined, identified, mitigated and managed risk in their supply chain with specific details and examples, and, in each reporting period, companies should demonstrate where they have made measurable improvements in terms of identification and management of risk in their conflict minerals supply chain.

The Amnesty International/Global Witness report, Digging for Transparency, is available at:

http://www.globalwitness.org/campaigns/democratic-republic-congo/digging-transparency/

Our related client publication is available at:

http://www.shearman.com/en/newsinsights/publications/2015/04/sec-conflict-minerals-rule-compliance

Sanctions Round-Up

On 22 April 2015, we published the first quarter 2015 issue of our quarterly Sanctions Round Up.

After months of intense negotiations, the first quarter of 2015 saw the announcement of a framework agreement between the P5+1 and Iran that, if it results in a final agreement, will lead to a suspension of Western sanctions. In another historic moment, the United States announced the first Cuba-related regulatory reforms following President Obama's 2014 announcement that his administration would seek to improve economic ties with the country. The United States and the EU continue to implement tough sanctions targeting Russia despite the negotiation of a new Ukraine armistice in February. In the spotlight for enforcement actions this quarter was the long-anticipated settlement between Commerzbank AG and US authorities over alleged sanctions violations.

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

- the United States and the EU continue targeting Russia for its activity in Ukraine;
- Cuba-related regulatory reforms announced;
- P5+1 and Iran reach framework agreement;
- US enforcement actions: Spotlight on Commerzbank AG;
- the United States uses sanctions to target terrorists abroad; and
- Office of Foreign Assets Control ("OFAC") continues use of Kingpin Act to target drug traffickers worldwide.

Our Sanctions Round-Up: First Quarter 2015 is available at:

http://www.shearman.com/en/newsinsights/publications/2015/04/sanctions-round-up-first-quarter-2015

Noteworthy US Securities Law Litigation

In Re Kingate Management Limited Litigation: Court Defines Contours of Preclusion of State Law Claims Under the Securities Litigation Uniform Standards Act

On 23 April 2015, the federal appellate court based in New York addressed the circumstances in which state law claims are precluded by the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"). SLUSA bars class (and certain other group) actions based on state law that allege falsity in connection with transactions in "covered securities". In *In re Kingate Management Limited*, the plaintiffs brought several state law causes of action arising out of their investments in a "feeder fund" that in turn invested those funds in Bernard Madoff's Ponzi scheme. The court here set forth several standards clarifying which state law claims are precluded by SLUSA, vacated the district court's decision and remanded the case for the district court to apply these standards.

The court first held that, even though the plaintiffs did not directly purchase "covered securities," their investments in funds that promised to invest only in common stocks that qualify as "covered securities" was sufficient to satisfy SLUSA's requirement of transactions in covered securities. Next, the court addressed what types of conduct are covered by SLUSA in light of the statute's goal of preventing plaintiffs from circumventing the strictures of the Private Securities Litigation Reform Act of 1995 by bringing state law claims for conduct that is actionable under the federal securities law. The court held that "claims accusing the defendant of complicity in the false conduct that gives rise to liability" are covered, but SLUSA does not apply where the defendant is not alleged to have been complicit. This ruling challenged the suggestion of other courts that SLUSA might extend to third-party conduct in which the defendant was not complicit.

Lastly, the court held that if the alleged falsity "is extraneous to the complaint's theory of liability, it cannot be the basis for SLUSA preclusion." But the court explained that, as long as the success of a state law claim depends on the defendant's false conduct, that claim is still barred under SLUSA even if the false conduct is not an essential element of the claim. Plaintiffs thus cannot evade SLUSA preclusion by artfully pleading a claim premised on false conduct under the guise of a state law cause of action that does not require falsity. Lastly, a plaintiff cannot evade SLUSA by omitting "status-based" allegations, such as an allegation that the false conduct related to transactions in "covered securities."

The court in *In re Kingate Management* applied these general principles to five categories of allegations and instructed the district court to determine whether SLUSA precludes the state law claims at issue based on the category that applies to each specific claim. In this case, the court enunciated general principles in an attempt to clarify what it viewed as "questions not clearly resolved by [SLUSA's] ambiguous text." These standards will aid litigants in determining, at least within the states under the jurisdiction of this appellate court, which state law claims related to securities transactions are precluded by SLUSA.

IBEW Local Union No. 58 Pension Trust Fund and Annuity Fund v. Royal Bank of Scotland Group, PLC: Court Dismisses Securities Claim at the Pleading Stage on Materiality Grounds

On 15 April 2015, in *IBEW Local Union No. 58 Pension Trust Fund and Annuity Fund v. Royal Bank of Scotland Group, PLC*, the federal appellate court in New York, affirmed the dismissal of claims brought under Sections 10(b) and 20(a) of the Exchange Act alleging that the Royal Bank of Scotland ("RBS") made fraudulent statements about its economic health during the recent financial crisis. The court affirmed the district court's granting of the defendants' motion to dismiss for several reasons, including the immateriality of RBS's statements about its subprime assets under the standards that the SEC has set forth in its Staff Accounting Bulletin No. 99 ("SAB 99").

The plaintiffs' claims related to statements that RBS made from mid-2007 through early 2008 concerning its exposure to subprime mortgage assets, the success of a bank that it acquired and RBS's decision to raise capital. First,

the court held that the allegation that RBS failed to disclose $6.8 billion in subprime assets was not material under SAB 99 because that amount did not meet the quantitative threshold of 5% of the company's assets, and SAB 99's qualitative factors did "not favor treating the presumptively immaterial statements as material." Even if asset-backed securities were important to RBS's profitability, that alone did not make the statements material when the plaintiffs failed to allege other qualitative indicia of materiality, such as masking a change in earnings, making the difference between a loss and a profit, unlawful activity, or a significant market reaction to the alleged misstatement.

Next, the court affirmed the dismissal of claims based on RBS's statements that it was "not asked to raise capital by anyone" and that it was "purely" RBS's decision to do so. Even though the head of the UK Financial Services Authority ("FSA") testified that RBS was "specifically required" to "raise as much capital as possible," the court held (over the dissent of one judge) that this statement was not material in light of RBS's statement that the FSA had encouraged it to raise capital, the fact that RBS was already preparing to do so, general knowledge about a deterioration in the market's and RBS's financial condition and RBS's compliance with FSA capital guidelines. Applying the well-established materiality standard, the court held that "[i]n light of the total mix of information available [. . .] , a reasonable investor would have deemed the difference between 'encouraged' and 'required' to be immaterial." Lastly, the court held that positive statements about the acquisition of another bank, such as the assertion that it was "off to a promising start," were "[s]tatements of general corporate optimism" and thus inactionable puffery.

This decision shows that, even though plaintiffs often argue that questions of materiality raise fact-intensive issues that cannot be decided at the pleading stage, at least some courts are willing to dismiss a securities claim even at the motion-to-dismiss stage if the court concludes that the statement would not be important to a reasonable investor. In addition, at least within the states under the jurisdiction of this appellate court, the quantitative and qualitative factors that the SEC has set forth in SAB 99 will play a significant role in determining the materiality of an alleged misstatement concerning a financial metric.

US Securities and Exchange Commission v. Big Apple Consulting USA, Inc.: Supreme Court's Limitation of Liability Under Rule 10b-5(b) of the Exchange Act to the "Maker" of a Statement Does Not Apply to Section 17(a)(2) of the Securities Act

On 9 April 2015, in *SEC v. Big Apple Consulting USA*, the federal appellate court based in Atlanta, Georgia, reviewed a jury verdict in favour of the SEC in an enforcement action under Section 17(a)(2) of the Securities Act. The defendants argued that, under the US Supreme Court's landmark decision in 2011 in *Janus Capital Group, Inc. v. First Derivative Traders*, they did not "make" the statements at issue because they only repeated statements given to them by the issuer. But the court held that *Janus*, which addressed claims brought under Rule 10b-5(b) of the Exchange Act, does not apply to claims brought under Section 17(a)(2) of the Securities Act.

The Supreme Court held in *Janus* that the "maker" of a statement under Rule 10b-5(b) "is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it." In *Big Apple Consulting*, the SEC brought a civil enforcement action under Section 17(a)(2) against parties that provided public relations services to a company that blatantly misrepresented its success in selling customisable USB drives. The court held that *Janus*'s limitation of liability to the "maker" of a misleading statement does not apply to claims brought under Section 17(a)(2) because Section 17(a)(2) covers those who "obtain money or property by means of" such statements. The court explained that because Section 17(a)(2), unlike Rule 10b-5, allows for only governmental actions, not private rights of action, "there is not the same concern regarding the expansion of a judicially-created private right of action." The court here also held that *Janus* does not apply to all of Section 17(a) as a whole. Under *Janus*, a party that does not "make" a statement can still be liable under Rule 10b-5(a) and (c), which "does not use the word 'make' or even address misstatements." The court reasoned that it would "be incongruous to remove the potential for liability under § 17(a)(1) and (3)," which served as models for Rule 10b-5(a) and (c).

In *Big Apple Consulting*, the court limited *Janus*'s holding by explaining that in its view the *Janus* rule does not apply to governmental claims brought under Section 17(a)(2). Moreover, according to this court, *Janus* does not apply to Section 17(a) at all or to Rule 10b-5(a) and (c). It is therefore important to remember that, while *Janus* places a substantial limitation on which parties are subject to liability as the "maker" of misleading statements under Rule 10b-5(b), those parties might still be subject to primary liability under other provisions of the securities laws.

Recent SEC/DOJ Enforcement Matters

In the Matter of KBR, SEC Administrative Proceeding No. 3-16466: SEC Enforces Whistleblower Protections Against Overbroad Confidentiality Agreements

On 1 April 2015, the SEC filed its first enforcement action under Section 21F of the Exchange Act and Exchange Act Rule 21F-17 promulgated thereunder, which is intended to prevent issuers from taking steps that impede employees from reporting potential federal securities law violations to the SEC. In its settlement with KBR, the SEC alleged that, at interviews during internal investigations, KBR required employees to sign a confidentiality statement containing overly restrictive language that could be read to discourage employees from reporting potential violations of the federal securities laws to the SEC.

In 2011, the SEC enacted Rule 21F-17 to implement whistleblower protections that Congress included in legislation following the recent financial crisis. In order to protect whistleblowers who report possible violations of the securities laws, this rule prohibits employers from "imped[ing] an individual from communicating directly with SEC staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement" that prohibits whistleblowers from communicating with the SEC. According to the SEC, KBR, a global technology and engineering firm based in the United States, routinely required employees to sign confidentiality agreements when it conducted investigative interviews regarding potential illegal or unethical conduct. Employees promised in these statements not to disclose any aspect of the investigation or the interview without prior authorisation from the company's legal department.

The form confidentiality agreements at issue here, which KBR had been using since before Rule 21F-17 existed, did not expressly prohibit communication with regulators. Nor did the SEC know of any efforts by KBR to enforce these confidentiality provisions or of any employees who had in fact been dissuaded from becoming whistleblowers by them. Yet the SEC claimed that requiring employees to agree to such broad confidentiality language could potentially discourage them from reporting possible securities law violations to the SEC. As part of its settlement, in which KBR neither admitted nor denied the SEC's claims, KBR agreed to (i) pay a civil penalty of $130,000, (ii) revise the language of its confidentiality agreement to make clear that it does not prohibit an employee from reporting possible violations of federal law or regulation to the government, (iii) try to contact the affected employees to clarify the scope of their confidentiality provisions and (iv) cease and desist from violating Rule 21F-17.

While KBR has been at the centre of the SEC's Rule 21F-17 enforcement efforts since at least June 2014, the SEC has more recently demonstrated a broader interest in the area of whistleblower protections. In February 2015, it was widely reported that the SEC's Enforcement Division sent inquiries to dozens of public companies asking for employment-related documents containing confidentiality provisions so that the SEC could investigate whether companies were stifling whistleblowing through overly restrictive language. Companies within the SEC's enforcement jurisdiction might consider consulting with counsel about whether they should change any of their employment-related agreements based on this enforcement action.

For more information on the KBR matter, please see our client note at:

http://www.shearman.com/en/newsinsights/publications/2015/04/confidentiality-agreements-impede-whistleblowing

In the Matter of BHP Billiton Ltd. and BHP Billiton Plc, SEC Administrative Proceeding No. 3-16546: SEC Charges FCPA Accounting and Books and Records Violations Without Allegations of Actual Bribery

On 20 May 2015, the SEC released an order settling alleged violations by BHP Billiton Ltd. and BHP Billiton Plc (collectively, "BHP") of the Foreign Corrupt Practises Act ("FCPA") stemming from BHP's sponsorship of the 2008 Beijing Olympics. The SEC alleged that BHP violated the FCPA through its invitations to foreign officials to attend the Olympics in Beijing. BHP agreed to pay $25 million to settle these claims, while neither admitting nor denying the SEC's allegations. Even though the SEC did not allege that BHP violated the FCPA's anti-bribery provisions, it pursued this civil enforcement action for alleged violations of the FCPA's accounting and books and records provisions.

According to the SEC Order, BHP, a multinational mining and resources company, received priority access to the Beijing Olympics in exchange for its sponsorship of the event. The company sought to use these benefits to further its business relationships. BHP also established an internal application process that sought to ensure that invitations extended to government officials did not constitute bribery. The SEC found BHP's internal application process to be deficient because of its insufficient review of applications, incomplete or inaccurate applications, lack of training, the absence of a process for updating applications and the failure to determine whether invitees had relationships with other parts of the company. The SEC found that, as a result of these holes in the company's application process, foreign officials from four countries that had the ability to directly influence BHP's current business interests received invitations and one of them attended. In addition, the SEC noted the large number of foreign officials that BHP invited, many of whom did business with BHP, as well as the luxurious nature of the hospitality packages that BHP offered.

In addition to the $25 million monetary penalty, BHP agreed to report to the SEC for one year on its FCPA and anti-corruption compliance programme. The SEC also noted the significant cooperation and remedial actions that the company had undertaken. The fact that the SEC charged BHP only with violations of the FCPA's accounting and books and records provisions, but not bribery, cuts both ways. On the one hand, this means that companies can be subject to FCPA enforcement based solely on their internal compliance procedures even if they do not engage in a quid pro quo exchange with foreign officials. But on the other hand, the SEC also noted what it viewed as substantial deficiencies in BHP's compliance procedures and ways in which BHP extended invitations in high-risk situations. What the SEC viewed as flaws in BHP's process for extending invitations to foreign officials can therefore provide guidelines as to how a company might make its process for offering benefits to government officials more compliant with the FCPA.

For more information on the BHP Billiton matter, please see our client note at:

http://www.shearman.com/en/newsinsights/publications/2015/06/fifa-and-bhp-billiton-the-unique-fcpa-challenges

Six Banks Plead Guilty to Various Criminal Violations in Connection with Practises Related to Benchmark Interest Rates and Foreign Exchange Activity

Since the end of April 2015, six major banks have pleaded guilty to criminal charges related to their roles in manipulating benchmark interest rates (such as the London Interbank Offered Rate ("LIBOR")) or foreign exchange transactions. There are differences between these agreements, including the conduct at issue, the penalty amounts, the statutory violations, the pleading entity's role within the organisation, and the government regulators involved. But all of these settlements also share important features that highlight current trends in regulatory enforcement of the financial markets.

On 23 April 2015, Deutsche Bank AG ("Deutsche Bank") and certain affiliates entered into a set of settlement agreements with several US and UK regulators in connection with investigations into its past submissions for several benchmark interest rates, including LIBOR. The bank agreed to pay approximately $2.5 billion in total to settle these claims. Broadly, the regulators charged that, from 2003 to 2011, Deutsche Bank's derivative traders arranged for parties submitting benchmark rates to manipulate those rates to benefit the traders' positions. Deutsche Bank was also accused of coordinating the manipulation of rates with other banks. DB Group Services (UK), a Deutsche Bank UK subsidiary, pleaded guilty to one count of federal wire fraud, a felony criminal charge, brought by the US Department of Justice ("DOJ"). Deutsche Bank also entered into a deferred prosecution agreement with the DOJ and settlements with several other US and UK regulators to resolve other charges related to these practises. The guilty plea of Deutsche Bank's subsidiary could have affected the company's ability to do business in the US securities markets in certain ways, including its qualification for exemptions from registration requirements for securities offerings and its ability to act as an asset manager, investment advisor or principal underwriter. But the SEC has granted Deutsche Bank waivers that allow it to continue conducting these activities, or Deutsche Bank has been told that regulators will support its pending applications for such exemptions.

On 20 May 2015, The Royal Bank of Scotland PLC, Barclays PLC, Citicorp and JP Morgan Chase & Co. each pleaded guilty to a single criminal charge brought by the DOJ of price fixing in violation of the antitrust laws in connection with their manipulation of the foreign exchange markets after varying periods from the end of 2007 to the beginning of 2013. UBS AG received immunity from these antitrust charges, but pleaded guilty to manipulating LIBOR because it engaged in other deceptive foreign currency practises in violation of its earlier non-prosecution agreement concerning LIBOR. Barclays also agreed that its foreign exchange activities violated its earlier LIBOR agreement. These five banks agreed to pay $5.6 billion in total, including penalties paid to other US and UK regulators. In combination with prior settlements, these five banks have agreed to pay nearly $9 billion in fines and penalties to settle claims relating to their foreign exchange practises. All five banks also agreed to a three-year probationary period and to notify parties that might have been affected by the relevant activity. As with the Deutsche Bank settlement described above, the guilty pleas here could affect these banks' ability to continue to conduct certain securities businesses. The DOJ even highlighted the significance of "parent-level guilty pleas." But, as with Deutsche Bank, these banks have already received, or are in in the process of applying for, waivers from these restrictions. Separate from these guilty pleas, Bank of America Corporation agreed to pay a $205 million penalty to resolve foreign exchange issues with the Federal Reserve.

While the details of these agreements vary, their commonalities show certain trends in US and UK regulators' enforcement actions aimed at financial fraud. First, the DOJ seems more ready to seek guilty pleas to criminal charges than it had been in the past. So far, regulators have permitted banks exemptions that enable them to avoid certain restrictions on their business activities that could otherwise result from criminal violations. But the public backlash against these exemptions raises some doubt as to whether these regulators will continue to grant such exemptions so freely in the future. In addition, while none of these agreements include charges against individual employees, they do not preclude such charges in the future. A number of individuals were fired as the conduct at issue came to light and several others were terminated as part of these agreements. Lastly, these agreements show that regulators are willing to find violations of prior non- (or deferred) prosecution agreements when they think subsequent activity violates those agreements.

Executive Compensation & Employee Benefits Developments

SEC Proposes Long-Awaited Pay for Performance Rules

On 29 April 2015, in a 3-2 vote of commissioners cast along party lines, the SEC proposed rules to implement Section 953(a) of the Dodd-Frank Act. Section 953(a) directs the SEC to promulgate rules to require public companies

to provide a clear description of any compensation required to be disclosed under Regulation S-K, Item 402, including information that shows the relationship between executive compensation "actually paid" to the registrant's named executive officers ("NEOs") and the registrant's financial performance, taking into account any change in the value of the shares of stock and dividends and any distributions. Foreign private issuers are exempt from these rules.

- Summary of Proposed Pay for Performance Rules
  - The proposed pay for performance rules would add a new paragraph (v) to Item 402 of Regulation S-K, which would require tabular disclosure of:
    - the compensation "actually paid" to the principal executive officer ("PEO");
    - an average of the compensation "actually paid" to the other NEOs;
    - the corresponding "total compensation" amount as shown in the summary compensation table ("SCT");
    - the registrant's total shareholder return ("TSR"); and
    - the registrant's peer group's TSR.
  - In addition, disclosure of the relationship between (1) compensation "actually paid" and the registrant's TSR on an annual basis and (2) the registrant's TSR and a peer group TSR on an annual basis, would be required in a narrative or graphical format or a combination of the two.
- Covered Executives
  - The proposed rules require disclosure for those executive officers for whom, under the current rules, compensation disclosure is required in the summary compensation table (i.e., the NEOs). The proposed rules would require that the compensation information be presented separately for the PEO and as an average for the remaining NEOs.
- Determining Compensation "Actually Paid"
  - The Dodd-Frank Act Section 953(a) provides no guidance as to what "actually paid" is intended to mean. The proposed rules would require registrants to determine compensation "actually paid" by reference to the "total compensation" measure included in the SCT, with certain modifications. Specifically, the "total compensation" measure should be modified with respect to:
    - Changes in actuarial pension value: only the actuarial present value of benefits attributable to services rendered during the applicable fiscal year, or the service cost (rather than the total change in actuarial pension value), is proposed to be included.
    - Equity awards: equity award values in this table would reflect the fair value on the vesting date (rather than the grant date), computed in accordance with the fair value guidance in FASB ASC Topic 718.
  - In addition to compensation "actually paid," the new tabular disclosure would also include the "total compensation" amount as shown in the summary compensation table presented separately for the PEO and as an average for the remaining NEOs, with footnote disclosures explaining the amounts included or deducted to arrive at amounts "actually paid," as well as any other materially different assumptions.
- Determining Measure of Performance (TSR)
  - Under the proposed rule, registrants are permitted to use the same index or peer group used for purposes of the "performance graph" under Item 201(e) of Regulation S-K, or, if applicable, the peer group used for the purposes of the benchmarking disclosures in the Compensation Discussion and Analysis on compensation

benchmarking practises. If the peer group is not a published industry or line-of-business index, the registrant must identify the companies comprising the group.

  - In the proposed rule, as TSR is measured at fiscal year-end, but equity award values are determined as of their respective vesting dates, there will be a mismatch in stock prices used in the disclosure.
  - Registrants would be permitted, as they currently are with other mandated disclosures, to disclose other measures of financial performance as long as that additional disclosure is clearly identified, not misleading and not presented with greater prominence than the required disclosure.
- Where Pay for Performance Disclosure is Required
  - The disclosure would be required in any proxy statement filed on Schedule 14A or information statement filed on Schedule 14C that mandates executive compensation disclosure under Item 402 of Regulation S-K, which would not include annual reports on Form 10-K or Form S-1 registration statements to the extent that disclosure under Item 402 of Regulation S-K is required therein.
  - In addition, as proposed, the disclosure would not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that a registrant specifically incorporates it by reference.
  - The proposal does not specify where in the proxy or information statement the new Item 402(v) disclosure must appear but rather affords registrants full flexibility to determine its location. We expect that registrants will include this information with the remainder of their Item 402 executive compensation disclosure.
- Covered Registrants
  - The proposed rules generally apply to all US companies that are registered under Section 12 of the Exchange Act, which are, therefore, subject to the federal proxy rules. As is the case with many disclosure requirements, special provisions apply to smaller reporting companies.
  - Emerging growth companies, foreign private issuers and registered investment companies would be exempt under the proposed rules.
- Covered Time Period; Transition Rules
  - The proposed rules would require registrants to provide the pay for performance disclosure for the five most recently completed fiscal years.
  - Registrants would be required to provide the proposed disclosure for three fiscal years, instead of five, in the first applicable filing after the rules become effective, and provide disclosure for an additional year in each of the two subsequent annual proxy filings where disclosure is required. Special transition rules apply for newly public companies.
- Disclosure to be Deemed "Filed"
  - The proposed rules provide that the pay for performance disclosure will be considered "filed" for purposes of liability under the Securities Act and the Exchange Act and the content is, therefore, subject to the certification requirements of Sections 13(a) and 15(d) of the Exchange Act.
- eXtensible Business Reporting Language ("XBRL") Format
  - Under the proposed rules, registrants would be required to tag the disclosure, including any footnote disclosure, in an interactive data format using eXtensible Business Reporting Language. This is the first time XBRL would be used for a proxy filing.

The comment period for the proposed rules ends on 6 July 2015. As the SEC received numerous comment letters on Section 953(a) prior to issuing the proposed rules, it is possible that final rules later this year would go into effect for the 2016 proxy season.

Our client publication discussing the proposed rules is available at:

http://www.shearman.com/en/newsinsights/publications/2015/04/long-awaited-pay-for-performance-rules

SEC Proposal on New Listing Standards for Compensation Recovery

On 1 July 2015, the SEC proposed rules to implement Section 954 of the Dodd-Frank Act. Section 954 directs the SEC to promulgate rules prohibiting any national securities exchange or securities association from listing any securities of an issuer that does not develop, implement and disclose a policy mandating that, in the event the issuer is required to prepare an accounting restatement due to the issuer's material noncompliance with any financial reporting requirement, the issuer will recover from any current or former executive officer any incentive-based compensation received by the executive officer during the previous 3-year period in excess of what would have been paid to the executive officer under the accounting restatement. The proposed rules refer to this excess compensation as "erroneously awarded compensation."

If finalized, the proposed rules would add Rule 10D-1 to the Exchange Act which sets forth the listing standards that the exchanges and associations would be required to establish. Pursuant to Rule 10D-1, these standards would require that each issuer's policy apply to incentive-based compensation received by any of its current or former executive officers during the three completed fiscal years immediately preceding the date on which the issuer is required to prepare a restatement. The erroneously awarded compensation would be determined without regard to any taxes paid. Failure of an issuer to adhere to the recovery policy would cause it to be delisted from any national securities exchange or association until it is in compliance. The following are some of the key components of proposed Rule 10D-1:

- Applies to almost all listed issuers, including smaller reporting companies, emerging growth companies, controlled companies, foreign private issuers and issuers that only list debt.
- Applies without regard to whether misconduct was a cause of the restatement.
- Includes a definition of "executive officer" that mirrors the definition of "officer" under Section 16 of the Exchange Act.
- Applies to incentive-based compensation based on, or derived from, financial information that must be reported under the securities laws, as well as on total shareholder return and stock price.
- Exempts awards that vest solely on the basis of time, including time-vested options.
- Recovers incentive-based compensation paid in excess of what would have been received had it been determined based on the restated financials.
- Prohibits the indemnification of covered officers against the loss of any recovered compensation.
- Requires the recovery policy be filed as an exhibit to the issuer's annual report.

The proposed rules also would: amend Regulation S-K by adding Item 402(w); amend the forms by which both domestic issuers and foreign private issuers file their Exchange Act annual reports, and, for certain investment companies, amend Form N-CSR and Schedule 14A. In addition to requiring disclosure regarding the listed issuers' recovery policies, these amendments would require disclosure by any issuer that, during the last completed fiscal year: (1) completed a restatement that required recovery of excess incentive-based compensation or (2) had an

outstanding balance of excess incentive-based compensation due to the application of the policy in a previous year. In addition, if an issuer decided not to pursue recovery from an individual, it must state the individual's name, the amount forgone and a brief description of the reason it decided not to pursue recovery. The disclosure required by Item 402(w) would have to be provided in interactive data format using the eXtensible Business Reporting Language ("XBRL"). As is the case with Rule 10D-1, these requirements would apply to foreign private issuers and certain investment management companies that are internally managed. The proposal would also require the Summary Compensation Table under Item 402(c) of Regulation S-K be updated as to prior years' compensation to reflect any reductions in compensation due to application of the clawback policy. While not addressed in the proposal, other tables and disclosures – notably pay for performance disclosure – could be impacted, as well.

Our client publication discussing the proposed rules is available at:

http://www.shearman.com/~/media/Files/NewsInsights/Publications/2015/07/SEC-Proposes-Highly-Anticipated-Clawback-Rules-ECEB-070915.pdf

ASIA DEVELOPMENTS

HKEx Publishes Consultation Conclusions on Weighted Voting Rights

On 19 June 2015, The Stock Exchange of Hong Kong Limited (the "Stock Exchange") published its Consultation Conclusions to its Concept Paper on Weighted Voting Rights ("WVRs" - governance structures that give certain persons voting power or other related rights disproportionate to their shareholding). For the background to the Concept Paper, you may refer to the Governance and Securities Law Focus of October 2014.

The Stock Exchange has stated that it is clear from responses to its Concept Paper that there are strong and divided views on WVRs but sufficient support to proceed to a second stage consultation on proposed listing rule changes on the acceptability of WVR structures. In terms of responses to its Concept Paper, the Stock Exchange reported that accountancy firms, investment banks, law firms and listed company staff overwhelmingly supported permitting WVR structures, in certain circumstances. Investment managers seemed split on the question whilst the professional bodies representing investment managers seemed, as a whole, strongly opposed to the possibility of companies with WVR structures listing in Hong Kong. A small number of respondents favoured the introduction of a class action regime prior to permitting companies with WVR structures listing but twice as many disagreed that this should be a prerequisite.

The Stock Exchange expects that listings of companies with WVR structures will not become commonplace in Hong Kong. The use of WVR structures would certainly be limited to new applicants though they will not be limited to a particular industry. The Stock Exchange believes that it is possible to implement certain investor protection standards, which may be associated with higher eligibility standards (e.g., a higher market capitalisation) and other pre-determined characteristics. Consultation with the Takeovers Panel of Hong Kong's Securities and Futures Commission ("SFC") is significant as the acceptance of certain WVR structures may be seen as frustrating bona fide offers for listed companies. Likely restrictions may also include the negation of WVRs on transfer, for example, to unaffiliated members of founding shareholders, and on-going requirements on the retention of a certain portion of equity for WVR rights to subsist.

The Stock Exchange has conducted a wholesale review of its listing rules and will propose changes to them as part of the second stage of its consultation on proposals to list companies with WVR structures. In addition, the Stock Exchange will review its policy that companies with a "centre of gravity" in China are not generally eligible for secondary listings. The purpose of this requirement was to ensure issuers based in Hong Kong or Mainland China that sought primary listings on other exchanges did not subsequently apply for a secondary listing in Hong Kong, taking

advantage of waivers that only pertain to secondary listings. Whilst this is likely to remain a relevant consideration, the Stock Exchange will review the "centre of gravity" restriction for secondary listings.

Subsequent to the issue of the Consultation Conclusions, Hong Kong's ultimate market regulator, the SFC issued a press release on 25 June 2015 stating that its Board does not support the draft proposal on primary listings with WVR structures. The SFC is of the view that Hong Kong's securities market and reputation would suffer if listed companies with WVR structures became commonplace. The SFC is concerned that the proposal to restrict WVR structures to large companies with high market capitalisations may be flawed as size offers no assurance that companies would treat its shareholders fairly. In addition, the reference to additional or enhanced "suitability" criteria involves a subjective element for regulators to determine eligibility, which gives rise to uncertainty and could result in inconsistent and unfair decision-making. It is also important to have measures in place to prevent ineligible issuers bypassing eligibility criteria through spin-offs, asset transfers or other corporate restructurings.

The Stock Exchange has indicated that it will consult further with the SFC in light of the views expressed and no expectation on timing for the second stage of the consultation was provided.

The Consultation Conclusions are aailable at:

http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp2014082cc.pdf

Corporate Governance Reforms in Japan

The last 18 months have brought a series of significant corporate governance reforms to Japan as part of the Abe government's economic revitalisation policies, including a Stewardship Code for institutional investors, a Corporate Governance Code for listed companies and a new board structure for public companies.

- Stewardship Code

  The first of such regulatory reforms, the Japanese Stewardship Code, was introduced in February 2014. Foreign observers have long criticised Japanese institutional investors for playing a passive role in corporate governance, prioritising their business relationships with the investee-company rather than financial returns. The Stewardship Code aims to change this dynamic by defining a more active role for these institutional investors. The Stewardship Code encourages institutional investors to work towards enhancing the medium to long-term investment return for their clients and beneficiaries by improving the investee companies' corporate value and sustainable growth through constructive engagement. The Stewardship Code sets forth seven principles, which are not legally binding but are applied in a comply-or-explain basis, and delineates duties that should be undertaken by institutional investors in order to ensure responsible investment. As of 11 June 2015, 191 institutional investors have announced their acceptance of the Stewardship Code.

  An English translation of the Stewardship Code can be found at:

  http://www.fsa.go.jp/en/refer/councils/stewardship/20140407/01.pdf

- Corporate Governance Code

  The most significant reform is the new Corporate Governance Code introduced in June 2015. The Corporate Governance Code applies to all listed companies in Japan and, similar to the Stewardship Code, will be binding on a comply-or-explain basis. The most noteworthy elements of the Corporate Governance Code include:

  - A requirement for at least two independent directors on the board of directors, with an aspirational goal that one-third of the directors be independent;
  - Encouragement of increased dialogue between companies and their shareholders;

  - A requirement for disclosure of the company's capital policy, cross-shareholdings in other listed companies and anti-takeover measures; and
  - A recommendation to arrange for director training and to disclose director training policies.

  An English translation of the Corporate Governance Code can be found at:

  http://www.fsa.go.jp/en/refer/councils/corporategovernance/20150306-1/01.pdf

- One Tier Board with Audit Committee Structure

  The final significant reform is a new board structure for public companies known as the "One-Tier Board with One Committee" structure, introduced through amendments to the Companies Act that became effective on 1 May 2015. The conventional board structure for Japanese companies is a two-tier structure, comprised of a board of directors and a committee of non-voting statutory auditors. The boards of directors under such structure have traditionally been comprised of inside directors, with non-management individuals serving only as non-voting statutory auditors. The new One-Tier Board with One Committee structure, by incorporating the audit committees into the board of directors, will result in the introduction of more outside directors because the audit committee must include at least two outside independent directors. As of 19 June 2015, over 200 listed companies have announced that they will adopt this new board structure.

CONTACTS

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

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