SHEARMAN & STERLING LLP

A QUARTERLY NEWSLETTER FOR CORPORATES

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EUROPE

Governance & Securities Law Update

Below is a summary of the main developments in US and EU corporate governance and securities law and certain financial markets regulation developments since our last update of July 2017.

The previous quarter's Governance & Securities Law Focus newsletter is available here. Financial regulation developments are available here.

In this Issue (please click on any title to go directly to the corresponding discussion):

EU DEVELOPMENTS

General

Directive (EU) 2017/1132 to Repeal and Codify Certain Existing Company Law Directives Has Been Published in the Official Journal

On 30 June 2017, Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017, relating to certain aspects of company law, was published in the Official Journal of the European Union. The directive repeals and codifies the following directives:

- Sixth Company Law Directive;
- Eleventh Company Law Directive;
- The Cross Border Mergers Directive;
- Directive 2009/101/EC regarding coordination of safeguards;
- Third Company Law Directive regarding mergers of public limited liability companies; and
- Second Company Law Directive regarding the formation of public limited companies and the alteration and maintenance of their capital.

This Directive entered into force on 20 July 2017, and a copy can be found at:

- *http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017L1132&from=EN*

ESMA Sees Continued Decline in Number of Prospectus Approvals

On 3 July 2017, the European Securities and Markets Authority ("**ESMA**") published its annual report on prospectus activity, where it reported that the number of prospectus approvals across the European Economic Area has fallen by roughly 8.5% from 2015 to 2016.

This report can be read at:

- *https://www.esma.europa.eu/press-news/esma-news/esma-sees-continued-decline-in-number-prospectus-approvals*

Prospectus Regulation: ESMA Publishes Consultation Papers on the Prospectus Regulation

On 6 July 2017, ESMA announced that it was publishing three consultation papers on the Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market ("**Prospectus Regulation**").

The consultation papers contain draft technical advice on:

- Format and content of the prospectus: ESMA includes proposals to reduce the burden and cost on issuers where securities are offered to the public or admitted to trading on a regulated market. This includes removing the requirement for a report by auditors or independent accountants on profit forecasts. ESMA has also developed draft requirements for the new universal registration document.
- The EU Growth prospectus: ESMA includes technical advice relating to the format and content of the small and medium enterprises ("**SME**") focused EU Growth prospectus. The consultation paper aims to ensure a proportionate disclosure regime for SMEs in relation to their size and the complexity of their operations. The consultation paper proposes:
    - a standardised format and sequence of the registration document and the securities note;
    - content requirements for the registration document and securities note; and
    - format and content of the summary.

- Scrutiny and approval of the prospectus: ESMA sought views on its draft technical advice to the European Commission ("**Commission**") on the scrutiny and approval of the prospectus. The consultation paper proposes:
    - a standard criteria for scrutiny of the prospectus which focuses on the completeness, comprehensibility and consistency of the prospectus. It goes on to suggest that, beyond that, national competent authorities should be given greater flexibility. ESMA also proposes to apply the general scrutiny criteria to the new universal registration document;
    - new approval and filing procedures for both market participants and national competent authorities, largely based on the existing provisions of the Omnibus II Regulation.

All three consultations closed on 28 September 2017, and ESMA will deliver the technical advice to the European Commission by 31 March 2018.

The consultation papers can be accessed here:

Format and content of a prospectus:

- *https://www.esma.europa.eu/sites/default/files/library/esma31-62-532_cp_format_and_content_of_the_prospectus.pdf*

The EU Growth prospectus:

- *https://www.esma.europa.eu/sites/default/files/library/esma31-62-649_cp_eu_growth_prospectus.pdf*

Scrutiny and approval of the prospectus:

- *https://www.esma.europa.eu/sites/default/files/library/esma31-62-650_cp_scrutiny_and_approval.pdf*

ESMA Publishes Updated Q&A on Alternative Performance Measures

On 12 July 2017, ESMA published updated Q&As on its guidelines on alternative performance measures ("**APMs**"). These guidelines ("**APM Guidelines**") are aimed at promoting the usefulness and transparency of APMs included in prospectuses and/or regulated information. They also seek to provide investor protection, and to give a true and fair view of an issuer's assets, liabilities and financial position and profit or loss pursued by the provisions.

Updates in the Q&A include:

- Question 8 – Interim Financial Statements: ESMA confirmed that Paragraph 31 of the APM Guidelines applies to APMs related to quarterly financial figures included in ad-hoc disclosures published in accordance with Article 17 of Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse ("**MAR**"), even when the issuer is not required to publish quarterly financial statements in accordance with the EU Transparency Directive;
- Question 9 – Concept of Prominence: ESMA confirmed that the APM Guidelines do not define the concept of prominence, and so issuers should use their judgement when complying with this principle. Judgement should be made on a case-by-case basis depending on the documents where the APMs are included. The updated Q&A provides a list of factors which may help issuers when exercising their judgement;
- Question 10 – Compliance by Reference: ESMA confirmed that Paragraphs 45 and 46 provide practical relief to issuers who may comply with the principles included in the APM Guidelines if they include a direct reference to other documents previously published which contain the disclosures required by the APM Guidelines;
- Question 11 – Definition of an APM: ESMA confirmed that "result of operating activities" is an APM for the purpose of the APM Guidelines unless the applicable financial reporting framework defines or specifies "result of operating activities".

The updated Q&A can be accessed at:

- https://www.esma.europa.eu/sites/default/files/library/esma32-51-370_qas_on_esma_guidelines_on_apms.pdf

ESMA Recommends Improvements in Financial Information Enforcement

On 18 July 2017, ESMA published the results of its peer review investigating how national competent authorities ("**NCAs**") supervise financial information as per the Guidelines on Enforcement of Financial Information. The report addresses areas where NCAs can improve their enforcement and makes recommendations to this effect, specifically:

- how issuers are selected to examine their financial information;
- the depth of inquiries into financial statements that go beyond correcting disclosure; and
- the financial and human resources allocated to the enforcement of financial information by NCAs.

The full text of the peer review is available here:

- https://www.esma.europa.eu/press-news/esma-news/esma-recommends-improvements-in-financial-information-enforcement

ESMA: Updated Q&A on MAR

On 1 September 2017 and 29 September 2017, respectively, ESMA published further updates to its Q&A on MAR. We discussed this in the Q2 2017 edition of *Governance & Securities Law Focus*. Changes since the last version include:

- A new question relating to market sounding (Q9): this asks whether communications of information to potential investors, made prior to the announcement of a transaction in order to gauge interest in a possible transaction are caught by Article 11 of MAR. ESMA's response distinguishes between situations where the financial instrument which is the subject of the possible transaction is:
    - already admitted to trading, is traded on a trading venue or a request for admission to trading has been made (when the transaction would fall within the scope of Article 11); and
    - not admitted to trading, not traded on a trading venue and no request for admission to trading has been made (when the instrument would not fall within Article 2(1)(a)-(c)).
- ESMA notes that an instrument could still be caught, by virtue of Article 2(1)(d) of MAR, if its price or value depended on, or had an effect on, the price or value of another instrument that was in scope of MAR. Disclosers must assess on a case-by-case basis whether there is any relationship between the price or value of the financial instrument which is the subject of the market sounding and any other instrument falling within the scope of MAR. Disclosers will be expected to document their assessment;
- Two questions relating to insider lists (Q10.1 and Q10.2): Q10.1 considers whether persons acting on behalf of or on account of an issuer, such as advisers and consultants, are subject to the obligation to draw up, update and provide, upon request, their own insider lists under Article 18(1) of MAR. Q10.2 discusses the circumstances in which an issuer remains responsible for compliance;
- A new answer to existing Q6.1 to clarify the scope of Article 16 MAR. ESMA states that non-financial firms trading in financial instruments as part of their business activities can be considered firms professionally arranging or executing transactions in financial instruments under Article 16(2) of MAR;
- A new question relating to disclosure of inside information (Q5.2): this asks what an issuer should do if disclosure of inside information has been delayed and then that information ceases to be inside information before the delayed disclosure is released.

  ESMA says that, where the issuer has delayed the disclosure of inside information in accordance with Article 17.4 of MAR, and the information subsequently loses the element of price sensitivity, Article 17.1 of MAR can no longer apply, so the "stale" inside information does not have to be announced.

However, given that the information has previously been inside information for a certain period of time, the issuer has to comply with the other MAR obligations that applied to the information while it qualified as inside information, such as entries on insider lists and the record-keeping required while the inside information was being delayed.

- The full text of the updated Q&A is available at:
- *https://www.esma.europa.eu/sites/default/files/library/esma70-145-111_qa_on_mar.pdf*

ESMA Welcomes Proposals Following the ESAs review

ESMA welcomes the European Commission's proposals published on 20 September 2017 following the outcome of its review on the operations of the European Supervisory Authorities ("**ESAs**").

ESMA will study the proposals with interest and await the outcome of the co-legislative process.

The proposals can be accessed here:

- *http://europa.eu/rapid/press-release_IP-17-3308_en.htm*

European Commission Publishes Proposals to Reform the EU's Supervisory Structure

On 20 September 2017, the European Commission published proposals to reform the EU's supervisory structure. This included extending the role and powers of ESMA with respect to market abuse and prospectuses, and signifies the first step towards the establishment of a single European capital markets supervisor.

Among other responsibilities, ESMA will be tasked with approving the following type of prospectuses:

- prospectuses for certain wholesale non-equity securities;
- prospectuses relating to asset-backed securities;
- prospectuses that are drafted by property, mineral, scientific research-based or shipping companies; and
- prospectuses drafted by non-EU country issuers.

The press release published by the European Commission can be found at:

- *http://europa.eu/rapid/press-release_IP-17-3308_en.pdf*

EU Final Draft Technical Standards on the Trading Obligation for Derivatives Published

On 28 September 2017, ESMA published a final report and final draft regulatory technical standards ("**RTS**") on the trading obligation for derivatives under the Markets in Financial Instruments Regulation ("**MiFIR**"). The trading obligation is applicable to classes of derivatives that: (i) have been declared subject to the clearing obligation under the European Market Infrastructure Regulation ("**EMIR**"), (ii) are admitted to trading or have traded on at least one EU trading venue (a regulated market, multilateral trading facility, organized trading facility or a third-country equivalent trading venue) and (iii) are sufficiently liquid. Where ESMA determines that a class of derivatives should be subject to the MiFIR trading obligation, third-country trading venues would only be permissible for trading by EU entities when determined to be equivalent by the European Commission. The trading obligation will apply to financial counterparties and to non-financial counterparties.

The final draft RTS on the trading obligation provide for the trading obligation to apply to fixed-to-float interest rate swaps ("**IRS**") denominated in euros, US dollars and pound sterling and to index credit default swaps ("**CDS**") (iTraxx Europe Main and iTraxx Europe Crossover). The trading obligation for both IRS and CDS will apply from 3 January 2018, unless the clearing obligation for a particular class of derivatives has not yet entered into force.

The Report sets out ESMA's responses to feedback on the trading obligation proposals published by ESMA in June 2017. ESMA has confirmed that, where exemptions from the clearing obligation are available under EMIR, the same exemptions will apply to the trading obligation for derivatives. ESMA will respond to requests for clarification on the treatment of packaged trades under the trading obligation by preparing a number of Q&As.

ESMA also noted that the trading obligation will be affected by the UK's exit from the EU. However, the final draft RTS have been prepared on the basis of the existing situation, albeit that some amendments may be needed in the future.

By way of background, the related clearing obligation applies to IRS denominated in seven currencies (EUR, GBP, JPY, USD, NOK, PLN and SEK) and to two classes of CDS indices (iTraxx Europe Main and iTraxx Europe Crossover). The obligation to clear OTC IRS denominated in all seven currencies is in force for clearing members of EU central counterparty clearing houses ("**CCPs**") as well as large financial counterparties and alternative investment funds. The IRS clearing obligation will apply to small financial counterparties and alternative investment funds ("**AIFs**") from 21 June 2019 and to non-financial counterparties from 21 December 2018 (for IRS denominated in the G4 currencies), and from 9 August 2018 for IRS denominated in CZK, DKK, HUF, NOK, SEK and PLN. The CDS clearing obligation is in force only for clearing members of EU CCPs. The CDS clearing obligation for large financial counterparties and AIFs and non-financial counterparties applies from 9 August 2019, and it applies to small financial counterparties and AIFs from 21 June 2019.

The final draft RTS have been submitted to the European Commission for consideration. Because these are only draft RTS, they are yet to become law. It is to be noted that the European Commission has not yet issued any equivalence determinations for purposes of the trading obligation. As a result, it is possible that the final RTS and such equivalence determinations would be coordinated in their timings.

The Report and final draft RTS on the trading obligation can be found at:

- *https://www.esma.europa.eu/press-news/esma-news/esma-finalises-mifid-ii%E2%80%99s-derivatives-trading-obligation*

ESMA's consultation paper on the trading obligation can be found at:

- *https://www.esma.europa.eu/sites/default/files/library/esma70-156-71_cp_trading_obligation.pdf*

UK DEVELOPMENTS

UK Corporate Law Developments

MiFID II: FCA Consultation on MiFID II Implementation (Corporate Aspects)

On 3 July 2017, the Financial Conduct Authority ("**FCA**") published a sixth consultation paper ("**CP 17/18**") on its implementation of the Markets in Financial Instruments Directive II ("**MiFID II**"), covering small amendments to the FCA handbook ("**FCA Handbook**").

The consultation applies, in particular, to banks, investment firms, recognised investment exchanges ("**RIEs**"), multilateral trading facilities ("**MTFs**"), organised trading facilities ("**OTFs**") and commercial firms trading financial and commodity derivatives.

The FCA proposes the following changes:

- to bring RIEs, operating MTFs and OTFs into the scope of the Financial Services Compensation Scheme cover;
- to amend the proposed Decision Procedures and Penalties Manual and Enforcement Guide as described in CP 17/18;
- to make technical changes to the Prospectus Rules and Glossary.

The consultation closed on 7 September 2017. The FCA aims to finalise the necessary rule changes by November 2017.

The full consultation paper can be accessed here:

- *https://www.fca.org.uk/publication/consultation/cp17-19.pdf*

Takeover Panel Publishes Statement on Publication of Practice Statement No 31

On 7 July 2017, the Panel on Takeovers and Mergers ("**Takeover Panel**") published Panel Statement 2017/12, announcing the publication of Practice Statement No. 31, which deals with strategic reviews, formal sale processes and other circumstances in which a company is seeking potential offerors. The statement also addresses the consequential withdrawal of, and amendments to, other Practice Statements.

In particular, the Practice Statement discusses the way in which the panel executive ("**Panel Executive**") normally interprets and applies Rules 2, 21.1 and 21.3, concerning announcements, inducement fees and equality of information to competing offerors.

The Practice Statement can be accessed here:

- *http://icgn.flpbks.com/icgn_global_governance_principles/#p=6*

Takeover Code: Consultation on Asset Sales in Competition with an Offer and Other Matters (PCP 2017/1)

On 12 July 2017, the Code Committee of the Takeover Panel published PCP 2017/1, seeking views on a number of proposed amendments to the Code in relation to asset sales in competition with an offer and other matters.

The Committee proposes to make the following changes in relation to the sale by a target of assets in competition with an offer (or possible offer) for the target:

- Amend Rules 2.8 (statements of intention not to make an offer), 35.1 (delay of 12 months) and 12.2 (competition reference periods) by inserting an additional restriction prohibiting any person, subject to these Rules, from purchasing, agreeing to purchase, or making any statement which raises or confirms the possibility that it is interested in purchasing the target's assets;
- Amend Rule 21.1, concerning "when shareholders' consent is required", so as to clarify the circumstances in which consent is not necessary, and to require that, where shareholder approval is to be sought in a general meeting for a proposed action under Rule 21.1, the target board must obtain competent independent advice as to whether the terms are fair and reasonable;
- Introduce a new Rule 4.7, concerning "asset disposals in competition with an offer"; this will prevent a purchaser of some or all of the target's assets from acquiring interests in shares in the target during the offer period, unless the target board has made a statement quantifying the cash sum expected to be paid to shareholders, and then only to the extent that the price paid does not exceed the amount stated;
- Introduce a new note on the definition of "quantified financial benefits statement" to ensure that, where the target board states it is proposing to sell all or substantially all of the company's assets and to return to shareholders all or substantially all of the company's cash balances, any statement made by the board of the target quantifying the cash sum expected to be paid to shareholders if the offer is withdrawn or lapses should be treated as a "quantified financial benefits statement".

In relation to other matters, the Committee proposes to amend:

- Rule 2.8 – "statements of intention not to make an offer" – and the accompanying Note 2, so as to require a person making a statement to specify the circumstances in which it reserves the right to set the statement aside;
- Rule 20.4 – "social media" – to remove the restrictions on the use of social media for the publication of information about a party to an offer (such that the restrictions in Rule 20.4 would apply only to the use of social media for the publication of information relating to the offer) and to permit the publication via social media of videos approved by the Takeover Panel in accordance with Rule 20.3 (*videos*);
- Note 1 on Rule 19.1 – "standards of care" – to ensure it is clear that financial advisers are responsible for guiding their clients with regard to the publication of information via social media in the same way as for information published by other means;

- Note 5 on the Notes of Dispensations from Rule 9 – to ensure the current note reflects the existing practice of the Panel Executive to consider granting a waiver from the obligation to make a mandatory offer that would otherwise arise under Rule 9 as a result of an issue of new securities if independent shareholders holding shares carrying more than 50% of voting rights of the company capable of being cast on a "whitewash" resolution give certain confirmations in writing.

Responses to the consultation are requested by 22 September 2017.

The full consultation can be accessed here:

- http://www.thetakeoverpanel.org.uk/wp-content/uploads/2017/07/PCP.192957_1.pdf

Takeover Panel Publishes 2016/17 Annual Report and Accounts

On 19 July 2017, the Takeover Panel issued a statement announcing publication of its Annual Report and Accounts for the year ended 31 March 2017.

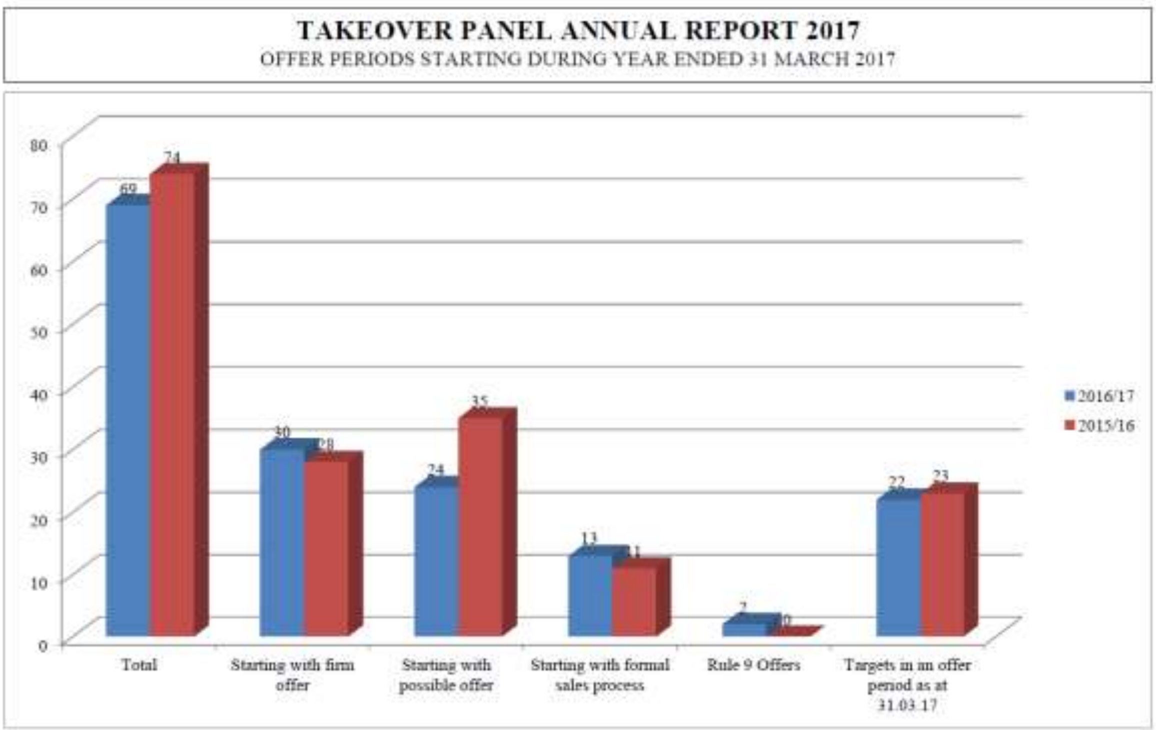
The report indicated that schemes of arrangement retained their popularity over the period under review; there were 30 schemes as compared to 22 contractual offers, and the vast majority of offers were friendly.

One letter of censure and 17 "educational/warning" letters were issued.

Two cases came before the Hearings Committee:

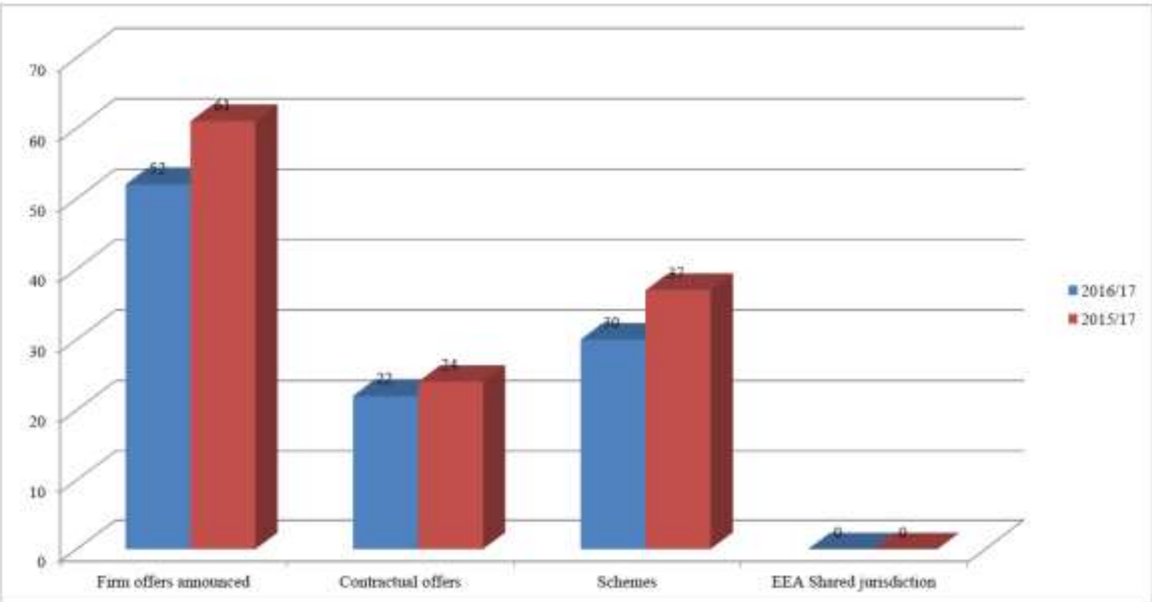
- the Rangers International Football Club case, which resulted in the Panel ordering that a mandatory offer be made – that offer having not been made, the Panel is currently seeking enforcement of its order before the Court of Session in Edinburgh;
- the "cold-shouldering" of Messrs Morton and Garner.

The charts below demonstrate the key offer statistics:

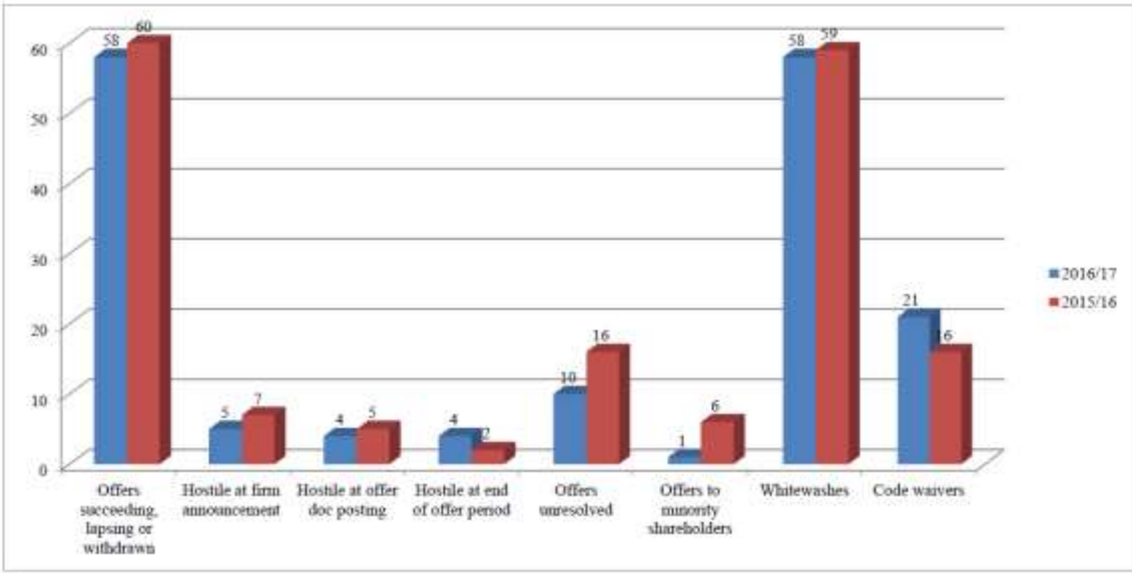


20 (2015/16 – 33) possible offers identified one potential bidder; 4 (1) identified > one potential bidder and none (1) did not identify a potential bidder

FIRM OFFERS ANNOUNCED DURING YEAR ENDED 31 MARCH 2017



OFFER OUTCOMES DURING THE YEAR ENDED 31 MARCH 2017



1. The 58 (60) offers were in respect of 51 (59) targets
2. None of the offers remaining hostile at the end of the offer period succeeded – all lapsed. In 2015/16 both hostile offers became unconditional as to acceptances
3. Code waivers – Code dispensations for offers/proposals to targets with very few shareholders
4. All these statistics are taken from pp. 20-1 of the Takeover Panel's Report and Accounts for the year ended 31 March 2017

The full report can be accessed here:

- *http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/Panel-ARA-2017.pdf*

Takeover Code: Consultation on Statements of Intention and Related Matters (PCP 2017/2)

On 19 September 2017, the Code Committee of the Takeover Panel issued a consultation paper (PCP 2017/2) seeking views on proposed amendments to the Takeover Code.

The proposed amendments of the Code Committee include:

- Requiring an offeror, when making statements of future intentions with respect of the target's business and employees, to make specific statements of intention with regard to the company's research and development functions, the balance of the skills and functions of the company's employees and management and the location of the company's headquarters and headquarter functions.

  Currently, the offeror only has to disclose these statements in its offer document under R24.2; however, the Panel has proposed that the offeror will also have to disclose specific statements of intention upfront in its firm offer announcement. Making these statements a requirement in the R2.7 announcement will assist employee representatives and pension scheme trustees in offering their own opinions on the effects of the bid.

- Introducing a requirement that an offeror must not publish an offer document for 14 days from the announcement of its firm intention to make an offer without the consent of the board of the offeree company.

  This allows the target more time to prepare their defence to the bid and also increases the period under R5.1 when the bidder is restricted from acquiring interests in the target's voting rights which take it to or above 30% (apart from one shareholder).

- Requiring offerors and offeree companies to publish reports on post-offer undertakings and post-offer intention statements given during the course of an offer.

Comments are invited up until 31 October 2017.

The full consultation is available here:

- http://www.thetakeoverpanel.org.uk/wp-content/uploads/2017/09/PCP-re-statements-of-intention-September-2017.pdf

International Corporate Governance Network Launches Fourth Edition of Global Governance Principles

On 11 July 2017, the International Corporate Governance Network ("**ICGN**") launched the fourth edition of its Global Governance Principles ("**Principles**"). The ICGN is an investor-led organisation of governance professionals, which seeks to inspire and promote effective standards of corporate governance to advance efficient markets and economies worldwide.

The Principles set out the responsibilities of investors and boards of directors, respectively, in order to promote dialogue between the two. The fourth edition makes amendments in order to stay in line with the latest regulatory and market developments.

The Principles apply primarily to publicly-listed companies, but are also relevant to non-listed companies which seek to adopt high standards of corporate governance practice.

The Principles can be accessed here:

- http://icgn.flpbks.com/icgn_global_governance_principles/#p=6

AIM Consultation on Changes to AIM Rules for Companies and AIM Rules for NOMADs

On 11 July 2017, the London Stock Exchange ("**LSE**") issued AIM Notice 46 to announce that it is consulting on proposed changes to the AIM Rules for companies and the AIM Rules for Nominated Advisers ("**NOMADs**").

The proposals set out in the discussion paper relate to: admission criteria; providing early clarity for applicants and Nominated Advisers in the admission process; ensuring consistency of approach across the nominated adviser community in respect of appropriateness considerations; and outlining appropriate levels of corporate governance.

Proposals on which the LSE seeks views include:

- The proposal to formalise the early notification process: the nominated adviser ("**Nominated Adviser**") would be required to enter into confidential discussions with the LSE, setting out key information regarding the company and its proposed admission to AIM, at an earlier stage in the admission process.
- The proposal to issue guidance on when the LSE may exercise its AIM Rule 9 powers: the LSE has discretion to refuse or impose conditions on an admission should there be any outstanding issues. The proposed guidance would seek to provide further certainty about the LSE's expectations about what the Nominated Adviser should take into account when meeting their obligations by introducing a non-exhaustive list of factors to consider.
- The proposal to insert a minimum free float requirement: The LSE currently does not consider it appropriate to set a numerical or percentage threshold for free float once companies are admitted to AIM. However, the LSE recognises that a qualitative approach is more meaningful, taking into account the guidance currently available (accessible here: *http://www.londonstockexchange.com/companies-and-advisors/aim/advisers/inside-aim-newsletter/consideration-of-freefloat.pdf*) and the promotion of early discussions with Nominated Advisers to strike a balance between supporting liquidity in the secondary market and supporting innovation and emerging growth in companies.
- The proposal to introduce a threshold that a company must raise in cash via an equity fundraising on, or immediately before, admission: AIM Rule 8 currently requires that an investment company must raise at least £6 million in cash via an equity fundraising on, or immediately before, admission. The discussion paper seeks views on, firstly, if this threshold should extend to all companies, and, if so, at what threshold should it be set.
- The proposal to amend the corporate governance requirements for AIM companies: The discussion paper questions whether the existing requirement for Nominated Advisers to assess the efficacy of a board at admission is effective. It also considers whether the existing corporate governance disclosure requirement in AIM Rule 26 is adequate or if the LSE should make it mandatory for AIM companies to comply and explain against an industry code of their choosing.
- What more the LSE can do to educate market participants: the LSE asks what else it can and cannot do in respect of its remit, beyond the information already available on its website.
- The proposal to introduce automatic fines for explicit breaches of the AIM Rules: The discussion paper asks whether automatic fines should be introduced, and, if so, what the level of those fines should be and the scope of the breaches to be covered.

The LSE invited responses to the discussion paper on or before 8 September 2017.

The full discussion paper can be accessed here:

- *http://www.londonstockexchange.com/companies-and-advisors/aim/advisers/aim-notices/aim-discussion-paper-july-2017.pdf*

The Competition & Markets Authority ("CMA") Announces New Merger Guidance

On 5 September 2017, the CMA announced that it has made changes to its guidance for merging companies. The changes are intended to streamline the CMA's process and reduce the requirements on businesses.

The changes include the following:

- publication of additional guidance on the CMA's use of initial enforcement orders and derogations in merger investigations;

- changes to the merger notice form to make it easier to understand, and provide further guidance on what information is likely to be required by the CMA; and
- minor amendments to the guidance on the CMA's merger intelligence function, which governs how the CMA collects information before deciding whether to investigate a merger.

The full guidance texts can be accessed here:

Guidance on initial enforcement orders:

- *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/642070/guidance-initial-enforcement-orders-and-derogations-merger-investigations.pdf*

Guidance on the CMA's mergers intelligence function:

- *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/642043/CMA56.pdf*

FCA Publishes Consultation on a New Category of Premium Listing for Sovereign Controlled Companies

On 13 July 2017, the FCA published a consultation paper (CP17/21) on its proposal to amend the listing regime to include a new fourth category of premium listing available to companies that have a sovereign controlling shareholder.

The FCA believes that this new category will facilitate greater accessibility to UK markets, whilst upholding the relevant investor protections. It would allow accessibility for those companies that cannot, or do not wish to satisfy the rules in respect of controlling shareholders and related party transactions, but that do wish to show they meet the other premium listing requirements. The category would also be accessible for companies wishing to list their interests in certificates representing securities (also known as depositary receipts), as well as equity shares.

The FCA proposes to make the following changes, amongst others:

- introduce key new definitions into the FCA Handbook, such as "sovereign controlled commercial company", and "State"; and
- introduce a new Chapter 21 of the Listing Rules, if the new premium listing category is created.

The consultation paper can be accessed in full here:

- *https://www.fca.org.uk/publication/consultation/cp17-21.pdf*

ICAEW Publishes New Guidance for Directors: Consultation Paper on Prospective Financial Information

On 19 July 2017, the Institute of Chartered Accountants in England and Wales ("**ICAEW**") published a consultation paper on prospective financial information ("**PFI**"), which seeks to acquire a mandate for the ICAEW's proposal to update, amend and expand the 2003 guidance (the "**2003 Guidance**") issued to directors on the subject of PFI. The 2003 Guidance was designed to help directors meet the needs of investors and regulators and to promote the publication of high-quality PFI.

The ICAEW believes that the 2003 Guidance requires amendment due to the following changes since 2003:

- options other than public equity or debt markets have become mainstream sources of new funds for business investment, and businesses tend to prepare PFI when applying to such sources for new or extended funding, despite the sources being private; and
- changes in IT, accountability and governance has heightened board expectations of PFI preparation and management's response to any problems identified in stress-testing.

The ICAEW proposes to make the following changes:

- introduce two new attributes of useful PFI in addition to those that underpin the 2003 Guidance. They state that PFI should (i) be aligned (with other business reporting and communications) and (ii) not be misleading;
- introduce new application notes for preparing PFI in the context of capital markets transactions;
- extend the PFI framework to private fundraisings; and
- broaden the application of the PFI framework.

The deadline for responses is 31 October 2017. An exposure draft of the new guidance, informed by feedback on the consultation paper, is expected to be published next year.

The consultation paper can be accessed here:

- https://www.icaew.com/-/media/corporate/images/corporate-finance-faculty/pfi-consultation.ashx?utm_campaign=ICAEW,%20Faculties%20and%20SIGs&utm_source=99226_CFF%20News%20July&utm_content=PFI%20Consultation&utm_medium=email&dm_t=0,0,0,0,0

Updated CLLS/Law Society MAR Q&A

On 21 July 2017, the City of London Law Society ("**CLLS**") and the Law Society published an update to their Q&A on MAR. This updated version of the Q&A includes a revised Question 7 (in Part A) relating to the need for notification under Article 19(1) MAR, where a transaction involves a "person closely associated".

Question 7 refers to a scenario where the director of a company, A, whose shares are traded on AIM, is also a person discharging managerial responsibilities in another company, B. The director does not control more than 50% of the shares of B and wants to know whether B is one of their "persons closely connected", so that B must notify A under Article 19(1) MAR, of transactions in A's shares conducted on its own account.

The CLLS and Law Society responded that B will only be treated as a "person closely associated" for the purposes of EU MAR if the director is:

- the sole director of B or has the right to appoint a majority of the board of directors of B; or
- the director (or senior executive) that personally has control over B’s management decisions.

The full text of the updated Q&A is available at:

- http://www.citysolicitors.org.uk/attachments/category/114/MAR%20QA%20(Updated%2021%20July%202017).pdf

PSC Amendment Regulations 2017: Entities Brought Within the PSC Regime

The Information about People with Significant Control (Amendment) Regulations 2017 ("**PSC Amendment Regulations 2017**") brought new entities within the scope of the PSC regime, including companies with voting shares admitted to trading on AIM and the NEX Exchange Growth market, as well as unregistered companies. We discussed the PSC Amendment Regulations 2017 in G&SL July 2017 edition.

From 24 July 2017, entities within the scope of the PSC regime are subject to the obligations under Chapters 3 and 4 Part 21A Companies Act 2006 – including the duty to keep a PSC register. Guidance from the PSC Register for Registered and Unregistered Companies, SEs, LLPs and Eligible Scottish Partnerships ("**PSC Register Guidance**") confirms that, by 7 August 2017, newly in-scope entities must have entered information on their PSC registers.

The PSC Amendment Regulations 2017 can be accessed in full here:

- https://www.legislation.gov.uk/uksi/2017/693/contents/made

The PSC Register Guidance can be accessed here:

- https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/621571/170623_NONSTAT_GU.pdf

Pre-Emption Rights: Pre-Emption Group Issues Statement on Pre-Emption Thresholds

On 27 July 2017, the Pre-Emption Group issued a statement confirming that it does not intend to change the pre-emption thresholds set out in the 2015 Statement of Principles.

The current pre-emption thresholds allow for two resolutions for disapplication authority – the first five per cent for general corporate purposes and, when applied for, the second five per cent for use only in connection with an acquisition or specified capital investment. No change to the flexibility permitted by the guidelines is expected as a consequence of the new Prospectus Regulation.

The full statement is available here:

- https://www.frc.org.uk/news/july-2017/no-change-to-pre-emption-thresholds-for-prospectus

Financial Reporting Council ("FRC") Consultation on Amendments to the Strategic Report Guidance

On 15 August 2017, the FRC published a consultation paper setting out draft amendments to its 2014 Guidance on the Strategic Report ("**Strategic Report Guidance**"). The amendments are not intended to be a fundamental review, but instead set out to:

- reflect the new disclosure requirements arising from the UK implementation of the Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups ("EU Non-Financial Reporting Directive"), which are effective for periods beginning on or after 1 January 2017;
- enhance the link between the purpose of the strategic report and the matters that directors should have regard to under section 172 Companies Act 2006; and
- make targeted improvements to certain areas of the Strategic Report Guidance to reflect key developments in corporate reporting.

The proposed amendments to the Strategic Report Guidance include, among other things:

- changes to sections 4 (*purpose*) and 7 (*content elements*) to strengthen the link between the purpose of the strategic report and the matters to which directors should have regard under section 172. Amendments to section 7 also aim to encourage companies to consider matters that may impact the value of the company over the longer term and to place more emphasis on how value is generated;
- changes to section 5 (*materiality*) which seek to clarify the use of the term "material" within the Strategic Report Guidance, to enhance the focus on broader, non-financial matters that may impact the business over the longer term and to clarify the scope of the derogation from the general requirement to disclose material information;
- enhancements to the principles in section 6 (*communication principles*) to encourage entities to better integrate related information in their annual reports and to communicate relevant information that will enable shareholders to assess the factors that may have an impact on the long-term success of the business.

The FRC is requesting comments by 24 October 2017.

The full text can be accessed here

- https://www.frc.org.uk/getattachment/f572977e-4275-42fb-9167-ad2fa4ea6cae/Invitation-to-comment-Draft-Amendments-to-Strategic-15-August-2017.pdf

Department for Business, Energy and Industrial Strategy ("BEIS") Publishes Response to Green Paper on Corporate Governance Reform

On 29 August 2017, BEIS published the Government's response to the green paper consultation on corporate governance reform, published on 29 November 2016. The Government response sets out a number of headline proposals for reform across three specific aspects of corporate governance on which BEIS consulted:

- Executive pay: the Government proposes changes to the UK's executive pay framework for quoted companies across four main areas: shareholder voting and other rights; the role of remuneration committees; transparency in executive pay; and long-term executive pay incentives. The Government intends to introduce pay ratio reporting that compares the remuneration of the CEO with average UK employee pay for quoted companies in order to help set executive pay in the wider company context.
- Strengthening the employee, customer and supplier voice: the Government intends to invite the FRC to consult on the development of a new principle in the UK Corporate Governance Code ("**UKCGC**") establishing the importance of strengthening the voice of employees and other stakeholder interests at board level. It also invites the FRC to consult on the introduction of a specific provision in the UKCGC requiring premium listed companies to adopt, on a "comply or explain" basis, one of three employee engagement mechanisms. BEIS noted that ICSA and the Investment Association are already developing practical guidance on boardroom engagement. This guidance has now been issued as "The Stakeholder Voice in Board Decision-Making" and is available at:

  https://www.theinvestmentassociation.org/assets/files/press/2017/2017-09TheStakeholderVoiceinBoardDecisionMaking.pdf
- Corporate governance in large privately held businesses: the Government intends to invite the FRC, together with the Institute of Directors, the CBI, the Institute for Family Business, the BVCA and others to develop a voluntary set of corporate governance principles for large private companies under the chairmanship of a business figure with relevant experience.

The current intention is to bring the reforms into effect by June 2018, in order to apply to company reporting years commencing on or after that date.

We previously published a client briefing on the reform on 1 September 2017, which can be accessed here:

- *http://www.shearman.com/en/newsinsights/publications/2017/09/uk-corporate-governance-reform*

The full text of the Government's response is available at:

- *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/640470/corporate-governance-reform-government-response.pdf*

UKLA Guidance Notes: Primary Market Bulletin No 18

On 31 August 2017, the Financial Conduct Authority ("**FCA**") published its 18th Primary Market Bulletin, which focuses on proposed new guidance for sponsors to ensure they understand their responsibilities and obligations under the listing rules, disclosure requirements and transparency rules, and that directors have established procedures to enable an issuer to comply with its obligations on an ongoing basis.

Some of the proposed changes include:

- three new technical notes that outline the FCA's expectations of sponsors and their obligations; and
- an updated technical note UKLA/TN/708.2, which sets out expectations of sponsors regarding financial position and prospects procedures.

In addition, the FCA has announced that the UKLA has been split into two separate departments: a Primary Market Oversight Department and a Listing Transactions Department, and enhancements have been made to the FCA document review process. On 4 September 2017, the FCA launched a new ESS system, which replaced faxed comments.

The bulletin can be accessed here:

- *https://www.fca.org.uk/publication/newsletters/primary-market-bulletin-18.pdf*

Corporate Governance: Government Response to Committee Report

On 22 September 2017, BEIS published the Government's response to its report on the inquiry into corporate governance. We discussed the BEIS Committee Report on corporate governance in G&SL April 2017 edition.

In relation to promoting good corporate governance, the Government:

- supports the recommendation that the FRC should amend the UKCGC to require informative narrative reporting on the fulfilment of section 172 duties. The Government plans to introduce secondary legislation to require all companies of a significant size (private and public) to explain how their directors have had regard to the employee and other non-shareholder interests set out in section 172. A draft statutory instrument will be published later this year;
- is concerned that a formal annual rating exercise risks undermining the valuable and legitimate flexibility of the UK's "comply or explain" approach to corporate governance;
- recognises that the FRC plays a central role in the UK corporate governance framework; however, it does not currently propose to give the FRC additional powers to engage and hold directors to account in respect of their duties; and
- supports the further development of the role of the "Investor Forum".

In relation to private companies, the Government:

- supports the recommendation that the FRC, Institute of Directors and Institute for Family Business should develop, with private equity and venture capital interests, a voluntary set of corporate governance principles with which the largest privately-held companies would be expected to comply; and
- does not envisage making compliance with a Code (or set of principles) mandatory and considers that large private companies should continue to be able to adopt the arrangements that suit them best. The Government does not propose to introduce a formal complaints mechanism.

In relation to executive pay, the Government:

- believes that companies should continue to exercise flexibility when deciding the long-term share remuneration policies and models that they put to investors for approval; however, the Government also considers that companies and shareholders should be open to alternatives to the LTIP model which currently dominates; and
- supports the idea of pay ratio reporting which will compare CEO remuneration to average pay in the wider company workforce. The Government intends to introduce secondary legislation to implement this.

In relation to the composition of boards, the Government:

- believes that the Government should remain focused on the current target of 33% of FTSE 350 board members as well as 33% of Executive Committees and their direct reports in the FTSE 100 should be women by 2020. The Government does not therefore propose to implement a new target that, from May 2020, at least half of all new appointments to senior and executive management level positions in the FTSE 350 and all listed companies should be women; and
- does not intend to give the FRC an additional role of overseeing the rigour of the board evaluation process by the external facilitator.

The full report can be accessed here:

- *https://publications.parliament.uk/pa/cm201719/cmselect/cmbeis/338/338.pdf*

Notable UK Litigation

New Corporate Offences of Failure to Prevent the Criminal Facilitation of Tax Evasion

The long-awaited new corporate offences of failure to prevent the facilitation of UK and foreign tax evasion (the "**Offences**") came into force on 30 September 2017.

The Offences, which are set out in Part 3 of the Criminal Finances Act 2017 ("**the Act**"), are part of the UK Government's drive to combat tax evasion and to "foster and promote economic crime prevention as part of corporate good governance".

Under the Act, it is an offence for a corporate body or partnership (referred to in the Act as a "**relevant body**"), wherever incorporated or formed: (i) to fail to prevent the facilitation of UK tax evasion offences ("**UK Offence**"); and (ii) to fail to prevent the facilitation of foreign tax evasion offences ("**Foreign Offence**"), in either case by a person with whom the relevant body is associated, provided that the person commits the relevant Offence in their capacity as the relevant body's associated person.

The Act's definition of "associated person" is deliberately wide-reaching and includes not only the relevant body's employees, but also agents or any other person or entity who performs services for or on behalf of the relevant body (such as prime and sub-contractors), and, in each case, who is acting in such a capacity at the time they commit the relevant facilitation Offence.

The UK Offence

Three conditions must be met for a relevant body to commit the UK Offence; these are:

- there must be criminal (i.e., fraudulent) UK tax evasion by a taxpayer under existing law;
- there must be deliberate and dishonest criminal facilitation of that tax evasion by an associated person of the relevant body acting in that capacity; and
- the relevant body must have failed to prevent the associated person from criminally facilitating the fraudulent tax evasion.

A relevant body can commit the UK Offence regardless of: (i) where they are incorporated or formed; and (ii) whether the facilitation offence was committed in the UK or overseas, provided that the facilitation offence concerns the fraudulent evasion of UK tax.

The Foreign Offence

The same three conditions applicable to the UK Offence apply in relation to the Foreign Offence (although condition one will relate to the fraudulent evasion of the applicable foreign tax). However, two additional conditions also must be met for a relevant body to commit the Foreign Offence:

- there must be a UK nexus, meaning that either: (i) the relevant body is incorporated/formed under UK law or carries on business or part of a business in the UK; or (ii) the associated person is located in the UK at the time that they committed some part of the facilitation offence; and
- there must be "dual criminality" of conditions 1 and 2, i.e., both the fraudulent evasion of foreign tax and the criminal facilitation of that evasion must be a criminal offence both in the relevant foreign jurisdiction and under UK law (i.e., it would constitute a crime if it were committed in the UK).

Accordingly, the Foreign Offence is slightly narrower in scope than the UK Offence.

Both of the new Offences are strict liability offences – there is no need to prove that the relevant body had any knowledge of the criminal conduct.

Defences and Penalties

In addition to any reputational damage, a relevant body found to have committed either Offence will be liable to unlimited financial penalties and may become subject to confiscation orders or "Serious Crime Prevention Orders".

However, it is a defence to both Offences if the relevant body can prove that, at the time that the relevant facilitation offence was committed, either: (a) the relevant body had in place such prevention procedures as were reasonable in all the circumstances; or (b) it was not reasonable in all the circumstances to expect the relevant body to have any prevention procedures in place.

The Government has published Guidance on the types of policies and procedures that relevant bodies should implement to prevent associated persons from committing facilitation Offences. These are not prescriptive or one-size-fits-all; rather, bespoke policies and procedures must be implemented by each relevant body. However, the guidance does set out six principles that a relevant body should follow when forming its procedures. These are:

- risk assessment: relevant bodies should carry out, document and keep under review a risk assessment to determine the nature and extent of their exposure to the risk of those acting in the capacity of an associated person committing a facilitation Offence;
- proportionality of risk-based prevention procedures: reasonable procedures should be proportionate to the risk of an associated person committing a facilitation Offence – this will depend on the nature, scale and complexity of each relevant body's activities;
- top level management commitment: the Government expects senior management to lead from the front and foster a culture within the relevant body that conduct intended to facilitate tax evasion is unacceptable. Among other things, senior management should be actively involved with the development and review of the necessary policies and preventative procedures;
- due diligence: the relevant body should apply due diligence procedures, which take an appropriate and risk-based approach, to all of its current and new contractual relationships (e.g., which agents, suppliers, contracts and customers);
- communication: the relevant body should look to ensure that its policies and procedures are communicated, accessible, understood and embedded throughout the organisation by internal and external communications (including training). The nature of the internal and external communications will likely vary according to the nature and type of risk being addressed and the size, organisation and business of the relevant body; and
- monitoring and review: relevant bodies must ensure that they monitor, review and (where appropriate) modify their policies and procedures on a regular basis.

The new Offences have significantly extended the scope of corporate criminal liability in the UK and it is important for – and HMRC actively expects and requires – businesses to take "*rapid implementation*" steps to ensure that they have reasonable, bespoke policies and preventative procedures in place.

Brexit

European Union (Withdrawal) Bill Passes Second Reading in House of Commons

On 7 and 11 September 2017, the European Union (Withdrawal) Bill 2017-19 ("**Bill**") received its second reading in the UK House of Commons and passed by a majority of 36. The Bill will now be debated at the committee stage by the House of Commons, where proposed amendments will be made.

European Union (Withdrawal) Bill: Constitution Committee Call for Evidence

On 14 September 2017, the House of Lords Constitution Committee published an invitation to contribute to its inquiry on the European Union (Withdrawal) Bill. The Committee is seeking evidence on the detailed provisions of the Bill and their legal and policy effect.

The inquiry will examine the constitutional implications of the Bill across three broad themes, including:

- the relationship between Parliament and the executive: This covers the delegated powers in the Bill and the Henry VIII clauses, the scrutiny of the delegated legislation that will flow from the Bill and sunset clauses for the powers;
- the rule of law and legal certainty: This covers the status of retained EU law and the relationship to domestic law, the proposals for the interpretation of judgments made by the Court of Justice of the European Union post-exit and the legal and practical challenges of producing a copy of retained EU law post-exit; and
- the consequences for the UK's territorial constitution: This covers the boundaries between reserved and devolved competence, the implications of the Bill for the balance of powers within the Union and the consequences.

The deadline for submissions was 12 October 2017.

The full text of the document is available here:

- *http://www.parliament.uk/documents/lords-committees/constitution/European-union-withdrawal-bill/call-for-evidence.pdf*

European Union (Withdrawal) Bill Receives First Reading in Parliament

On 13 July 2017, the Government introduced the Bill to Parliament and published its "Explanatory Notes". The Bill intends to repeal the European Communities Act ("**ECA**") 1972 and prepare the UK's legislative framework for withdrawal from the European Union on 29 March 2019.

The Bill includes four central functions:

- the repeal of the ECA and the end of the supremacy of EU law following withdrawal from the European Union;
- conversion of EU law into UK law so that the UK's legislation retains a functioning statutory framework after Brexit;
- creating powers that correct existing legislative provisions, where the Government considers it necessary; and
- maintaining the current scope of devolved decision making powers in areas currently governed by EU law.

The Bill can be accessed in full here:

- *https://services.parliament.uk/bills/2017-19/europeanunionwithdrawal.html*

UK Publishes Brexit Position Papers on Ongoing Union Judicial and Administrative Proceedings and Privileges and Immunities

On 13 July 2017, the Department for Exiting the European Union published position papers outlining the UK's position on the following issues:

- judicial and administrative proceedings that are ongoing at the point of exit from the European Union: on the date of withdrawal from the EU, cases before the Court of Justice of the EU that involve the UK shall remain ongoing, as will administrative procedures undertaken by EU institutions that concern the UK;
- privileges and immunities as the UK negotiates its exit from, and new partnership with, the EU: the EU may have property funds, assets and operations in the UK after the withdrawal date, and traditional periods will be implemented to give the EU a reasonable time in which to wind up its current operations; and
- ownership and responsibility for special fissile material and related safeguards equipment: the paper sets out the UK's high-level negotiating principles for its exit from the Treaty establishing the European Atomic Energy Community ('Euratom Treaty').

The three papers can be located here:

Ongoing Union judicial and administrative proceedings – position paper:

- https://www.gov.uk/government/publications/ongoing-union-judicial-and-administrative-proceedings-position-paper

Privileges and immunities – position paper:

- https://www.gov.uk/government/publications/privileges-and-immunities-position-paper

Nuclear materials and safeguards issues – position paper:

- https://www.gov.uk/government/publications/nuclear-materials-and-safeguards-issues-position-paper

US DEVELOPMENTS

SEC and NYSE/Nasdaq Developments

SEC Provides Additional Relief to Facilitate IPO Filings

On 17 August 2017, the SEC's Division of Corporation Finance issued guidance further extending an important accommodation provided to companies contemplating going public. Under the updated guidance, all issuers, including those that do not qualify as emerging growth companies ("**EGCs**"), would be permitted to omit from confidential draft registration statements interim financial statements and related financial information (including management discussion and analysis ("**MD&A**") disclosure) that they reasonably believe will not be required to be included at the time the registration statement is publicly filed or, for EGCs only, at the time of the contemplated offering. The Division had previously provided this accommodation with respect to annual financial statements and related financial information. This accommodation does not extend to registration statements that are filed publicly on EDGAR. As a reminder, the submission of confidential draft registration statements prior to public filing is available for initial registrations and for follow-on registrations within 12 months of the effectiveness of the initial registration.

Under this guidance, a calendar year-end issuer that submits a confidential draft registration statement in November 2017 and reasonably believes it will first publicly file (or launch its offering, if an EGC) in April 2018 may omit its interim financial information for the nine months ended 30 September 2017 and 2016, along with omitting annual financial information for 2014 (and 2015, if an EGC). This is because none of the omitted financial information would be required at the time of its first public filing (or launch of its offering, if an EGC) in April 2018.

This announcement is the latest of what is expected to be a number of reforms and SEC staff ("**Staff**") policy changes designed to streamline the IPO process and enhance capital formation in public markets that SEC Chairman Jay Clayton has said is an important objective of the agency. This development is expected to allow companies to submit registration statements faster and reduce the cost of the registration process by eliminating the need for the preparation of financial statements and other financial information and auditor reviews of information that will ultimately not be included in a registration statement. Companies, however, should bear in mind that giving the Staff an opportunity to review recent MD&A disclosure and financial statements earlier in the registration process can also have benefits. Drawing out SEC questions and concerns at an earlier stage allows more time for such comments to be addressed. This can potentially prevent these comments from being raised later in the review process when they can have a real impact on transaction timing.

The SEC guidance is available at:

- https://www.sec.gov/divisions/corpfin/guidance/safinterp.htm#20101.04

Our related client publication is available at:

- http://www.shearman.com/en/newsinsights/publications/2017/08/sec-extends-ipo-accommodations

SEC Rules Requiring Exhibit Hyperlinking Take Effect

Starting 1 September 2017, new rules requiring hyperlinking of exhibits in SEC filings have taken effect. As discussed in our Q1 2017 Memorandum, the SEC adopted these rules in March in order to make access to exhibits in registration statements and periodic reports that were originally provided in previous filings easier for market participants to locate.

As a reminder, the new rules apply to companies that file registration statements and periodic and current reports that are subject to the exhibit requirements under Item 601 of Regulation S-K, or that file on Forms F-10 or 20-F, but will not apply to Form 6-Ks.

The relevant SEC announcement of last March is available at:

- https://www.sec.gov/news/pressrelease/2017-55.html

Our related client publication is available at:

- http://www.shearman.com/en/newsinsights/publications/2017/03/sec-adopts-t2-settlement-cycle-for-exhibits

Proposed Revision to Nasdaq Shareholder Approval Rules

The Nasdaq Stock Market ("**Nasdaq**") recently solicited comments from the public relating to proposed revisions to Nasdaq Stock Market Rule 5635(d), which requires shareholder approval in connection with certain equity private placements. The public comment period ended on 31 July 2017.

Rule 5635(d) sets forth the circumstances under which shareholder approval is required prior to an issuance of securities in connection with private placements when a transaction (other than a public offering) involves the sale, issuance or potential issuance by a Nasdaq-listed company of common stock (or securities convertible into or exercisable for common stock) equal to 20% or more of the common stock or voting power outstanding, if the offer price for such shares is less than the greater of the book or market value of the stock.

The proposed changes to the rule include:

- in the determination of market value, changing from a single day's closing bid price to a five-day average of closing prices;
- requiring the approval by either a committee of independent directors or a majority of the independent directors on the board, unless it is approved by the company's shareholders, of any transaction of more than 20% of the company's shares outstanding; and
- removing the book value requirement.

If Nasdaq decides to proceed with these revisions, the proposal will then be subject to public notice and comment as part of the SEC's review and approval process.

Nasdaq's announcement is available at:

- https://listingcenter.nasdaq.com/assets/Shareholder%20Approval%20Comment%20Solicitation%20June%2014%202017.pdf

T+2 Settlement Takes Effect

On 5 September 2017, the securities industry successfully implemented an amended rule adopted by the SEC last March that shortens the standard settlement cycle for most broker-dealer securities transactions by one business day, to two business days following the trade date, thus bringing the U.S. settlement cycle in line with European markets.

As mentioned in our Q1 2017 Memorandum, the amended rule is aimed at enhancing efficiency, preventing market and liquidity risk arising from unsettled securities trades and ensuring a co-ordinated and expeditious transition by market participants to a shortened standard settlement cycle.

The SEC's statement on T+2 implementation is available at:

- *https://www.sec.gov/news/press-release/2017-163*

Our related client publication is available at:

- *http://www.shearman.com/en/newsinsights/publications/2017/03/sec-adopts-t2-settlement-cycle-for-exhibits*

NYSE Announces Ex-Dividend Date Changes for T+2 Settlement

On 17 July 2017, the NYSE announced changes to its ex-dividend trading policy, following the recent SEC rule changes shortening the settlement cycle for securities trades from T+3 to T+2. Under this revised NYSE policy, which has been in effect since 5 September 2017, ex-dividend trading will commence one trading day prior to the record date established for a declared dividend. The revised policy will apply to the selection of record dates and the preparation of related announcements by NYSE-listed companies paying dividends in September and thereafter.

As of 7 September, dividends have traded ex-dividend on D-1 instead of D-2. For example, securities with a dividend record date of 7 September 2017 began ex-dividend trading on 6 September 2017.

The NYSE announcement is available at:

- *https://www.nyse.com/trader-update/history#110000069618*

SEC Updates Interpretive Guidance on Revenue Recognition for Bill-and-Hold Arrangements

On 28 August 2017, the Staff updated its interpretive guidance relating to revenue recognition for bill-and-hold arrangements through a release as well as a "Staff Accounting Bulletin".

The interpretive release is intended to bring existing guidance into conformity with Financial Accounting Standards Board Accounting Standards Codification Topic 606, Revenue from Contracts with Customers ('ASC Topic 606'). Following adoption of ASC Topic 606, registrants should no longer rely on the guidance in Securities Exchange Act Release No. 23507 and Accounting and Auditing Enforcement Release No. 108, *In the Matter of Stewart Parness*, which provide the criteria to be met in order to recognise revenue when delivery has not occurred.

Furthermore, the SEC's Office of the Chief Accountant and Division of Corporation Finance released Staff Accounting Bulletin No. 116 (SAB 116), with the purpose of bringing Staff guidance on revenue recognition in conformity with the Financial Accounting Standards Board's adopted and revised ASC Topic 606.

As noted by the Staff, registrants should continue to rely on prior guidance until they adopt ASC Topic 606.

The SEC's interpretive release on bill-and-hold guidance is available at:

- *https://www.sec.gov/rules/interp/2017/33-10402.pdf*

SEC Staff Accounting Bulletin No. 116 is available at:

- *https://www.sec.gov/interps/account/sab116.pdf*

SEC Approves NYSE Expanded Hours for Dividend Notice Policy

On 14 August 2017, the SEC approved a rule change proposed by NYSE pursuant to which listed companies would be required to provide ten minutes' advance notice to the NYSE before making any public announcement about a dividend or stock distribution, including outside the hours of operation of the NYSE's "immediate release policy". Previously, this policy only applied to announcements made within the hours of operation of the "immediate release policy".

In this context, the NYSE indicated that "it intends to have its staff available at all times to review dividend or stock distribution notices immediately upon receipt, regardless of the time or date the notices are received. […] The Exchange staff will contact a listed company immediately if there is a problem with its notification."

The NYSE has subsequently proposed to amend the rule to delay its implementation to no later than 1 February 2018. Listed companies will be provided reasonable advance notice of the new implementation date.

The order granting approval of proposed rule change is available at:

- *https://www.sec.gov/rules/sro/nyse/2017/34-81393.pdf*

The NYSE proposal to further amend the rule is available at:

- *https://www.nyse.com/publicdocs/nyse/markets/nyse/rule-filings/filings/2017/SR-NYSE-2017-43.pdf*

NYSE Proposes to Revise Rule Relating to News Releases Issued at Market Close

On 29 August 2017, the SEC announced a proposed rule change submitted by the NYSE that would amend Section 202.06 of the NYSE Listed Company Manual. Section 202.06 currently provides only an advisory text requesting that listed companies intending to release material news after the close of trading on the NYSE wait until the earlier of the publication of their security's official closing price on the NYSE or 15 minutes after the scheduled closing time on the NYSE.

For the purpose of mitigating the risk of market disruption and investor confusion, the proposal intends to prohibit listed companies from issuing material news after the NYSE's trading session official closing time (4:00 p.m. Eastern Time) until the earlier of (i) the publication of such company's official closing price on the NYSE or (ii) five minutes after the official closing time.

For the NYSE, this proposed Section 202.06 amendment would mainly:

- prevent the occurrence of significant news-related price volatility on other markets during the brief period between the NYSE's official closing time and the completion of the closing auction. Therefore, significant price differences in nearly contemporaneous trades on other markets and the closing price on the NYSE would be avoided, without imposing a burden on competition; and
- promote just and equitable principles of trade by ensuring that participants in a NYSE closing auction do not have their trades executed at a price that is inconsistent with contemporaneous trading prices on other markets that reflect material news that was released after the NYSE's official closing time.

The SEC's announcement is available at:

- *https://www.sec.gov/rules/sro/nyse/2017/34-81494.pdf*

The proposed rule change from NYSE is available at:

- *https://www.nyse.com/publicdocs/nyse/markets/nyse/rule-filings/filings/2017/NYSE-2017-32,%20Re-file%202.pdf*

SEC Chairman Sets New SEC Agenda

On 12 July 2017, in his first public speech as Chairman of the SEC, Jay Clayton set out some guiding principles for his leadership of the agency. The SEC's traditional disclosure-based approach to regulation was reaffirmed. The protection of the average investor, the modernising of the trading and markets system, the facilitation of capital formation, as well as increasing the attractiveness of the U.S. public capital markets, were among the main stated objectives of the SEC under the new Chairman's tenure.

Some of the other highlights of Chairman Clayton's speech included:

- rather than being merit-based, the federal securities laws should be focused on ensuring that "investors have access to a well-crafted package of information that facilitates informed decision-making". The Chairman may consider softening certain disclosure requirements for public companies, as he believes that the current regulations are too burdensome;
- the compliance rules adopted by the SEC should be clear and precise, and the costs associated with such rules should be carefully considered by it before their adoption; and
- SEC enforcement should focus on traditional serious fraud, such as "pump-and-dump schemes" and "microcap fraud", except with regard to cybersecurity issues, which the Chairman deems as essential in a modern market.

Chairman Clayton's complete speech may be accessed at:

- *https://www.sec.gov/news/speech/remarks-economic-club-new-york*

Exclusion of Companies with Multi-Class Capital Structures from Global Market Indices

Following the recent initial public offering of Snapchat in March 2017, the Council of Institutional Investors lobbied the major index providers to remove companies offering non-voting shares from their most restrictive indices. Global index providers have responded by reviewing their index policy in order to exclude companies with multiclass capital structures and limited public voting rights.

On 31 July 2017, the S&P Dow Jones Indices announced its decision to exclude, with immediate effect, multiclass share companies from the S&P Composite 1500 and its component indices comprising S&P 500, S&P MidCap 400 and S&P SmallCap 600, which cover approximately 90% of U.S. market capitalisation.

- Such companies will remain in the broad market S&P Global BMI Indices and S&P Total Market Index, which follow less restrictive eligibility rules; and
- in order to minimise the impact of such changes, companies already included in the S&P Composite 1500 and its component indices will not be affected by the new S&P Dow Jones policy. Furthermore, a newly public company offering multiclass shares spun off from a S&P Composite 1500 index constituent will be exempted from satisfying the new criteria by benefiting from its parent's grandfathering.

On 26 July 2017, FTSE announced that companies which do not have at least 5% of their voting rights held by unrestricted (free float) shareholders will no longer be eligible for inclusion in its standard indices, including the Russel 3000 and Russel 2000 indices. These measures will not be immediately operative – companies included in the Russel indices will have until 2022 to comply with these new restrictions. The 5% free float requirement will be reviewed on an annual basis.

The S&P Dow Jones Indices press release is available at:

- *https://www.spice-indices.com/idpfiles/spice-assets/resources/public/documents/561162_spdjimulti-classsharesandvotingrulesannouncement7.31.17.pdf?force_download=true*

The 'FTSE Russel Proposal' is available at:

- *http://www.ftse.com/products/downloads/FTSE_Russell_Voting_Rights_Consultation_Next_Steps.pdf*

DTC Expands the Consent Solicitations for Which ATOP Is Mandatory

On 7 July 2017, the Depository Trust Company ("**DTC**"), the U.S. securities clearing system, filed a proposed rule change with the SEC that will require certain consent solicitations involving book entry-only securities for which DTC holds the entire amount of the issue in a global note to use the DTC Automated Tender Offer Program ("**ATOP**") for solicitation and collection of consents, as well as payment of consent fees, if any, rather than being processed outside of DTC.

The rule change expands ATOP to include consent solicitations that do not require blocking of securities. ATOP remains closed in circumstances where a creditor meeting is sought, or where a "snooze-you-lose" negative consent provision is used. The majority of tabulation agents, in particular for large corporate issues, already use ATOP, where permitted.

For foreign private issuers, this change affects consent solicitations for the majority of their U.S. dollar-denominated debt securities. Securities denominated in other currencies settle via alternative clearing systems that have similar systems. This rule change was effective from 1 September 2017.

SEC Updates Financial Reporting Manual

On 25 August 2017, the SEC Division of Corporation Finance published an update to its Financial Reporting Manual.

The most significant updates include:

- a new section that precedes the table of contents has been added. This section describes how registrants may communicate with the Division's Office of the Chief Accountant ("**CF-OCA**") when requesting reporting relief under Rule 3-13 of Regulation S-X, answers to interpretative letter requests or informal advice, or assistance to identify and explain applicable SEC rules, regulations, forms and guidance that affect the form and content of financial statements or other financial information required to be included in SEC filings. In each case, the manual provides appropriate contact information;
- section 2065 has been amended to clarify that this section also applies if the business acquired is identified as a predecessor of the registrant. Registrants may thus directly request permission from the CF-OCA to provide abbreviated financial statements instead of full financial statements for an acquired business that represents a predecessor of the registrant;
- in addition, the Staff made corresponding changes in the manual in light of the Compliance and Disclosure Interpretations ("**C&DIs**") update of 17 August 2017 related to the circumstances under which certain financial information may be omitted from draft and filed registration statements. See "*SEC Provides Additional Relief to Facilitate IPO Filings*" above; and
- the updates in Section 10220.5 refer to FAST Act C&DI Question 2, which clarifies that an EGC may omit financial statements of other entities from its filing or submission if it reasonably believes that those financial statements will not be required at the time of the offering.

The updated Financial Reporting Manual is available at:

- https://www.sec.gov/corpfin/cf-manual/index.html

SEC Increases Fee Rates for Fiscal 2018

On 24 August 2017, the SEC announced an increase in the fees charged to issuers to register their securities. The fee rates for registration of securities and certain other transactions will be $124.50 per million dollars of securities registered in fiscal year 2018 (from $115.90 per million dollars in fiscal year 2017).

Noteworthy US Securities Litigation

Federal District Court Opens Door for Plaintiffs to Bring Securities Claims Arising from FCPA Violations

While there is no private right of action under the Foreign Corrupt Practices Act ("**FCPA**"), the plaintiffs' bar may have a new tool to punish companies for related conduct. On 19 September 2017, a federal district court in New York allowed a putative securities fraud class action to proceed against VEON Ltd. ("**VEON**") and several of its current and former executives for violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 (the "**Exchange Act**"). In *In re VEON Ltd. Securities Litigation*, the plaintiffs had alleged that VEON failed to disclose in its SEC filings that it had engaged in a bribery scheme in Uzbekistan and that, as a result, its statements about the company's growth were materially misleading. VEON countered that the plaintiffs' claims were an impermissible attempt to enforce the FCPA through a private right of action. But ultimately the court held that the plaintiffs' allegations were sufficiently distinct to plead violations of Sections 10(b) and 20(a) of the Exchange Act.

By way of background, in February 2016, VEON, a telecommunications company formerly known as VimpelCom, entered into a deferred prosecution agreement ("**DPA**") with the United States Department of Justice and pleaded guilty to conspiracy to violate the anti-bribery and books and records provisions of the FCPA and a violation of the internal controls provision of the FCPA. In the complaint in the civil litigation, the plaintiffs had relied on VEON's admissions in the DPA.

In largely denying VEON's motion to dismiss, the court held that VEON's alleged failure to disclose its bribery scheme, when it said that its sales and marketing efforts in Uzbekistan resulted in increased subscribers and revenues, made those and similar statements an adequate basis to bring a claim. Regarding alleged misstatements concerning the Governmental authorities in Uzbekistan, the court held that general disclosures about the relevant oversight bodies were true and therefore not a sufficient basis to assert a claim. But it held that, in light of the company's bribes, its statement that "all owners of telecommunication networks have equal rights and enjoy equal protection guaranteed by the law" was materially misleading and therefore could form the basis of a claim. In addition, the court held that certain of VEON's statements about its internal controls could serve as the basis for a claim because plaintiffs alleged that those statements regarding the "existence and efficacy" of those controls were knowingly false. Notably, however, the court found that, to the extent the plaintiffs' claim was based on the failure to follow internal controls, without more, that aspect of the claim was dismissed because it constituted "mismanagement," which cannot support a claim for securities fraud. The court separately held that the plaintiffs had sufficiently alleged fraudulent intent on the part of the VEON executives. Their intent could therefore be attributed to the company.

This case highlights that, while alleged FCPA violations alone cannot give rise to a private right of action, plaintiffs may be able to sustain securities claims based on alleged criminal wrongdoing if they can sufficiently plead that the failure to disclose such conduct made the company's other disclosures materially misleading.

Addressing Insider Trading, Federal Appeals Court Clarifies What Constitutes a "Personal Benefit"

On 23 August 2017, in a widely followed case (*United States v. Martoma*), a divided panel of the Second Circuit Court of Appeals (which hears appeals from district courts in Connecticut, New York and Vermont) upheld the insider trading conviction of portfolio manager Mathew Martoma of SAC Capital Advisors, LLC. The decision marked that court's first occasion to consider its landmark decision in *United States v. Newman* (which we have written about in previous editions of this newsletter) in light of the United States Supreme Court's subsequent decision in *Salman v. United States*. In *Salman*, the Court found that a jury could infer that a tipper personally benefited from making a gift of confidential information to a relative who traded on it.

Over a strong dissent, the majority found that the logic underpinning the *Salman* decision abrogated *Newman*'s requirement that a "meaningfully close personal relationship" must exist between a tipper and tippee before allowing a jury to infer the personal benefit necessary to establish insider trading liability merely from a tip of inside information. The majority held "that an insider or tipper personally benefits from a disclosure of inside information whenever the information was disclosed with the expectation that the recipient would trade on it and the disclosure resembles trading by the insider followed by a gift of the profits to the recipient, whether or not there was a meaningfully close relationship between the tipper and tippee". In so ruling, the court shifted the focus from the relationship between a tipper and tippee to the tipper's subjective intent in making the tip and seemingly did away with the limiting principle that *Newman* had established.

While clearly a win for prosecutors, this new standard will still require a highly fact-intensive inquiry into the purpose of any tip. As a result, it remains to be seen how much of a shift in law it portends. Furthermore, the requirement established in *Newman*—that a tippee must know about the personal benefit received by the insider – remains unchanged and will continue to limit prosecutions involving extended tipping chains.

Olagues v. Icahn, et al.: A Limited but Important Ruling on Disgorging Short-Swing Profits

The Second Circuit Court of Appeals has issued a limited, but potentially significant, ruling on disgorging short-swing profits. In *Olagues v. Icahn, et al.*, the court affirmed the dismissal of a "short-swing" trading suit brought by a shareholder in Herbalife, Ltd., Hologic Inc. and Nuance Communications, Inc., against investment entities controlled by Carl C. Icahn ("**Icahn**" and the "**Icahn Entities**"). The plaintiffs had sought disgorgement of certain consideration that the Icahn Entities allegedly received in violation of Section 16(b) of the Exchange Act and regulations promulgated thereunder.

Section 16(b) of the Exchange Act aims to prevent corporate insiders, who are presumed to possess material information about the corporation, from earning short-swing profits by buying and selling securities within a six-month period. Exchange Act Rule 16b-6(d) applies where an insider receives a premium for writing (that is, selling) an option that is cancelled or expires unexercised within six months.

Here, the plaintiffs first acknowledged that the Icahn Entities disgorged premiums on certain put options that were cancelled unexercised within six months of their sale, as required by Section 16(b). They next alleged that the Icahn Entities should have also disgorged the "value" of alleged discounts that Icahn received on purchases of related call options. In affirming the district court's decision, the Second Circuit rejected this new argument and ruled that the plaintiff failed to state a plausible claim for additional disgorgement.

The court focused on the plaintiff's exclusive reliance on comparisons to options traded on the open market. The panel found that these open-market options had "no meaningful similarities to the options at issue here" and therefore concluded that the plaintiff failed to allege that the Icahn Entities disgorged less than the total amount of premiums they actually received. In issuing this ruling, the court emphasized the "limited nature" of its holding, because its conclusion that the complaint did not state a claim for relief reflected the plaintiff's exclusive reliance upon open-market options that were not truly comparable to the options at issue in this case.

PSLRA "Safe Harbour" Protections Do Not Extend to Statements that Are Not Forward-Looking, Even if Mixed With Those that Are, Court of Appeals Finds

On 28 July 2017, in *In Re Quality Systems, Inc. Securities Litigation*, the Ninth Circuit Court of Appeals issued a decision holding that courts should sort out statements that are "forward-looking" from those that are not when analyzing whether statements with elements of both are entitled to the "safe harbour" protections of the Private Securities Litigation Reform Act of 1995 ("**PSLRA**"). In so doing, the court reversed a lower court decision dismissing a putative class action lawsuit against Quality Systems, Inc. ("**QSI**") and several of its officers. The plaintiffs had alleged that QSI's statements over several months concerning its past and projected sales, as well as guidance to investors about the company's projected growth and revenue, violated Section 10(b) of the Exchange Act and Rule 10b-5. In reversing the lower court, the appeals court found that many of the defendants' statements constituted a mixture of statements that were forward-looking (which are protected under the PSLRA's "safe harbour" provision) and those that were not. The Ninth Circuit (which covers California and eight other Western states) held, on an issue of first impression within that circuit, that courts should consider the two categories of statements separately for purposes of the forward-looking statement analysis.

Federal Appeals Court, Partially Vacating Class Certification, Holds that Whether Securities Transactions Are "Domestic" Raises Predominance Issues under Rule 23

On 7 July 2017, in *In re Petrobras Securities*, the Second Circuit Court of Appeals partially vacated an order certifying classes asserting claims under the Exchange Act and the Securities Act of 1933, on the basis that the lower court had insufficiently considered whether individual determinations as to whether over-the-counter bond purchases were "domestic" transactions would predominate over common issues of fact and law.

Under *Morrison v. National Australia Bank Ltd.*, a seminal United States Supreme Court case decided in 2010, a foreign plaintiff cannot recover in the United States courts for securities fraud perpetrated outside the United States in connection with securities traded on foreign exchanges.

In the *Petrobras* case, the court ruled that, in the class proposed by the plaintiffs, issues as to whether a transaction was foreign or domestic under *Morrison* would predominate over the issues common to the entire proposed class. For that reason, said the court, it could not fully uphold the district court's ruling certifying the case as a class action. The predominance of common issues is a threshold requirement for class certification under Rule 23 of the Federal Rules of Civil Procedure.

The court also clarified that, unlike other circuit courts, the Second Circuit requires only that a class be "defined using objective criteria that establish a membership with definite boundaries" to meet the threshold "ascertainability" requirement under Rule 23.

In affirming the lower court decision in part, the Second Circuit also held that, in Exchange Act cases, plaintiffs may be able to avail themselves of the "fraud on the market" presumption that the defendant relied on the allegedly false statement, even if they do not establish that the news released to the market caused statistically significant changes in the share price.

This decision is significant in several respects. First, it clarified the Second Circuit's position on ascertainability. Second, it established the importance, when considering class certification, of carefully reviewing *Morrison* issues. Finally, it clarified the Second Circuit's position on the fraud-on-the-market presumption of reliance at the class certification stage.

More information on *Petrobras* is available at:

- http://www.lit-sl.shearman.com/second-circuit-partially-vacates-class-certificat

Asia Developments

Joint Consultation Conclusions on Proposed Enhancements to the Stock Exchange's Decision-Making and Governance Structure for Listing Regulation

Following our article published in the July 2016 edition of the Governance & Securities Law Focus in connection with the joint consultation launched on 17 June 2016 by the Securities and Futures Commission ("**SFC**") and The Stock Exchange of Hong Kong Limited ("**Stock Exchange**") on proposed enhancements to the Stock Exchange's decision-making and governance structure for listing regulation (the "**Proposals**"), the SFC and the Stock Exchange issued the consultation conclusions ("**Consultation Conclusions**") on 15 September 2017.

Originally under the Proposals, two new committees, each with equal representation from the SFC and the Stock Exchange, would be formed, namely a Listing Policy Committee and a Listing Regulatory Committee. As the vast majority of the respondents opposed the Proposals, the Consultation Conclusions concluded that in place of the originally proposed Listing Policy Committee, a Listing Policy Panel ("**LPP**"), which will not be a committee under the SFC or the Stock Exchange, will be established as an advisory, consultative and steering body to initiate and centralise discussions on listing policy with broader regulatory or market implications. In addition, the proposed Listing Regulatory Committee will not be established.

Listing Policy Panel

The LPP will be constituted by memorandum of understanding arrangements between the SFC and the Stock Exchange and will serve as a focal point for new policy proposals. The panel, on which the SFC and the Hong Kong Exchanges and Clearing Limited (and its wholly-owned subsidiary the Stock Exchange) are equally represented, will have 12 members with a composition as follows:

- two non-executive Directors from the board of directors of Hong Kong Exchanges and Clearing Limited ("**HKEX**"), the Chairperson and two Deputy Chairpersons of the Listing Committee of the Stock Exchange (the "**Listing Committee**") and the Chief Executive of HKEX; and
- two non-executive Directors from the board of directors of the SFC, the Chairperson of the "Takeovers and Mergers Panel", the Chief Executive Officer of the SFC, the Executive Director of the Corporate Finance Division of the SFC and a Senior Director of the Corporate Finance Division of the SFC.

The LPP will have no rule-making powers, and its recommendation will not be binding on the organisations represented on the LPP. The LPP may request the Listing Department of the Stock Exchange to work on a detailed proposal in relation to any policy matter, and the Listing Department will consult the LPP from an early stage when formulating Listing Rule amendments or other policy proposals. The views, advice or recommendations of LPP members will be relayed to the Listing Committee, the HKEX's board and the SFC's board when their approvals are sought for any policy or rule changes.

IPO Applications

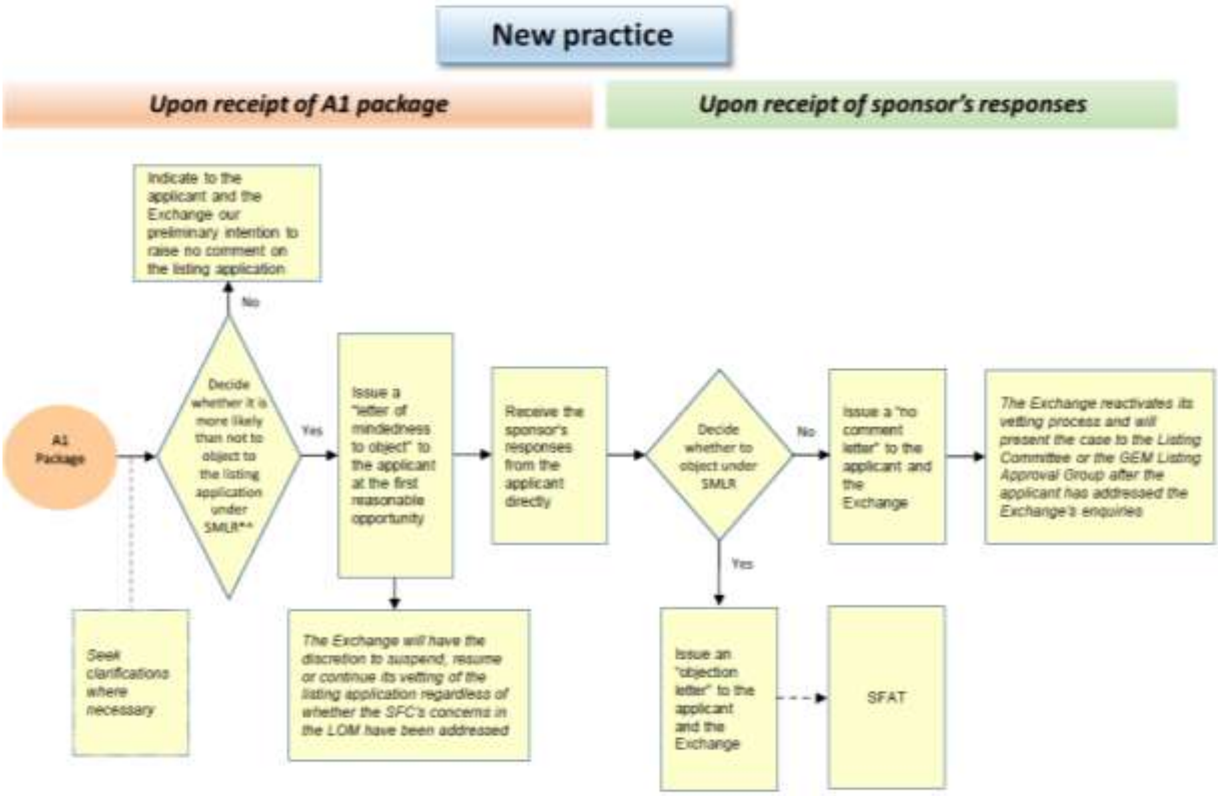
Under the Proposals, the Listing Regulatory Committee (with equal representation from the SFC and the Exchange) will be established to decide on initial listing applications that have suitability concerns or broader policy implications. The Listing Committee, which comprises representatives of investors, listed issuers and market practitioners, together with the Listing Department of the Stock Exchange, will continue to decide initial listing applications which do not involve suitability issues or give rise to broader policy implications. After considering market feedback, the SFC and the Stock Exchange have decided not to pursue such proposal. The Stock Exchange will continue to make decisions under its Listing Rules (including decisions on suitability for listing), and the role of the Listing Committee as the decision-maker for IPO applications will remain unchanged.

The SFC, as the statutory regulator, will adopt a new approach and concentrate its manpower in more serious listing matters that fall within the scope of the Securities and Futures (Stock Market Listing) Rules ("**SMLR**") or the Securities and Futures Ordinance ("**SFO**"). Section 6(2) of the SMLR sets out the grounds on which the SFC may object to a listing application, including:

- the application does not comply with the Listing Rules or applicable law;
- the application does not contain such particulars and information which is necessary to enable an investor to make an informed assessment of the applicant and the rights attaching to its securities;
- the application is false or misleading as to a material fact or is false or misleading through the omission of a material fact;
- the applicant has failed to supply to the SFC such further information as the SFC may reasonably require for the performance of its functions under the SMLR; or
- it would not be in the interest of the investing public or in the public interest for the securities to be listed.

The SFC will cease to review a listing application once it determines that the case does not raise concerns under the SMLR. If the SFC forms the view that it is more likely than not that an objection will be raised under the SMLR, it will promptly issue a "letter of mindedness to object" ("**LOM**") with detailed reasons for its concerns directly to the listing applicant. If the SFC considers that an applicant's submissions in response to the LOM are inadequate, it will issue a final decision notice ("**FDN**") under the SMLR to object to the listing application. All requests for information, LOMs and FDNs will be issued within the time periods specified in the SMLR.

The Stock Exchange, as the primary front-line regulator, will remain the contact point for all listing applications save in respect of concerns raised by the SFC under the SMLR. The following chart sets out the SFC's approach to processing IPO applications going forward:



* The application proof should be substantially complete with sufficient information for an informed assessment.
^ Prior to issuing an LOM, when the SFC staff see potential grounds for issuing an LOM but require further clarification from the applicant, they will directly ask the applicant for the necessary information.

Source: the Consultation Conclusions issued by the SFC and the Stock Exchange

SFC's Oversight of the Listing Function

After considering the public submissions, the original proposal for the Listing Policy Committee (with equal representation from the SFC and the Stock Exchange) to replace the Listing Committee as the body responsible for oversight of the listing function and for the Listing Department of the Stock Exchange to report to the Listing Policy Committee on its work will not be pursued. Instead, the SFC will enhance its supervisory function of auditing or reviewing the Stock Exchange's performance by focusing on:

- whether the Stock Exchange, in carrying out its listing regulatory function, has discharged its duties under the SFO;
- adequacy of the Stock Exchange's systems, processes, procedures and resources for performing its listing function; and
- the effective management of conflicts of interest within the Stock Exchange as a regulator and as part of a for-profit organisation; including the supervisory functions performed by the Listing Committee.

According to the Consultation Conclusions, this enhanced approach will clearly delineate the role of the SFC as regulator and those of the Stock Exchange and HKEX as regulatees under the SFO. The SFC will publish its supervisory audit or review reports on the Stock Exchange's performance from time to time in accordance with current procedures.

The joint consultation paper and the Consultation Conclusions are available at:

- *http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp201606.pdf*
- *http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp201606cc.pdf*

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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