The 2011 Form 20-F
New Developments, Practices and Trends

In order to assist with the preparation of this year’s Form 20-F, this note summarizes new developments and best practices that should be taken into account and highlights topics and trends that will likely be the focus of review by the US Securities and Exchange Commission (the “SEC”).

SEC Rules and Guidance

Form 20-F Due Date

Beginning with fiscal years ending on or after 15 December 2011, the new, accelerated deadline for foreign private issuers to file their Form 20-F will be four months, shortened from the previous six months. For companies with a calendar fiscal year, the Form 20-F for 2011 must be filed on or before 30 April 2012.

While many foreign private issuers may see the accelerated filing deadline as a challenge, we believe it provides an opportunity to integrate the preparation of the Form 20-F with the preparation of the year-end financial statements and the home country annual reporting. Although it will be necessary to start the preparation of the Form 20-F earlier than in prior years, an integrated process may ultimately result in increased efficiencies in terms of commitment of time and resources, as well as ensuring consistency of disclosure across all year-end reporting documents.
New Guidance on Cybersecurity Disclosure

The staff of the SEC’s Division of Corporation Finance recently issued guidance on the disclosure obligations relating to cybersecurity risks and cyber incidents that should be taken into consideration when preparing the 2011 Form 20-F. The guidance does not impose new disclosure requirements, but instead analyzes cybersecurity risk like any business risk that may require disclosure under a number of existing disclosure obligations. It is the SEC’s view that companies should consider the following items in assessing their disclosure obligations with respect to cybersecurity risks and incidents:

▶ **Risk Factors.** In assessing required risk factor disclosure, companies should consider the probability of cyber incidents occurring and the quantitative and qualitative magnitude of those risks, including the occurrence of prior cyber incidents and their severity and frequency and the adequacy of preventative actions taken.

▶ It is important that any risk factor disclosure be tailored to the specific facts and circumstances of the company and not be boilerplate. Appropriate disclosure may include a discussion of:

▶ the aspects of the business or operations giving rise to material cybersecurity risks and the potential costs and consequences;

▶ outsourced functions that have material cybersecurity risks and how those risks are addressed;

▶ experienced or threatened cyber incidents that, individually or in the aggregate, are material and the related costs and consequences;

▶ risks related to cyber incidents that may remain undetected for an extended period of time; and

▶ relevant insurance coverage.

▶ **MD&A.** Companies should consider if there are costs or other consequences associated with one or more known cyber incidents or if the risk of potential incidents represent a material event, trend or uncertainty that is reasonably likely to have a material effect on the company’s results of operations, liquidity or financial condition or would cause reported financial information not to be necessarily indicative of future operating results or financial condition. Examples include the theft of material intellectual property that is reasonably likely to have a material effect, such as reduced revenues or an increase in cybersecurity protection costs.

▶ **Business Description and Legal Proceedings.** Disclosure is required if one or more cyber incidents materially affect a company’s products, services, relationships with customers or suppliers, or competitive conditions, and such disclosure should consider the impact on each of the company’s reportable segments. Additionally, any material pending legal proceeding involving a cyber incident may also have to be disclosed.

▶ **Financial Statement Disclosure and Disclosure Control and Procedures.** Companies should also contemplate whether costs relating to cyber incidents may have an impact on their financial statements. Items that may have to be accounted for include costs to prevent cyber incidents, or, during or after a cyber incident, incentive payments to customers to maintain the business relationship, losses from asserted and unasserted claims or diminished future cash flows. In addition, to the extent a cyber incident poses a risk to a company’s ability to record, process, summarize, and report information that is required to be disclosed in SEC filings, appropriate disclosure of the conclusions on the effectiveness of its disclosure controls and procedures may have to be made.

**Review of Adequacy of Current Disclosure relating to Cybersecurity.** Companies should review the adequacy of their current disclosure relating to cybersecurity risks and cyber incidents and monitor it on an ongoing basis. The guidance clarifies, however, that detailed disclosure that itself would compromise a company’s cybersecurity, for example by providing a “roadmap” for those seeking to infiltrate a company’s network security, is not required.
Credit Ratings

As a reminder, the repeal of Rule 436(g) under the Securities Act of 1933, as amended (the “Securities Act”), brought about by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) in 2010 meant that credit rating agencies must now consent to the use of their credit ratings in Securities Act registration statements and prospectuses. The repeal had the effect of exposing credit rating agencies to liability as experts under Section 11 of the Securities Act when credit ratings they provide to a company are included or incorporated by reference into a Securities Act registration statement or prospectus.

We understand that credit rating agencies continue to refuse to provide consents to companies and, as a result, companies that disclose credit ratings in their Form 20-F may not be able to incorporate these filings into their Securities Act registration statements, which could limit their ability to use public offerings to access the capital markets if they conclude that the consent of the credit rating agency is required. Companies are permitted to include credit ratings without consent in certain limited circumstances when the disclosure of the rating is required to satisfy a company’s disclosure obligations, for example, in the context of a discussion of changes to a credit rating, the liquidity of the company, the cost of funds for a company or the terms of agreements that refer to credit ratings. Shearman & Sterling LLP and other Wall Street law firms issued a Whitepaper setting forth possible approaches to address the issues raised by the repeal of Rule 436(g) that is available at http://www.shearman.com/files/Uploads/Documents/whitepaper5%20_2_.pdf.

Absent an exception, we continue to recommend that companies refrain from including credit ratings in their 2011 Form 20-F. Any company that plans to include credit ratings should consult with counsel.

Proposed SEC Rules

New Disclosure Requirements for Extractive Industries

The Dodd-Frank Act contained three provisions adding new disclosure requirements relating to the extraction and use of natural resources, which are at various stages of implementation. The SEC has announced that it plans to adopt final rules implementing these provisions before the end of 2011.

Conflict Minerals

The SEC’s rules promulgated under the conflict minerals provision of the Dodd-Frank Act will require companies to disclose annually whether the “conflict minerals” used in, or in the manufacturing of, their products originated in the Democratic Republic of Congo or an adjoining country. Companies that use conflict minerals originating in these countries will be required to submit to the SEC a report describing the due diligence undertaken on the source and chain of custody of the conflict minerals, including an independent private sector audit, and certain other specified disclosures. “Conflict minerals” are defined as columbite-tantalite (coltan), cassiterite, gold, wolframite, or their derivatives, namely tin, tantalum and tungsten. While the SEC is proposing to also subject mining companies to the conflict minerals reporting by considering mining to come within the definition of “manufacturing”, the rules clearly apply to any manufacturing company if conflict minerals are necessary for the functionality or production of its products. This is true even if the final product does not contain any conflict minerals, as long as a conflict mineral is intentionally included in a product’s production process and is necessary to that process.

On 18 October 2011, the SEC held a public roundtable on the agency’s conflict minerals rulemaking, which helped to further define the concerns of the various stakeholders involved, highlighted the areas of consensus and identified concrete challenges faced by companies in complying with the new rules. In doing so, the roundtable provided insight regarding the issues the SEC considers important and the shape that the final rules may take. Our client publication on

While the SEC’s proposed rules contemplate that the required disclosures will be made as part of a company’s annual report on Form 20-F, in addition to publication of the information on the company’s web site, it has solicited comments on whether another form (such as Form 6-K) and another annual deadline for submitting the disclosure would be more appropriate. Because there is still uncertainty on how the final rules will implement the conflict minerals disclosure requirements, as a practical matter it may be difficult for companies to voluntarily comply with the conflict minerals rules prior to adoption of the final rules.

Assuming the SEC adopts final rules implementing the conflict minerals provision of the Dodd-Frank Act by the end of 2011, it is expected that companies will need to comply with the rules for their first full fiscal year beginning after the adoption of the rules (i.e., for companies with a 31 December fiscal year-end, their first conflict minerals disclosure will be with respect to the year ended 31 December 2012). Given that it may take a certain period of time for the structures necessary for verifying the sources of conflict minerals to be put in place and mature, we recommend that companies begin reviewing the verification process for their supply chains and how they and their suppliers trace the source of conflict minerals used in their products.

Mine Health and Safety

The mine safety disclosure requirements of the Dodd-Frank Act are already in effect, and companies should include the required disclosure in their 2011 Form 20-F. The SEC rules will amend Form 20-F to explicitly incorporate the new disclosure requirements. Companies, including foreign private issuers, that, directly or indirectly, operate a coal or other mine in the US are required to disclose in their periodic reports filed with the SEC certain specified information about mine health and safety for the period covered by the report, mostly relating to violations and orders issued under the US Federal Mine Safety and Health Act of 1977. Companies that operate, directly or indirectly, mines outside the United States are not subject to the disclosure requirements with respect to such mines. However, to the extent mine safety issues relating to non-US mines are material, disclosure may otherwise be required under the SEC rules. In addition, the SEC is seeking comments on whether it should require foreign private issuers to disclose the receipt of certain orders or notices relating to imminent danger or violations of mine safety regulations on a current basis, as is required for US companies.

Government Payments

The SEC is also proposing amendments to Form 20-F that would require any resource extraction company that is a SEC reporting company to include in its annual report information relating to any payments made by that company to US or non-US governments for the purpose of the commercial development of oil, natural gas or minerals. Information required to be disclosed relates to both the type and total amount of payments made for each project and to each government. The SEC is proposing to require the government payments disclosure to be presented in interactive data format (specifically, XBRL), as well as in standard HTML or ASCII format. Many companies already disclose similar “publish what you pay” information as part of their annual disclosure under the guidelines of the Extractive Industries Transparency Initiative, either voluntarily or pursuant to the requirements of certain non-US stock exchanges.

Companies in the EU will likely be required to make similar disclosure under proposed EU law. On 25 October 2011, the European Commission issued a proposal to introduce mandatory “publish what you pay” rules of all payments made to governments of countries rich in natural resources by listed and large private mining, oil, timber and gas companies.
Compensation Committee Independence

In 2011, the SEC proposed new rules directing the US national securities exchanges, like the New York Stock Exchange (“NYSE”) or NASDAQ, to prohibit the listing of the securities of any company whose compensation committee is not comprised exclusively of independent directors. Foreign private issuers are exempt from this requirement if they disclose in their Form 20-F the reasons why they do not have an independent compensation committee. Our client publication on the proposed rules is available at http://www.shearman.com/secs-proposed-rules-on-compensation-committee-independence-largely-follow-provisions-of-dodd-frank-04-04-2011/.

* The criteria necessary to establish independence would be set by the exchanges themselves based on SEC guidance as to “relevant factors”, which, at a minimum, would include taking into account the source of compensation of the committee member and whether such member is affiliated with the company.

For foreign private issuers listed on the NYSE, this proposal crystallizes at the SEC level the independence requirement that already exists under the NYSE corporate governance standards. Although the final rules have not yet been issued, foreign private issuers that do not already comply with the NYSE independence requirement are well advised to review the composition of their compensation committee against the factors set out in the SEC guidance and, if necessary, consider appropriate disclosure for inclusion in their 2011 Form 20-F.

Compensation Consultants

In addition, the SEC has proposed that the compensation committee must have sole discretion to obtain the advice of compensation advisors and be directly responsible for the appointment, payment and oversight of compensation advisors. A compensation committee may select compensation consultants only after considering certain specified factors related to the consultants' independence. These proposed SEC rules allow the US national securities exchanges to decide whether to propose that certain categories of companies, such as foreign private issuers, be exempted from these requirements and it remains to be seen whether any resulting Form 20-F disclosure will be required.

Temporary Relief regarding Interactive Data Files

The SEC's Division of Corporation Finance issued a no-action letter providing that foreign private issuers that prepare their financial statements in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”) are not required to submit to the SEC and post on their corporate website, if any, Interactive Data Files until the SEC specifies on its website a taxonomy for use by such foreign private issuers in preparing their Interactive Data Files.

* In 2009, the SEC adopted rules that require companies to provide their financial statements to the SEC and on their corporate website in an interactive format using XBRL or eXtensible Business Reporting Language. Foreign private issuers that prepare their financial statements in IFRS as issued by the IASB were required to comply with these rules for fiscal periods ending on or after 15 June 2011.

* In preparing the Interactive Data Files, the relevant SEC rules, however, require the use of a taxonomy to be specified on the SEC’s website, which the SEC has not done yet.
Focus Areas

Operating and Financial Review and Prospects

Material Known Trends and Uncertainties

One of the most important aspects of the Financial Review disclosure is the discussion of material known trends and uncertainties, which assists investors in understanding the extent to which historical financial information is indicative of future results. Companies are required to provide disclosure of any trend, demand, commitment, event or uncertainty unless the company is able to conclude either that it is not reasonably likely that the trend, uncertainty or other event will occur or come to fruition, or that a material effect on the company’s liquidity, capital resources or results of operations is not reasonably likely to occur. Item 303 of Regulation S-K and the related SEC guidance call for companies to focus on matters that have not had an impact on operations in the past but would have an impact going forward and on matters that have had an impact on reported operations but are not expected to have an impact on future operations.

In preparing the 2011 Form 20-F, companies should particularly consider whether any of the new rules under the Dodd–Frank Act relating to derivatives and proprietary trading are expected to have an effect on results going forward and whether these effects should be disclosed in the Financial Review as known trends or uncertainties.

Liquidity and Capital Resources Guidance, Re-Financings and Going Concern Issues

In light of ongoing challenging economic conditions and credit concerns, the SEC is likely to remain focused on companies’ liquidity and capital resources disclosure. Companies are therefore reminded of the guidance released by the SEC in September 2010 which:

- reiterated long-standing principles as they apply to disclosure of critical liquidity matters;
- made clear that an SEC-reporting company cannot use financing structures, whether on- or off-balance sheet, designed to mask its reported financial condition;
- emphasized that leverage ratios and other financial measures included in SEC filings must be calculated and presented in a way that does not obscure a company’s leverage profile or reported results; and
- addressed divergent practices that have arisen in the context of tabular disclosure of contractual obligations, to focus companies on providing meaningful disclosure about their future payment obligations.


In addition, we anticipate that the expected increase in refinancing risks in the near- to medium-term will result in an increased focus from auditors on the facts underlying the going concern assumption. Similarly, the challenging economic and financial conditions are expected to focus greater attention on disclosures about companies’ freely available cash and whether there are any restrictions on a company’s ability to use its cash to finance its operations.

Short-Term Borrowings Proposals

The rules proposed by the SEC in September 2010, which would require additional disclosure about short-term borrowings in registration statements and periodic reports, including Form 20-F, have not been adopted to date. The SEC proposing release is available at: http://sec.gov/rules/proposed/2010/33-9143.pdf.

Loss Contingencies

Companies are reminded that the SEC indicated in 2010 that it intends to focus more closely on compliance with Financial Accounting Standards Board (FASB) standards for disclosure required by ASC Subtopic 450-20 Contingencies-Loss Contingencies (previously referred to as FASB Statement No. 5, Accounting for Contingencies).
October 2011, the SEC issued a “Dear CFO” letter about the potential risks and costs associated with mortgage and foreclosure-related activities or exposures that highlighted the requirement to disclose loss contingencies in accordance with the accounting standard. We expect this area to continue to be a focus of SEC review.

Other Possible Comments

- **Segments.** To the extent that companies have responded to the challenging economic conditions by reorganizing their operations, they should analyze whether their segment disclosures included in their Financial Review and financial statements footnotes need to be updated to the extent an internal restructuring has modified how they manage their businesses. In particular, companies should be vigilant in ensuring that segment disclosures made in their Form 20-F comport with statements made in webcasts, earnings calls or investor conferences.

- **Internal Controls over Financial Reporting.** Companies should consider whether and how reduced spending on information technology, internal reorganizations, reduction in staffing and other changes effected in response to the challenging economic climate may have affected their internal controls over financial reporting and whether any discernable changes are disclosable.

- **Asset and Goodwill Impairment.** We anticipate the SEC to continue to focus on asset and goodwill valuation, especially in light of the challenging economic environment. Although companies may not expect that the requirement for impairment testing will have been triggered, the SEC expects early warning disclosure in the Financial Review if an asset or a reporting unit is at risk of failing the impairment test and an actual impairment would be material. This is in line with general guidance in respect of known trends and uncertainties.

- **Non-GAAP Financial Measures.** There has been an increasing number of SEC comments questioning whether an expense excluded in the preparation of a non-GAAP financial measure is in fact a non-recurring expense, as required by Item 10(e)(1)(ii)(B) of Regulation S-K and further explained in Question 102.03 of the non-GAAP financial measures Compliance and Disclosure Interpretations (C&DIs) initially published by the SEC in January 2010. Companies are reminded that a charge cannot be eliminated as non-recurring if “it is reasonably likely to recur within two years or there was a similar charge...within the prior two years.” The non-GAAP financial measures C&DIs are available at: [http://www.sec.gov/divisions/corpfin/guidance/nongaapinterp.htm](http://www.sec.gov/divisions/corpfin/guidance/nongaapinterp.htm).

Risk Factors

**Current Economic Uncertainty and Credit Risks**

Current market uncertainty and fluctuating conditions in the global economy continue to affect all companies and therefore, as was the case in 2008 and 2009, companies should consider including or updating risk factors on the current economic and fiscal climate. Disclosure and risk factors on credit risk and the challenging economic environment used in 2008 and 2009 filings could be helpful and should be revisited and updated to reflect developments in 2011 and risks going forward in 2012.

**The Euro Zone Crisis**

If one or more countries exit the monetary union, or in the event of a breakup of the monetary union entirely, the financial markets will experience severe volatility. In addition to general economic upheaval, for many companies, the economic and political uncertainty emanating from the euro zone will require disclosure relating to their exposure to the euro. The nature and extent of the changes facing the euro zone will continue to evolve over the Form 20-F filing period; at this time, discussions on the outcome are speculative. However, given the profound and fundamental changes that may arise, companies must address potential significant risks in their disclosure.

The effects of any shift in the composition of the monetary union will be governed by the law in effect at the time, though the shape of this framework is yet to be determined. Political decisions may mitigate disruption resulting from changes
to the euro zone. In the meantime, risk factors should highlight specific elements of the situation in the euro zone that are relevant to the company’s operations and business, and companies may wish to consider the following:

- **Redenomination:** in the event of the dissolution of the monetary union in its entirety or a creation of an alternative currency with different participating member states, debts may be redenominated. This will affect EU- and non-EU-based companies differently. For a non-EU-based company, risk factors should describe the company’s exposure to euro-denominated debt and obligations and possible challenges resulting from the redenomination of its obligations and the uncertainties related to the dissolution and redenomination process, as well as future access to European markets. For those within, changes to the euro zone will underpin all their activities, and so while any risk factors on this issue would by necessity be presented in broader terms, companies should seek to identify specific risks investors should be aware of where possible;

- **Exposure to Sovereign Debt:** companies have been including risk factors related to their euro zone sovereign debt exposure in their disclosure for several months. This continues to be relevant given the ongoing upheaval; and

- **Exchange Risks:** in addition to the redenomination of debts discussed above, companies may face currency and exchange risks related to dividends, foreign cash balances and investments in addition to risks related to failures of hedging policies, where applicable.

**Regional Political Risks**

Beyond the economic and political environment in Europe, political uncertainty in any region should also be considered, particularly where such civil unrest and regional turmoil have disrupted operations, or where the company has significant operations that may be disrupted. It may be appropriate to disclose where, for example, political uprisings in the Middle East have affected the company’s business (for example, where operations were suspended due to political violence in Libya, where recent upheaval resulted in withdrawal of expatriate employees, or subsequent fluctuations in energy or raw material supplies or prices), or where political instability and uncertainty, whether resulting from regime changes, armed protests or political impasse, have a material effect on the company’s operations.

**Contacts with Sanctioned Countries**

As noted under “Iran Sanction and Other Office of Global Security Risk Issues” below, we expect heightened focus from the SEC on dealings with sanctioned countries, particularly Iran. This continues the trend seen in recent comments to Form 20-F risk factors, where the SEC requested disclosure on contacts in and agreements with entities in sanctioned countries, soliciting further details such as the amount, the nature and the materiality of any contracts within sanctioned countries.

**2010 Climate Change Guidance – Risk Factor Disclosure**

On 2 February 2010, the SEC issued a release addressing climate change disclosure that remains applicable and is discussed in more detail below. Beyond discussion of climate change disclosure, within the release the SEC reaffirms its stance that companies must avoid boilerplate language when drafting risk factors. Recent staff comments reiterate that risk factor disclosure must be meaningful and specific to the company rather than vague or overbroad. For any category of risk factors and as emphasized by the SEC in relation to climate change disclosure, “registrants should not present risks that could apply to any issuer,” and should tailor risk factors accordingly. The SEC guidance is available at: [http://www.sec.gov/rules/interp/2010/33-9106.pdf](http://www.sec.gov/rules/interp/2010/33-9106.pdf).
Corporate Governance

General Reminders

All SEC reporting companies must meet a set of corporate governance requirements that were adopted as part of or pursuant to the Sarbanes-Oxley Act of 2002 and are being adopted pursuant to the Dodd-Frank Act, many of which require disclosure in the Form 20-F concerning compliance with the relevant requirement. Most of the Sarbanes-Oxley corporate governance requirements apply to foreign private issuers, but only a few of the Dodd-Frank corporate governance requirements apply. Other than the proposed provisions described above relating to an independent compensation committee and various criteria for compensation consultants, there are no changes to the required Form 20-F corporate governance disclosures.

The NYSE and NASDAQ also have a set of corporate governance standards for their listed companies, which sometimes but not always overlap with the Sarbanes-Oxley and Dodd-Frank requirements. In the case of foreign private issuers, the NYSE and NASDAQ standards defer to home country practice except for compliance with certain audit committee requirements.

As a reminder, a foreign private issuer is required to disclose, in a separately captioned section of its Form 20-F (i) a brief summary of any significant ways in which its corporate governance practices (as opposed to the general corporate governance practices of its home country) differ from the NYSE standards or (ii) each NASDAQ requirement that it does not follow and the home country practice that the company follows in lieu of the requirement. Each year, foreign private issuers should compare their corporate governance practices, and home country requirements, with the NYSE or NASDAQ standards to identify such differences for disclosure purposes and to assess if any changes should be made to existing practices.

Disclosure Trends

Today, in an increasingly convergent global corporate governance environment and period of global economic and fiscal challenge, the pressure for change and transparent disclosure relating to corporate governance practices has intensified for both US companies and foreign private issuers alike. Organizations such as Institutional Shareholder Services Inc. (ISS) and Glass, Lewis & Co. publish their proxy voting guidelines and advice, not only for US companies, but also for foreign private issuers. These organizations update their guidelines and advice each year, taking into account emerging issues and trends, the evolution of market standards, regulatory changes and, importantly, feedback provided by institutional investors and other stakeholders.

As a result, foreign private issuers are increasingly looking to align their governance regimes and disclosures with a variety of emerging global trends and practices driven to a large extent by robust stakeholder activism and resulting regulations in various jurisdictions. For example, the mandatory adoption of say-on-pay for US companies last year has prompted many public companies to rethink their compensation programs and processes, as well as how they disclose this information to investors, including, importantly, the relationship of compensation to risk. For foreign private issuers, even absent a mandatory say-on-pay requirement, there is increasing pressure to similarly provide more transparent disclosure and analysis on executive compensation and, particularly, its relationship to risk.

Two other areas related to risk are now required disclosure for US companies: board leadership and the role of the board of directors in risk oversight. Although these requirements are not mandatory for foreign private issuers in their Form 20-F, stakeholders increasingly want to understand a board’s leadership structure and how public companies identify and manage risk and the risk oversight function of the board of directors.

* Board Leadership: US companies are required to disclose in their annual proxy statements their board leadership structure and the reasons why they believe that a particular structure is appropriate. US companies that combine the
roles of the board chair and CEO positions are required to disclose whether and why they have a lead independent director and that person’s specific role.

- **Risk Oversight**: US companies are also required to disclose in their annual reports the extent of the board’s role in the risk oversight of a company, such as how the board administers its oversight function, and the effect this has on the board’s leadership structure. Issues to be addressed in the disclosure include:
  - the way in which the company perceives the role of its board in overseeing risk;
  - the relationship between the board and senior management in overseeing risk;
  - the way in which the board implements and manages its risk oversight function (i.e., through the board as a whole or through a committee such as a specially designated risk committee or the audit committee with added responsibilities);
  - whether those responsible for overseeing risk report directly to the board as a whole or to a committee; and
  - whether and how the board or committee monitors risk.

Like public company reporting on corporate social responsibility policies and practices discussed below, corporate governance reporting has seen a radical shift within the past ten years. Unlike corporate social responsibility reporting though, governance reporting has been largely prompted by mandatory requirements and guidance in the US, the UK, the EU and elsewhere. However, increasingly corporate governance reporting is shifting to include voluntary disclosures driven by stakeholder demands and market/peer company practices.

When reviewing the corporate governance disclosures for the 2011 Form 20-F, we would encourage companies to assess whether additional voluntary disclosures, such as on board leadership and risk oversight, would be beneficial in order to provide stakeholders with a more transparent and comparative basis of information about the company’s governance regime.

**Corporate Social Responsibility/Environmental General Trends**

Public company reporting on corporate social responsibility policies and practices has seen a radical shift within the last ten years, going from being a non-existent practice to virtually a standard one with detailed disclosure for large enterprises. It is increasingly common for large multinational companies annually to publish a stand-alone report on their corporate social responsibility initiatives and practices.

While there is no single definition of corporate social responsibility, it is conventionally thought of as policies and practices that a company establishes in order to actively monitor and improve its compliance with ethical standards, as well as the impacts of its business on the environment, consumers, employees, communities, stakeholders and the public. The concepts that usually fall under the rubric of corporate social responsibility are: corporate governance, environmental protection, public health and safety, employee working conditions, human rights, energy efficiency/sustainable use of natural resources, climate change mitigation, economic development and more generally, ethical, non-corrupt behavior.

To date corporate social responsibility reporting has largely been a voluntary initiative, first driven by investor demands and subsequently by market/peer company practice. However, mandatory requirements and SEC guidance are emerging that signal a convergence of voluntary reporting with the reporting of business and financial information in the Form 20-F.
Voluntary Disclosure Frameworks

The Global Reporting Initiative, or GRI, is the most recognized global standard for sustainability reporting. It sets out the principles and indicators that organizations can use to measure and report their economic, environmental and social performance. The cornerstone of the framework is the Sustainability Reporting Guidelines. Other standards are the AA1000 series, the OECD Guidelines for Multinational Enterprises and the International Organization for Standardization, or ISO, 26000 standard.

Emerging Legal Requirements

The proposed SEC conflicts minerals, mine health and safety and government payments rules discussed above are examples of emerging disclosure requirements in this area. Other notable examples are:

- **SEC Climate Change Guidance.** In 2010, the SEC issued interpretive guidance concerning climate change-related disclosure by reporting companies, laying out the principal areas that companies will need to consider when evaluating whether business or legal developments related to climate change could have a material impact on their business. The guidance stressed that it does not change existing SEC disclosure requirements, nor is it intended to change long-standing interpretations of materiality. Nonetheless, the mere fact that the SEC issued the guidance signals that climate change disclosure is a growing area of focus for the SEC and an area where many companies may need to expand their disclosure. Our client publication on the climate change guidance is available at [http://www.shearman.com/sec-votes-to-issue-interpretive-guidance-on-climate-change-disclosure-01-29-2010/](http://www.shearman.com/sec-votes-to-issue-interpretive-guidance-on-climate-change-disclosure-01-29-2010/).

The SEC highlighted four areas where climate change may trigger disclosure requirements under the existing framework for evaluating materiality for purposes of disclosures related to the company’s business, risk factors, legal proceedings and management’s discussion and analysis:

- The impact of any existing or pending climate change legislation or regulation;
- The risks or effects of climate change-related international accords or treaties;
- The actual and potential indirect consequences of climate change-related regulation or business trends. As an illustration, the SEC indicated that legal, technical, political and scientific developments may create new risks or opportunities for a company, such as decreased demand for goods that produce, or whose production requires, significant greenhouse gas emissions or increased demand for goods that produce low emissions; and
- The actual and potential physical impacts of climate change, such as increased droughts or storms, other changes in weather or rising sea levels.

- **California Transparency in Supply Chains Act of 2010.** This new law will require every retail seller and manufacturer having more than $100 million in annual worldwide gross receipts and doing business in California to disclose via a “conspicuous link” on its main website its efforts (if any) to address risks related to slavery and human trafficking in its supply chains. The law is designed to address the difficulty of policing slavery and human trafficking crimes by requiring companies to provide consumers with information that can be used to influence corporate policy by means of purchasing power. This law will go into effect on 1 January 2012.

Good Practice

As a general matter, corporate social responsibility reporting is encouraged and should be considered beneficial to investors even if all of its elements do not fall within the scope of SEC reporting requirements. However, many companies draft their corporate social responsibility reports with more of a “free self-promotional hand” than they do their mandatory business and financial disclosure, including their SEC reports, and this approach carries liability risks. A company can be liable under US federal securities law for any of its disclosure outside its SEC reports and, further, a company’s disclosure outside its SEC reports can be used as evidence of the misleading nature of its SEC disclosure.
Therefore, it is important that companies align the material information conveyed in their corporate social responsibility and SEC reporting.

**Iran Sanctions and Other Office of Global Security Risk Issues**

Since 2005, the SEC has sharply increased its scrutiny of disclosures by companies, US and non-US, of their business activities with governments, entities and individuals disfavored by the US government. With the imposition of new expanded sanctions against Iran by the US, the UK and Canada on 21 November 2011 and the broadening of sanctions against Iran and Syria by the EU on 1 December 2011, any disclosure about business relationships in or with Iran, Syria or other countries considered state sponsors of terrorism will certainly remain a focus area for the SEC and will also be monitored by the Office of Global Security Risk (“OGSR”) in the review of 2011 Forms 20-F.

The additional sanctions focus on Iran’s petrochemical industry, oil and gas industry and the financial sector. The US significantly expanded its existing sanctions to target the supply of goods, services, technology, and support to Iran for the development of its petroleum resources and the maintenance and expansion of its petrochemical industry. Like the Comprehensive Iran Sanctions, Accountability, and Divestment Act (“CISADA”) that came into force last year, the new US sanctions apply extraterritorially and allow sanctions against any party that provide such support above certain thresholds. The US also identified the entire Iranian banking sector, including the Central Bank of Iran, as a threat to governments and financial institutions that do business with Iranian banks. In the UK, all credit and financial institutions were required to cease trading with Iran’s banks and Canada is banning the export to Iran of all goods used in the petrochemical, oil and gas industries as part of the sanctions package. In addition, under the broadened EU sanctions, European companies are banned from doing business with an extended number of blacklisted companies and organizations in Iran and Syria and the EU is considering adopting additional measures.

The disclosure standard applicable to a company’s activities in sanctioned countries is not clear. On the one hand, the SEC has clearly stated that “the materiality standard applicable to a company’s activities in or with state sponsors of terrorism is the same materiality standard applicable to all other corporate activities”; namely, is there a substantial likelihood that a reasonable investor would consider the information important in making an investment decision. However, in practice this materiality standard seemingly is reversed with respect to reviews conducted by the OGSR of the SEC; namely, any business activity in or with a sanctioned country is material to a company with the burden then on the company to refute that presumption by clear evidence.

In light of these tightened sanctions and the heightened SEC focus in this area, we recommend that companies review their current Form 20-F disclosure, in particular in the risk factor section, about their business relationships with Iran, Syria, Sudan and Cuba. Companies need to keep in mind that, in addition to reviewing SEC filings like Forms 20-F and 6-K, the OGSR also regularly monitors press releases, websites and other social media networks, such as Facebook and Twitter, for references to a company’s activities in sanctioned countries and therefore companies must ensure that their disclosure is aligned. Companies that disclose activities in sanctioned countries through any of these means can expect to receive a comment letter from the OGSR asking various questions about those business activities, which may lead to enhanced disclosure.

Activities in or with these countries will in any event need to be reviewed to determine compliance with US sanctions legislation, which may apply even to foreign private issuers, and which may affect their ability to undertake certain activities, including raising capital, in the United States.
Other

SEC Updates


Disclosure of Corporate Spending on Political Activities: Petition

On 3 August 2011, the Committee on Disclosure of Corporate Political Spending, a group consisting of ten corporate and securities law experts, submitted a petition to the SEC for rulemaking under Section 14 of the Securities Exchange Act of 1934, as amended, asking for the development of rules to require public companies to disclose to shareholders the use of corporate resources for political activities. The Committee argues that providing shareholders with information about corporate political spending is necessary for corporate accountability and oversight mechanisms to work and for markets and the procedures of corporate democracy to ensure that such spending is in shareholders’ interest.

While the petitioned rulemaking relates to the US proxy rules that are not applicable to foreign private issuers, the topic should be of interest to all public companies, US and non-US, given the strong interest expressed by institutional shareholders in receiving information about corporate spending on politics. In the US, since 2004, large public companies have increasingly agreed voluntarily to adopt policies requiring disclosure of the company’s spending on politics, responding to increased shareholder demand for that kind of information and showing that such disclosure is both feasible and practicable. According to a report issued by the Center of Public Accountability in October 2011, more than half of the largest US public companies now disclose their direct political spending and have adopted board oversight mechanisms. As a result, companies may want to consider whether, as a matter of best practice, they want to make some disclosure about political spending in their 2011 Form 20-F.
This note is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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

LONDON
Pamela Gibson
+44.20.7655.5006
pamgibson@shearman.com

David Dixter
+44.20.7655.5633
david.dixter@shearman.com

Apostolos Gkoutzinis
+44.20.7655.5532
apostolos.gkoutzinis@shearman.com

Jacques McChesney
+44.20.7655.5791
jacques.mccchesney@shearman.com

Richard Price
+44.20.7655.5097
rprice@shearman.com

Mehran Massih
+44.20.7655.5603
mmassih@shearman.com

Babett Carrier
+44.20.7655.5945
bcarrier@shearman.com

Ellen Shieks
+44.20.7655.5199
elshieks@shearman.com

Jacques McChesney
+44.20.7655.5791
jacques.mccchesney@shearman.com

Richard Price
+44.20.7655.5097
rprice@shearman.com

London
Pamela Gibson
+44.20.7655.5006
pamgibson@shearman.com

David Dixter
+44.20.7655.5633
david.dixter@shearman.com

Apostolos Gkoutzinis
+44.20.7655.5532
apostolos.gkoutzinis@shearman.com

Jacques McChesney
+44.20.7655.5791
jacques.mccchesney@shearman.com

Richard Price
+44.20.7655.5097
rprice@shearman.com

Mehran Massih
+44.20.7655.5603
mmassih@shearman.com

Babett Carrier
+44.20.7655.5945
bcarrier@shearman.com

Ellen Shieks
+44.20.7655.5199
elshieks@shearman.com

Jacques McChesney
+44.20.7655.5791
jacques.mccchesney@shearman.com

Richard Price
+44.20.7655.5097
rprice@shearman.com

Mehran Massih
+44.20.7655.5603
mmassih@shearman.com

Babett Carrier
+44.20.7655.5945
bcarrier@shearman.com

Ellen Shieks
+44.20.7655.5199
elshieks@shearman.com

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