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

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

US DEVELOPMENTS

Securities and Exchange Commission ("SEC") Developments

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

SEC Reporting Companies Begin to Comply with New Iran-Related Disclosure Requirements

Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012 ("Section 219"), which was codified as Section 13(r) of the US Securities Exchange Act of 1934, as amended, imposes on SEC-registered companies specific additional disclosure requirements concerning certain business activities relating to Iran and other targets of US economic sanctions programs. For a summary of these new disclosure requirements, please refer to our update on October 9, 2012.

A large number of SEC-registered companies have now filed their annual reports on Form 10-K or Form 20-F including the disclosures required under Section 219. Collectively, these disclosures highlight several issues relating to this new reporting requirement. More importantly, these disclosures make it clear that further guidance regarding compliance with the disclosure requirements under Section 219 would be most beneficial.

Based on the filings to date, several noteworthy trends have emerged:

- activities of foreign subsidiaries of US companies have dominated the disclosures;
- reporting issuers have taken a broad view of affiliates in their disclosures;
- most of the activities disclosed under Section 219 to date were not sanctionable at the time the activity was conducted; and
- issuers recognize that there is no de minimis value threshold for reporting under Section 219.

Our related client publications are available at:

http://www.shearman.com/flash-report-section-219-disclosures-under-the-iran-threat-reduction-and-syria-human-rights-act-of-2012-02-14-2013/and

http://www.shearman.com/whats-going-on--over-a-month-of-section-219-disclosures-under-the-iran-threat-reduction-and-syria-human-rights-act-of-2012-03-20-2013/.

SEC Says Social Media is Acceptable for Company Announcements if Investors Are Alerted

On April 2, 2013, the SEC issued a report that makes clear that companies can use social media outlets like Facebook and Twitter to announce key information in compliance with Regulation Fair Disclosure ("Regulation FD"), so long as investors have been alerted about which social media will be used to disseminate such information.

Regulation FD requires companies to distribute material information in a manner reasonably designed to get that information out to the general public broadly and non-exclusively. It is intended to ensure that all investors have the ability to gain access to material information at the same time. Regulation FD does not technically apply to foreign private issuers, although many foreign private issuers choose to comply with its principles.

The SEC's report of investigation confirms that Regulation FD applies to social media and other emerging means of communication used by public companies the same way it applies to company websites. The SEC issued guidance in 2008 clarifying that websites can serve as an effective means for disseminating information to investors if they have been made aware of them as a source of information. The report clarifies that company communications made through social media channels could constitute selective disclosures and, therefore, require careful Regulation FD analysis.

The SEC's report stems from an inquiry launched in response to a post by Netflix CEO Reed Hastings on his personal Facebook page stating that Netflix's monthly online viewing had exceeded one billion hours for the first time. We reported on the Netflix matter in our January 2013 update. Netflix did not report this information to investors through a press release or Form 8-K filing, and a subsequent company press release later that day did not include this information. Neither Hastings nor Netflix had previously used his Facebook page to announce company metrics, and they had never before taken steps to alert investors that Hastings' personal Facebook page might be used as a medium for communicating information about Netflix. Netflix's stock price had begun rising before the posting and increased from $70.45 at the time of the Facebook post to $81.72 at the close of the following trading day.

The SEC did not initiate an enforcement action or allege wrongdoing by Hastings or Netflix. Recognizing that there has been market uncertainty about the application of Regulation FD to social media, the SEC issued the report of investigation.

The report explains that although every case must be evaluated on its own facts, disclosure of material, non-public information on the personal social media site of an individual corporate officer — without advance notice to investors that the site may be used for this purpose — is unlikely to qualify as an acceptable method of disclosure under the securities laws. Personal social media sites of individuals employed by a public company would not ordinarily be assumed to be channels through which the company would disclose material corporate information.

This serves as a reminder that a company's disclosure controls and procedures should not be limited to the documents that the company files with the SEC, such as its reports on Form 20-F and 6-K, but should encompass other disclosures attributable to the company and its senior management, including press releases, websites, blogs and postings on social media networks such as Facebook or Twitter.

The SEC's report is available at:

http://www.sec.gov/litigation/investreport/34-69279.pdf.

SEC Publishes "A Brief Overview for Foreign Private Issuers"

The SEC recently published "A Brief Overview for Foreign Private Issuers" on its website. This is a short and simple summary of various US federal securities law issues relating to foreign private issuers, as well as additional matters these issuers may wish to take into account when considering having their securities trade in the US capital markets.

"Accessing the U.S. Capital Markets — A Brief Overview for Foreign Private Issuers" is available at:

http://www.sec.gov/divisions/corpfin/internatl/foreign-private-issuers-overview.shtml.

New Developments, Practices and Trends for the 2012 Form 20-F

In January 2013, we published our annual client publication "It's Annual Report Time! — New Developments, Practices and Trends for the 2012 Form 20-F." In order to assist with the preparation of the 2012 Form 20-F, this publication summarizes new developments and best practices, highlights topics and trends that will likely be the focus of review by the SEC and discusses various other developments of interest to non-US companies.

Our "It's Annual Report Time! — New Developments, Practices and Trends for the 2012 Form 20-F" client publication is available at:

http://www.shearman.com/its-annual-report-time-new-developments-practices-and-trends-for-the-2012-form-20-f-01-22-2013/.

SEC Approves NYSE and Nasdaq Listing Standards for Compensation Committees and Their Advisors

On January 11, 2013, amendments to the listing standards of each of the New York Stock Exchange ("NYSE") and the NASDAQ Stock Market ("Nasdaq") were approved. The amendments implement the SEC's final rules ("Final Rules") on the independence of compensation committees and their selection of advisors pursuant to Rule 952 of the Reform Act. The final listing standards were adopted substantially as proposed by the exchanges in September 2012. Notable provisions in the NYSE and Nasdaq listing standards include the following:

- Nasdaq significantly enhanced its listing requirements regarding the composition of compensation committees and now will, like the NYSE, require listed companies to (i) have a standing compensation committee consisting of at least two independent directors and (ii) adopt a formal, written compensation committee charter specifying certain responsibilities and authority;
- Nasdaq partially harmonises the compensation committee director independence criteria with those of the audit committee and therefore prohibits independent compensation committee members from accepting, directly or indirectly, any consulting, advisory or other compensatory fee from the listed company or its subsidiaries;
- The NYSE added an additional test for director independence that requires the board to consider all factors relevant to determining whether the director has a relationship that is material to the director's ability to be independent from management; and
- Both the NYSE and Nasdaq adopted the six advisor independence factors as set forth in the Final Rules. Although the SEC invited the exchanges to add to the list of factors, neither Nasdaq nor the NYSE elected to do so. Nasdaq clarified that compensation committees are required to consider only the six specified factors when evaluating advisor independence. The NYSE rules provide, however, that compensation committees must consider all factors relevant to an advisor's independence, including the six factors. Neither the Final Rules nor the listing standards require that a compensation advisor actually be independent but only that the committee consider the six factors when selecting or seeking advice from a given advisor.

Effective Dates

Nasdaq. Nasdaq rules relating to the compensation committee's (i) retention, compensation, oversight and funding of advisors and (ii) requirement to analyse advisor independence will be effective on July 1, 2013. Compliance with the remaining provisions will be required by the earlier of: (1) the listed company's first annual meeting after January 15, 2014 or (2) October 31, 2014. Companies must certify compliance with the applicable requirements no later than 30 days after the applicable implementation deadline. The form of certification will be available through Nasdaq's Listing Center website prior to the effective date of the Nasdaq rules.

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

Exemption for Foreign Private Issuers

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

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

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

Next Steps

Listed companies that are subject to the amended listing standards or foreign private issuers that voluntarily choose to comply with them should begin to take action to comply with these rules. In particular:

- Compensation committee charters should be reviewed and revised as necessary to ensure that the compensation committee is provided the powers and authorities articulated in the Final Rules and the amended listing standards. Although not a required element of the charter under the Nasdaq or NYSE standards, companies should consider adding to the charter a requirement that the compensation committee carry out the required advisor independence assessments. NYSE listed companies must have a compliant charter in place by July 1, 2013. Nasdaq listed companies generally must adopt a compliant charter by the earlier of: (i) the first annual meeting after January 15, 2014 or (ii) October 31, 2014 to comply; however, any Nasdaq company that does not have a compliant charter in place by July 1, 2013 should adopt a board resolution providing the compensation committee with the authority and responsibilities with respect to advisors.
- Implement new procedures or revise existing procedures to reflect the new compensation committee independence standards. This will likely include amendments to the company's D&O questionnaire.
- Implement new procedures or revise existing procedures related to the evaluation of compensation committee advisor independence. The evaluation should be done prior to selecting or receiving advice from a new advisor and at least annually thereafter. In order to ensure a consistent basis for analysing advisor independence, companies should consider developing a questionnaire that all advisors (other than in-house counsel) will be required to complete and that will elicit the information relevant to the independence assessment. Information and representations obtained from an advisor can be used as the basis of the committee's analysis but should not replace the committee's independent assessment and independence determination.
- Nasdaq-listed companies that do not already have a compensation committee must establish one by the earlier of: (i) the first annual meeting after January 15, 2014 or (ii) October 31, 2014 to comply.
- As a reminder, any proxy statement for an annual meeting occurring on or after January 1, 2013 must include a disclosure of any conflicts of interest arising as the result of the engagement of compensation consultants (but not other advisors). The instruction to item 407(e)(3)(iv) states that the six factors relevant to consultant independence should be considered in determining whether a conflict of interest exists. If not yet completed, all listed companies should conduct a conflicts analysis to prepare for this disclosure. It should be noted that the disclosure requirement is an obligation of the company, whereas the assessment of compensation consultant independence is required to be conducted by the compensation committee. Companies should consider procedures that will enable the company to benefit from the compensation committee's analysis for purposes of determining whether any conflict disclosure is required.

Our related client publication is available at:

http://www.shearman.com/sec-approves-nyse-and-nasdaq-listing-standards-for-compensation-committees-and-their-advisors-01-29-2013/.

SEC Staff Issues No Action Letter to Allow Participation in an Equity-Based Compensation Program Involving Loans to Officers and Directors

On March 4, 2013, the SEC's Division of Corporate Finance issued new guidance on how companies may provide equity-based incentive compensation ("EBIC") to their employees without violating Section 402 of the SOX, which prohibits companies from making personal loans to officers and directors. The SEC approved a specific type of EBIC program that involves loans to officers and directors made through a trust. The no-action letter is noteworthy as it represents the first interpretive guidance from the SEC staff under Section 402 of the SOX.

The SEC issued the no-action letter in response to a formal request sent to the SEC staff seeking guidance on Section 402 of the SOX with regard to the EBIC program that had been developed by RingsEnd Partners, LLC in collaboration with BNP Paribas. The EBIC program contemplated awards of company stock to participating employees and, thereafter, a transfer of that stock to an independently managed Delaware statutory trust. The trust would then use the stock as collateral to obtain term loans from a third-party banking institution.

In the no-action letter, the SEC stated that an issuer that permits its directors and officers to participate in the EBIC program would not be deemed to violate Section 402 of SOX. Further, the SEC stated that the issuer's undertaking of certain limited ministerial and administrative activities relating to the participation of its directors and officers in the EBIC program would not violate Section 402.

The SEC's no-action letter is available at:

http://www.sec.gov/divisions/corpfin/cf-noaction/2013/ringsend030413.htm.

The incoming letter seeking guidance from the SEC is available at:

http://www.sec.gov/divisions/corpfin/cf-noaction/2013/ringsend030413-13-incoming.pdf.

Noteworthy US Securities Law Litigation

Amgen v. Connecticut Retirement Plans and Trust Funds: US Supreme Court Allows Plaintiff Class to be Certified Without Separate Materiality Inquiry

In February 2013, the US Supreme Court issued an important decision regarding the requirements for class certification in securities fraud cases under Section 10(b) of the Securities Exchange Act of 1934. In ***Amgen***, the Court held that a plaintiff did not need to prove that an alleged misstatement or omission was material in order to satisfy one of the prerequisites to class certification – namely, that questions of law or fact common to the class predominate over any questions affecting only individual class members.

As background, in order to establish a claim under Section 10(b), a plaintiff must prove, among other things, the element of reliance by showing that the plaintiff was aware of the defendant's misrepresentation and engaged in the securities transaction based on that specific misrepresentation. More than 20 years ago, the Supreme Court recognised in

Basic v. Levinson the difficulty of proving direct reliance and endorsed the "fraud-on-the-market" theory, which permits a plaintiff to invoke a rebuttable presumption of reliance on material misrepresentations communicated to the general public. The fraud-on-the-market theory rests on the premise that well-developed markets are efficient processors of public information and that the market price of securities that trade on those markets will reflect all publicly available information. Under this theory, if a plaintiff establishes that the market for a security is efficient, then the court may presume that an investor who traded the security relied on public, material misrepresentations. Absent the fraud-on-the-market theory, the requirement that a plaintiff establish reliance would ordinarily preclude certification of a class action seeking money damages because individual reliance issues would overwhelm questions common to the class.

In ***Amgen***, the issue was whether a plaintiff asserting securities fraud had to prove materiality in order to satisfy the class certification requirement (set forth in Rule 23(b)(3) of the Federal Rules of Civil Procedure) that questions of law or fact common to class members predominate over any questions affecting only individual members. The Court held that the plaintiff did not need to prove materiality at class certification for two reasons. First, the Court explained that, because the question of materiality is an objective one that involves the significance of a misrepresented or omitted fact to a reasonable investor, materiality can be proved through evidence common to the class. Second, the Court stated that there is no risk that the failure of proof on the common question of materiality will result in individual questions predominating. The Court explained that, because materiality is an essential element of a Section 10(b) claim, a plaintiff's failure to present sufficient evidence of materiality at summary judgment or trial would end the case and no claim would remain in which individual reliance issues could potentially predominate.

The ***Amgen*** decision is significant because it eliminates one of the arguments that defendants often make in opposition to class certification in securities fraud cases. For more information on the ***Amgen*** case, please see our client note at:

http://www.shearman.com/supreme-court-decides-amgen--allows-plaintiff-class-to-be-certified-without-separate-materiality-inquiry-03-01-2013/.

Gabelli v. SEC: US Supreme Court Rejects SEC's Request for Exception to Statute of Limitations

In February 2013, the US Supreme Court held that, in civil actions brought by the SEC in which the SEC seeks civil penalties, the five-year statute of limitations begins to run when the fraud occurs and not when the fraud is discovered by the SEC. In ***Gabelli***, the SEC brought a civil enforcement action against the chief operating officer and portfolio manager of an investment advisor for allegedly allowing one investor to engage in market timing in the fund. The defendants moved to dismiss the complaint because the SEC did not file the suit until April 2008, which was more than five years after the alleged market timing ended in August 2002. The district court agreed and dismissed the SEC's civil penalty claim as time-barred, but a federal appeals court reversed.

Before the Supreme Court, the SEC argued that, because the underlying violations sound in fraud, the Court should apply the "discovery rule" and the statute of limitations should not begin to run until the claim is discovered or could have been discovered through the exercise of reasonable diligence. The Court rejected the SEC's argument and ruled that the discovery rule does not apply to government enforcement actions for civil penalties. The Court first focused on the plain language of the statute and stated that the most natural reading of the statute is that a claim first accrues when the defendant's allegedly fraudulent conduct occurred, not when the claim is discovered. In addition, the Court explained that there is no basis to extend the discovery rule to the SEC because, unlike a private party who has no reason to suspect fraud, the SEC's very purpose is to root out fraud and has many tools to discover it, including the power to subpoena documents and witnesses and to pay monetary awards to whistleblowers. Finally, the Court stated that the SEC should not have the benefit of the

discovery rule because, unlike a private plaintiff that seeks compensation for its losses, the SEC in this case seeks civil penalties that are intended to punish and label the defendants as wrongdoers. In such situations, the Court stated that the defendants should have some certainty about when the limitations period expires and not have it hinge on speculation about what the Government knew, when it knew it or when it should have known it.

The ***Gabelli*** decision serves as an important check on the powers of the SEC and other government enforcement agencies and provides a clear limitation on the government's ability to bring claims for civil penalties. More information on the ***Gabelli*** case is available at:

http://www.shearman.com/supreme-court-rejects-secs-request-for-exception-to-statute-of-limitations-in-gabelli-03-01-2013/.

Meyer v. Greene: The Eleventh Circuit Rules that the Disclosure of an SEC Investigation is Insufficient to Plead Loss Causation

In February 2013, a federal appeals court ruled that an announcement of an investigation by the SEC followed by a decline in a company's stock price is insufficient to plead loss causation in a federal securities fraud case. In ***Meyer***, the plaintiffs alleged that the St. Joe Company, one of the largest real estate developers in Florida, made material misstatements and omissions in its SEC filings by overstating the value of its real estate holdings and failing to take an impairment charge after the real estate market in Florida crashed in 2008. The plaintiffs asserted that the truth about St. Joe's misrepresentations emerged, in part, when St. Joe disclosed that the SEC had initiated an informal inquiry into the company's policies and practices concerning the impairment of its real estate assets. After the defendants filed a motion to dismiss, the district court dismissed the case in its entirety.

On appeal, the federal appeals court affirmed that district court's decision and held that the commencement of an SEC investigation, without more, is insufficient to constitute a corrective disclosure for purposes of establishing loss causation. The Court noted that stock prices may fall upon the announcement of an SEC investigation but only because the investigation may be seen to portend an added risk of future corrective action. It does not mean that the investigation, in and of itself, reveals to the market that a company's previous statements were false or fraudulent. As a result, the Court ruled that St. Joe's disclosure of the SEC investigation does not qualify as a corrective disclosure for purposes of pleading loss causation.

This decision is noteworthy because it is the first federal appellate decision to hold that the announcement of an SEC investigation, without more, is insufficient to plead loss causation. This decision adds weight to the growing number of district court decisions from around the US that have reached similar conclusions.

More information on the ***Meyer*** case is available at:

http://www.shearman.com/The-Eleventh-Circuit-Rules-that-the-Disclosure-of-an-SEC-Investigation-is-Insufficient-to-Plead-Loss-Causation-03-19-2013/.

In re LIBOR-Based Financial Instruments Antitrust Litigation: Federal Court Dismisses Antitrust Claim Against Banks Involved In Alleged LIBOR Manipulation

In March 2013, a federal court in New York granted in part and denied in part the defendants' motions to dismiss the class action lawsuit that had been filed against certain banks for allegedly manipulating the London Interbank Offered Rate ("LIBOR") in violation of the antitrust laws, the federal civil Racketeer Influenced and Corrupt Organizations Act ("RICO") and the Commodities Exchange Act ("CEA").

First, the court dismissed the plaintiffs' antitrust claim based on a lack of standing. In order to have standing to state an antitrust claim, a plaintiff must allege plausible facts that it suffered an injury and that the injury was caused by the defendants' anticompetitive conduct. Here, the court ruled that, even if the plaintiffs were harmed by the defendants' manipulation of LIBOR, the plaintiffs could not allege that their injury resulted from anticompetitive conduct because LIBOR is not set through a competitive process. As a result, the court ruled that the plaintiffs did not have standing to assert an antitrust claim.

Second, the court dismissed the plaintiffs' federal civil RICO claim as barred by the Private Securities Litigation Reform Act ("PSLRA"). Under the PSLRA, a plaintiff is prohibited from bringing a RICO claim where the alleged predicate acts for the RICO claim could form the basis of a securities fraud claim. Here, the court ruled that the allegations underlying the plaintiffs' RICO claim, i.e., that the defendants made misleading statements and omissions in connection with the purchase and sale of LIBOR-based financial instruments, could have been subject to a securities fraud action. As a result, the court ruled that the plaintiffs' RICO claim was barred by the PSLRA.

Third, the court denied in part and granted in part the defendants' motion to dismiss the plaintiffs' CEA claim. Under the CEA, a plaintiff must allege, among other things, that the defendants intentionally caused an artificial market price. Here, the court ruled that the plaintiffs stated a claim for commodities manipulation because (i) the plaintiffs purchased Eurodollar futures contracts, (ii) the price underlying Eurodollar futures contracts was LIBOR, and (iii) the plaintiffs alleged sufficient facts that the defendants intentionally manipulated LIBOR. The court, however, limited the scope of plaintiffs' CEA claim by ruling that the claim was barred, in part, by the CEA's two-year statute of limitations. Specifically, the court held that well-publicised reports and news articles in April and May 2008 placed the plaintiffs on notice that they might have been injured by alleged manipulation of LIBOR. Because the plaintiffs did not file their complaint until more than two years after they were put on inquiry notice, the court ruled that, at a minimum, the plaintiffs' CEA claims based on Eurodollar futures contracts entered into from the beginning of the class period
(August 2007) until May 29, 2008 were time barred.

This is the first ruling related to the well-publicized allegations that certain banks manipulated LIBOR and will likely have a significant impact on the resolution of motions to dismiss in other lawsuits that assert similar claims.

Recent SEC/DOJ Enforcement Matters

RBS LIBOR Investigation

In February 2013, The Royal Bank of Scotland plc and RBS Securities Japan Limited entered into agreements with the Department of Justice ("DOJ"), the Commodities Futures Trading Commission ("CFTC") and the UK Financial Services Authority ("UK FSA") to resolve multi-year investigations into RBS's alleged manipulation of LIBOR for the yen and Swiss franc. In the agreements, RBS acknowledged that certain of its employees had worked with co-workers and employees at other banks to manipulate LIBOR in order to enhance the profits they earned from trading derivatives linked to LIBOR.

RBS Securities Japan agreed to plead guilty to felony wire fraud charges, and The Royal Bank of Scotland plc agreed to enter into a deferred prosecution agreement whereby it would continue to cooperate with the DOJ in exchange for the deferral of criminal wire fraud and antitrust charges.

In addition, RBS agreed to pay more than $612 million in penalties and disgorgement - $325 million in the CFTC action, $150 million in the DOJ action and $137 million in the UK FSA action. RBS also agreed to take certain remedial actions,

including implementing firewalls to prevent improper communications between traders and rate submitters, enhancing auditing and monitoring procedures, developing a training program for all employees who are involved in the rate submitting process and making regular reports to the regulators regarding its compliance efforts.

Numerous regulators around the world are currently investigating the alleged manipulation of LIBOR, TIBOR, and EURIBOR rates. RBS is the third financial institution to enter into settlement agreements with the regulators (Barclays was the first in June 2012 and UBS was the second in December 2012), and RBS Securities Japan is the second entity to plead guilty to a criminal offense related to LIBOR manipulation (UBS Japan was the first).

DEVELOPMENTS SPECIFIC TO FINANCIAL INSTITUTIONS

Global Developments

Obligations Coming into Force under EMIR

The European Regulation on over the counter derivatives, central counterparties and trade repositories ("EMIR") came into force on August 16, 2012. EMIR applies to:

- a financial counterparty, which are entities such as banks, investment firms, credit institutions, insurers, registered UCITS funds, pension funds and alternative investment fund managers;
- a non-financial counterparty ("NFC") which is established in the EEA and is not a financial counterparty (i.e. corporates); and
- a non-EU entity that would be subject to certain obligations under EMIR if the counterparty were established in the EU.

There are four key obligations under EMIR, some of which already require compliance and others for which compliance is imminent. The obligations are:

- Applying risk mitigation techniques to OTC derivative contracts:
  - From March 15, 2013, all counterparties will need to ensure the timely confirmation of the terms of the OTC derivative contracts that they enter into.
  - From September 15, 2013, counterparties will also need to put procedures in place for portfolio reconciliation and compression and dispute resolution.
- Reporting all derivatives contacts (OTC, exchange-traded, intragroup and trades with FCs and other NFCs) to a registered trade repository:
  - From September 23, 2013, credit and interest rate derivatives will need to be reported to a registered trade repository. If no repository is registered by April 1, 2013, then the obligation applies 90 days from registration of a trade repository.
  - From January 1, 2014, all other derivatives will need to be reported to a registered trade repository. If no repository is registered by October 1, 2013, then the obligation applies 90 days from registration of a trade repository.
- An NFC must notify regulators when the clearing threshold has been exceeded or is no longer exceeded:

- From March 15, 2013, an NFC that exceeds the clearing threshold (an "NFC+") must notify both ESMA and the relevant regulator (in the UK, this is the Financial Conduct Authority).
- Clearing OTC derivatives that are subject to the clearing obligation through a central counterparty ("CCP"):
  - From 2014, the clearing obligation will come into force on a phased basis as asset classes are determined to be subject to the clearing obligation by the European Commission.

Report on the Suitability Requirements for Complex Financial Transactions

On January 21, 2013, the International Organisation of Securities Commission ("IOSCO") published its final report on Sustainability Requirements for the Distribution of Complex Financial Products.

The report was prompted by concerns that customers were insufficiently protected with regard to the distribution of complex financial products by intermediaries (firms in the business of managing individual portfolios, providing investment advice, dealing in or distributing securities).

The report proposed nine principles on Sustainability Requirements:

- Principle 1 - intermediaries should be required to adopt and apply appropriate policies and procedures to distinguish between retail and non-retail customers. The classification of customers should be based on a reasonable assessment of the customer concerned, taking into account the complexity and riskiness of different products and services. The regulator should consider providing guidance to intermediaries in relation to customer classification;
- Principle 2 – irrespective of the classification of a customer as retail or non-retail, intermediaries should be required to act honestly, fairly and professionally and take reasonable steps to manage conflicts that arise in the distribution of complex financial products, including through disclosure, where appropriate;
- Principle 3 – investors should receive or have access to material information to evaluate the nature, costs and specific risks of the complex financial product. Any information communicated by intermediaries to their customers regarding a complex financial product should be communicated in a fair, comprehensible and balanced manner;
- Principle 4 – even when an intermediary sells to a customer a complex financial product on an unsolicited basis (no management, advice or recommendation), the regulatory system should provide for adequate means to protect customers from associated risks;
- Principle 5 – whenever an intermediary recommends to a customer that it purchase a particular complex financial product, including where the intermediary advises or otherwise exercises investment management discretion, the intermediary should be required to take reasonable steps to ensure that recommendations, advice or decisions to trade on behalf of such customer are based upon a reasonable assessment that the structure and risk-reward profile of the financial product is consistent with such customer's experience, knowledge, investment objectives, risk appetite and capacity for loss;
- Principle 6 – an intermediary should have sufficient information in order to have a reasonable basis for any recommendation, advice or exercise of investment discretion made to a customer in connection with the distribution of a complex financial product;

- Principle 7 – intermediaries should establish a compliance function and develop appropriate internal policies and procedures that support compliance with suitability obligations, including when developing or selecting new complex financial products for customers;
- Principle 8 – intermediaries should be required to develop and apply proper policies that seek to eliminate and incentives for staff to recommend unsuitable complex financial products; and
- Principle 9 – regulators and self-regulatory organizations should supervise and examine intermediaries on a regular and on-going basis to help ensure firm compliance with suitability and other customer protection requirements relating to the distribution of complex financial products. Enforcement actions should be taken by the national regulator, as appropriate. Regulators should consider the value of making enforcement actions public in order to protect investors and enhance market integrity.

The SEC has objected to the publication of the report indicating that they did not think the report accurately reflected the law in the United States.

The report can be found at:

https://www.iosco.org/library/pubdocs/pdf/IOSCOPD400.pdf.

IOSCO Report on the Protection of Client Assets

On February 8, 2013, IOSCO published a consultation paper on recommendations regarding the protection of client assets. The IOSCO report was partly motivated by the insolvencies of Lehman Brothers and MF Global and the ensuing difficulties for clients claiming money back from these intermediaries.

The report sets out eight principles designed to help regulators with their supervision of intermediaries that hold client assets.

- Principle 1 – an intermediary should maintain accurate and up-to-date records and accounts of client assets that readily establish the precise nature, amount, location and ownership status of client assets and the clients for whom the client assets are held. The records should also be maintained in such a way that they may be used as an audit trail;
- Principle 2 – an intermediary should provide a statement to each client on a regular basis, as well as on request, detailing the client assets held for or on behalf of such client;
- Principle 3 – an intermediary should maintain appropriate arrangements to safeguard the clients' rights in client assets and minimise the risk of loss and misuse;
- Principle 4 – where an intermediary places or deposits client assets in a foreign jurisdiction, the intermediary should understand and take into account the foreign regime to the extent necessary to achieve compliance with applicable domestic requirements;
- Principle 5 – an intermediary should ensure that there is clarity and transparency in the disclosure of the relevant client asset protection regime(s) and arrangements and the consequent risks involved;
- Principle 6 – where the regulatory regime permits clients to waive or to modify the degree of protection applicable to client assets or otherwise to opt out of the application of the client asset protection regime, such arrangements should be subject to the following safeguards:

    - The arrangement should only take place with the client's explicit written consent;
    - Before such consent is obtained, the intermediary should ensure that the client has been provided with a clear and understandable disclosure of the implications of giving such consent; and
    - If such arrangements are limited to particular categories of clients, clear criteria delineating those clients that fall within such categories should be defined;
- Principle 7 – regulators should oversee intermediaries' compliance with the applicable domestic requirements to safeguard client assets; and
- Principle 8 – where an intermediary places or deposits client assets in a foreign jurisdiction, the regulator should, to the extent necessary to perform its supervisory responsibilities concerning applicable domestic requirements, consider information sources that may be available to it, including information provided to it by the intermediaries it regulates and/or assistance from local regulators in a foreign jurisdiction.

The report can be found at:
http://www.iosco.org/library/pubdocs/pdf/IOSCOPD401.pdf

BCBS and IOSCO Consultation on Margin Requirements for Non-centrally Cleared Derivatives

The Basel Committee and IOSCO have published a second consultation paper on proposals for minimum standards for margin requirements for uncleared derivatives. Responses to the consultation were due on March 15, 2013. The proposals envisage a gradual phase-in of the requirements over a four-year period starting in 2015 with the largest, most active and systemically risky derivative market participants.

Contact Us

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

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

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