SHEARMAN & STERLING LLP

A QUARTERLY NEWSLETTER FOR CORPORATES

Governance & Securities Law Focus

OCTOBER 2016/ASIA

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

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

Financial regulation developments are available here.

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ASIA DEVELOPMENTS

Approval in Principle of Shenzhen-Hong Kong Stock Connect

On 16 August 2016, the China Securities Regulatory Commission and the Securities and Futures Commission jointly announced (the "**Joint Announcement**") the approval, in principle, of the establishment of Shenzhen-Hong Kong Stock Connect. Under Shenzhen-Hong Kong Stock Connect, Hong Kong and international investors will be able to trade in eligible shares listed on the Shenzhen Stock Exchange ("**SZSE**") through The Stock Exchange of Hong Kong Limited ("**SEHK**") via a Northbound Shenzhen Trading Link. Likewise, Mainland investors may trade in eligible shares listed on SEHK through SZSE via a Southbound Hong Kong Trading Link.

The principal arrangements for Shenzhen-Hong Kong Stock Connect are similar to those under Shanghai-Hong Kong Stock Connect launched in November 2014. For details of Shanghai-Hong Kong Stock Connect, you may refer to the Governance & Securities Law Focus of January 2015. The other key features of Shenzhen-Hong Kong Stock Connect are set out below:

Northbound Shenzhen Trading Link

For the Northbound Shenzhen Trading Link, eligible stocks will include:

- any constituent stock of the SZSE Component Index and SZSE Small/Mid Cap Innovation Index which has a market capitalisation of RMB6 billion or above; and
- all SZSE-listed shares of companies that have issued both A shares and H shares.

For shares that are listed on the ChiNext Board of SZSE, only institutional professional investors (as defined under the Securities and Futures Ordinance and its related rules and regulations) will be eligible to trade at the initial stage of Shenzhen-Hong Kong Stock Connect. Subject to the resolution of related regulatory issues, other investors may subsequently be allowed to trade such shares.

Southbound Hong Kong Trading Link

For the Southbound Hong Kong Trading Link, eligible stocks will include:

- constituent stocks of the Hang Seng Composite LargeCap Index and Hang Seng Composite MidCap Index;
- any constituent stock of the Hang Seng Composite SmallCap Index which has a market capitalisation of HK$5 billion or above; and
- all SEHK-listed shares of companies that have issued both A shares and H shares.

Investment Quota

The Shenzhen-Hong Kong Stock Connect daily quota will be the same as that under Shanghai-Hong Kong Stock Connect, i.e.:

- a daily quota of RMB13 billion for the Northbound Shenzhen Trading Link; and
- a daily quota of RMB10.5 billion for the Southbound Hong Kong Trading Link.

There will be no aggregate quota under Shenzhen-Hong Kong Stock Connect. The aggregate quota under Shanghai-Hong Kong Stock Connect was also abolished with immediate effect on the date of the Joint Announcement.

The launch of Shenzhen-Hong Kong Stock Connect is subject to the grant of all necessary regulatory approvals, and the regulators estimate that it will take approximately four months from the date of the Joint Announcement to complete the technical and operational preparations, including finalizing the relevant trading and clearing rules and systems and putting in place arrangements for cross-boundary regulatory and enforcement cooperation.

The Joint Announcement is available at:

- http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=16PR80

US DEVELOPMENTS

SEC and NYSE/Nasdaq Developments

SEC Proposes Streamlining Disclosure Requirements

On 13 July 2016, the US Securities and Exchange Commission ("**SEC**") released a 318-page proposal setting out a number of technical amendments to disclosure requirements for SEC filers that it believes have become outdated or are identical or similar to overlapping requirements contained in other SEC rules, US generally accepted accounting principles ("**US GAAP**") or international financial reporting standards ("**IFRS**").

With respect to financial statement disclosures, the proposed relaxations relate to requirements in respect of foreign currency disclosure, consolidation, changes in issued debt, income tax rate reconciliation, related party transactions, material contingencies and earnings per share, among others.

With respect to qualitative disclosures, the proposal contemplates eliminating repetition of information that is disclosed both in the financial statements and management's discussion and analysis section, such as: segment financial information and performance, geographic areas of operation, foreign operations, seasonality and research and development.

The release is also soliciting comments on whether some disclosure requirements that overlap with US GAAP but require incremental information should be eliminated or referred to the Financial Accounting Standards Board for potential incorporation into US GAAP. These overlapping areas include financial statement disclosure; major product, service and customer disclosure; and legal proceedings disclosure.

The SEC proposes deletions of requirements that have become obsolete as a result of the passage of time or changes in the business environment, such as: deleting references to the SEC's Public Reference Room, replacing detailed disclosure requirements for most issuers on the trading of their stock with trading market and ticker, and deleting requirements relating to disclosure of readily available foreign exchange data.

For IPOs by foreign private issuers, the changes would permit using annual financial statements that are older than 12 months but not older than 15 months without the need for a waiver.

While most of these changes are minor, changing the location of disclosure may affect its prominence for investors, or require auditor involvement if the new disclosure is contained in the financial statements. The public comment period expired on 3 October 2016. The SEC will consider the comments received in formulating a final rule.

Our related client publication is available at:

- http://www.shearman.com/~/media/Files/NewsInsights/Publications/2016/07/SEC-Proposes-Streamlining-Disclosure-Requirements-CM-07152016.pdf

SEC Seeks to Improve Corporate Governance Disclosure Effectiveness

On 25 August 2016 the SEC issued a request for public input regarding the modernisation and simplification of Items 401 through 407 of Regulation S-K, which codifies disclosure requirements that relate primarily to a registrant's management, certain security holders and corporate governance matters.

The proposed changes do not affect Form 20-F and therefore would not apply to foreign private issuers.

In particular, the SEC is proposing to update disclosure requirements related to:

- compensation and biographies of officers, directors, promoters and control persons;
- beneficial ownership of securities and related party transactions; and

- officer ethics programmes and corporate governance measures.

The comment period will remain open until 31 October 2016. For further information, see the SEC release at:

- https://www.sec.gov/rules/other/2016/33-10198.pdf

SEC Proposes That Filings Include Hyperlinks to Exhibits

On 31 August 2016, the SEC proposed that issuers would be required to include hyperlinks to their exhibits in their filings with the goal of making it easier to locate documents that are filed as exhibits.

This proposal would require issuers filing on forms F-10 or 20-F to include a hyperlink to each exhibit listed in the index. Issuers would also be required to file in HTML format. In 2015, 99% of filers already used HTML format, but a hardship exemption would be available.

SEC Announces Increase in Registration Fees

On 31 August 2016, the SEC announced that for the 2017 fiscal year the SEC filing fees that are paid to register securities will increase to $115.90 per million dollars of securities registered from $100.70 per million dollars of securities registered.

The fee increase is effective from 1 October 2016. For further details see the SEC press release at:

- https://www.sec.gov/news/pressrelease/2016-175.html

New Nasdaq Rule Requires Disclosure of Third Party Compensation to Directors

On 11 July 2016, the SEC approved a proposed revision to Nasdaq Rule 5250 requiring Nasdaq-listed companies to disclose annually, either on their website or in their proxy statements, any third party payments made to their directors in connection with their service on the board.

This new rule was created in response to the rise in the number of directors nominated by, or closely associated with, activist investors. With this new disclosure, investors will be better able to assess the potential for conflicts of interest, fiduciary duty concerns and promotion of a short-term focus rather than long-term value creation.

In advance of this new rule, a number of public companies had already addressed this issue by amending their bylaws to either require similar disclosure, or to prohibit third-party compensation for directors. The rule came into effect on 31 July 2016, for all Nasdaq-listed companies.

Foreign private issuers may elect to follow their home country practice in lieu of complying with this rule, subject to certain conditions.

Our related client publication is available at:

- http://www.shearman.com/~/media/Files/NewsInsights/Publications/2016/07/Nasdaq-Golden-Leash-Disclosure-Rule-Approved-by-SEC-CGE-07152016.pdf

Proxy Advisory Firm Policy Developments

Institutional Shareholder Services Opposes Anti-Takeover Charter Provisions in IPOs

In November 2015, Institutional Shareholder Services ("**ISS**") adopted a "vote against"/"withhold" policy for the directors of companies that prior to or in connection with their initial public offering adopt charter provisions or by-laws which it considers to be anti-takeover defenses, such as: a classified board, supermajority voting requirements or other limitations on the amending of the charter or by-laws, or dual-class share structures.

Despite this opposition, companies making their initial public offering continue to adopt anti-takeover charter provisions without any notable impact on valuation or marketing, according to a recent survey. The impact of ISS opposition was most apparent in

companies with institutional shareholder bases, where directors received 10-20% votes against their re-election. Those companies with major venture capital or private equity shareholders saw minimal impact in terms of votes against directors.

This trend may strengthen over time if ISS maintains its negative recommendation against board members. Companies can avoid a continuing negative recommendation by putting their anti-takeover policies to a vote within three years of their initial public offering, in accordance with ISS policy.

Noteworthy US Securities Litigation

SEC v. Jensen: CEO or CFO Could Be Liable for a False Section 302 Certification and Liable for Disgorgement Irrespective of Personal Misconduct

On 31 August 2016, the federal appellate court based in San Francisco reversed a lower court's ruling with respect to chief executive officer ("**CEO**") and chief financial officer ("**CFO**") liability under Section 304 ("**Section 304**") of the Sarbanes-Oxley Act ("**SOX**") and Rule 13a-14 ("**Rule 13a-14**") of the Securities Exchange Act of 1934 (the "**Exchange Act**"). The court held that CEOs and CFOs are subject to disgorgement under Section 304 following an accounting restatement as long as the restatements were issued because of misconduct, even if the defendant was not involved in that misconduct. In addition, the court held that Rule 13a-14 creates a cause of action against CEOs and CFOs not only if they fail to sign certifications of financial requirements that are required by SOX, but also if they sign false certifications.

The lower court in this case found that the company prematurely recognised revenue in six transactions, shortly after its initial public offering, thereby substantially overstating its revenues. Both the CEO and CFO received significant incentive-based compensation during the period of overstatement. However, the CEO and CFO were not found by the lower court to have acted with fraudulent intent or personal misconduct.

That court held, following a bench trial, that Section 304 requires officers to disgorge incentive-based and equity-based compensation only if the company issues an accounting restatement because of the officers' own misconduct, but not if the accounting restatement was caused by the issuer's misconduct. Section 304 requires that if a restatement is required because of material non-compliance consisting of misconduct, the CEO and CFO are required to reimburse the issuer for equity and incentive-based compensation received for the 12 months following the misstated financials. In reversing the lower court's ruling, the appellate court agreed with the SEC that the misconduct that gives rise to disgorgement is that of the issuer, rather than the personal misconduct of the CEO and CFO.

On a separate issue, the appellate court reversed the district court's grant of summary judgment in favour of the defendants, which dismissed the SEC's claim under Rule 13a-14 (promulgated under Section 302 of SOX). That rule requires certain reports filed with the SEC, including quarterly and annual financial reports, to contain a certification signed by the issuer's CEO and CFO attesting to the accuracy of the report's financial statements. The court here held, contrary to the lower court's ruling, that Rule 13a-14 contains an "implicit truthfulness requirement," and thus creates a cause of action permitting the SEC to bring claims for making false certifications, in addition to claims based on the failure to make SOX certifications and independent of other provisions of the Exchange Act prohibiting fraudulent (as opposed to untrue) statements. The court, however, declined to determine the precise mental state required for a violation of Rule 13a-14, or how that mental state compares to the intent requirement under Section 10(b) of the Exchange Act, because the parties did not address that issue.

OFI Asset Management v. Cooper Tire & Rubber Co.: Federal Appellate Court Affirms Dismissal of Plaintiffs' "Kitchen-Sink" Pleading and Holds That Speaker's State of Mind is Irrelevant When a Forward-Looking Statement is Accompanied by Sufficient Cautionary Language

On 22 August 2016, in *OFI Asset Management v. Cooper Tire & Rubber Company*, the federal appellate court based in Philadelphia, Pennsylvania affirmed the lower court's dismissal of a securities class action against Cooper Tire & Rubber Company ("**Cooper**") and two of its executives. In addition to affirming the district court's ruling that the plaintiffs failed to plead several essential elements of their claim, the court held that the plaintiffs' lengthy allegations amounted to nothing more

than claims of "fraud by hindsight" and approved of the district court's effort to streamline its consideration of these allegations by focusing on the plaintiffs' key claims.

The plaintiffs in this case were investors in Cooper who alleged that the defendants made material misrepresentations and omissions related to Cooper's planned merger with another tire company, in violation of the Exchange Act. The district court granted the defendants' motion to dismiss the complaint, and found that these statements were either true, forward-looking (and accompanied by sufficient cautionary language) or missing a strong showing of scienter (fraudulent intent).

In its opinion affirming the district court's dismissal, the court held that it did not matter whether the defendants believed that their forward-looking statements were true because the speaker's state of mind is irrelevant when sufficient cautionary language brings a forward-looking statement within the safe harbor of the Private Securities Litigation Reform Act of 1995. The court noted, however, that if the defendants did not believe the cautionary language itself to be true, the safe harbor protection might no longer apply. The court also held that, even if some of the defendants' other statements might have been technically incorrect, the plaintiffs did not plead facts supporting a strong inference that these misstatements were made with scienter. Rather, these statements were more likely just made without sufficient precision.

Lastly, the court rejected the plaintiffs' argument that the district court erred by directing them to focus at oral argument on just their five most compelling allegations. The court explained that the plaintiffs' rambling 245-paragraph complaint presented an "extraordinary challenge" for the district court because of its length and lack of clarity. The lower court's effort to streamline the plaintiffs' arguments did not preclude it from also evaluating their other allegations and assessing these claims holistically. As the appellate court explained, the plaintiffs' "post hoc scouring of countless pages of documents for a stray and inartfully phrased comment" is "just the sort of litigation maneuver" that the law is designed to prevent. In addition to explaining key points of securities law, this decision thus provides a helpful guide for how defendants might approach the type of lengthy and disjointed complaint that the plaintiffs filed in this case

In re Lehman Brothers Securities & ERISA Litigation; SRM Global Master Fund Limited Partnership v. Bear Stearns Companies; Dusek v. JPMorgan Chase & Co.: Federal Appellate Courts Hold That Statutes of Repose for Securities Claims Are Not Tolled by Filing of Related Class Action

In 1974, in *American Pipe & Construction Co. v. Utah*, the US Supreme Court held that the filing of a class action tolls (or suspends) the running of the statute of limitations for all members of the proposed class during the pendency of the case. In recent years, courts around the country have debated whether this same principle applies to statutes of repose under the federal securities laws. Three recent decisions by federal appellate courts address this issue: on 8 and 14 July 2016, the federal appellate court based in New York, in *In re Lehman Brothers Securities & ERISA Litigation* and *SRM Global Master Fund Limited Partnership v. Bear Stearns Companie*s, respectively, and on 22 August 2016, the federal appellate court based in Atlanta, Georgia, in *Dusek v. JPMorgan Chase & Co*., all held that statues of repose under various provisions of the federal securities laws are not tolled during the pendency of a class action.

The courts in *Dusek* and *SRM* both addressed whether the applicable statute of repose was tolled by class actions brought under the Exchange Act. *Dusek* dealt with claims against various JPMorgan entities and employees arising out of Bernard L. Madoff's Ponzi scheme, which came to light in December 2008. *SRM* dealt with claims related to the collapse of Bear Stearns in 2008. *Lehman Brothers* addressed claims brought under the Securities Act of 1933 (the "**Securities Act**") growing out of offerings by Lehman Brothers in 2007. The plaintiffs in all of these cases filed their claims past the applicable statutory repose period (five years under the Exchange Act and three years under the Securities Act), but sought to rely on earlier-filed class actions raising similar claims to toll these repose periods. The courts in all three cases held, following a 2013 ruling by the federal appellate court based in New York, in a case called *Police & Fire Retirement System of City of Detroit v. IndyMac MBS, Inc*. (which this memorandum covered at the time), that the filing of a prior class action did not toll the applicable statute of repose.

The courts in these three cases held that regardless of whether the tolling of the statute of limitations is equitable or legal in nature, it does not apply to the statutes of repose under the Securities Act and the Exchange Act. Whereas statutes of limitations merely

limit the availability of remedies to plaintiffs, statutes of repose create a substantive right for potential defendants to be free from liability after a legislatively-determined period of time. As the *IndyMac* decision (and now these three new cases) held, if the tolling of statutes of limitations is equitable in nature, it cannot modify a legislatively-enacted repose period. And if the tolling principle is legal in nature because it is rooted in the laws governing class actions, it cannot apply to the securities laws' statutes of repose because doing so would modify the substantive right to be free from suit after the repose period expires. This modification would not be permitted under a statute known as the Rules Enabling Act, which prohibits the interpretation of the class action rules in a way that would "abridge, enlarge or modify any substantive right." These new decisions extend this prior reasoning to the statute of repose under the Exchange Act and explain that it applies regardless of whether the plaintiffs in the prior class action had standing to properly bring those claims.

While the three new decisions, and a decision earlier this year by the federal appellate court based in Cincinnati, Ohio, all held that the tolling principle does not apply to statutes of repose under the federal securities laws, the federal appellate court based in Denver, Colorado has held that the Securities Act's statute of repose can be tolled by a prior class action. The Supreme Court had agreed in early 2014 to review the *IndyMac* case in order to resolve the conflict between the appeals court opinions, but dismissed the case after the parties settled their dispute. In the *Lehman Brothers* case, the court noted the split among federal appellate courts about the fundamental nature of *American Pipe* tolling, and suggested that the question may therefore "be ripe for resolution by the Supreme Court."

For additional information about this case, please see our client notes:

- http://www.shearman.com/en/newsinsights/publications/2016/07/two-second-circuit-decisions-address-pipe-tolling
- http://www.shearman.com/en/newsinsights/publications/2014/03/supreme-court-to-review-second-circuit-decision

GAMCO Investors, Inc. v. Vivendi Universal, S.A.: Federal Appellate Court Affirms Lower Court's Rejection of Securities Fraud Where Plaintiffs Would Have Bought Securities Even If They Had Known of the Alleged Fraud

On 27 September 2016, in *GAMCO Investors, Inc. v. Vivendi Universal, S.A.*, the federal appellate court based in New York affirmed the district court's ruling following a bench trial that the defendants had rebutted the presumption under Section 10(b) of the Exchange Act that investors rely on the fairness of the market price of securities when making securities transactions. The court upheld the lower court's finding that the plaintiffs here — a group of funds bringing individual (rather than class) claims — did not rely on the market price of Vivendi's stock because the plaintiffs would have purchased the securities even had they known of the company's alleged misrepresentations concerning its liquidity risk. This ruling was made on the same day that the court affirmed the jury's verdict in the securities class action arising from the same underlying facts.

The plaintiffs in this case were a group of investment funds that took a "value" approach to investing whereby they would make investment decisions based on their own independent estimation of the value of a publicly traded company's securities. Under this approach, the plaintiffs would purchase securities when there was (i) a sufficiently large difference between their independent valuation of the security's "intrinsic value" and the market price of a security and (ii) evidence of a "catalyst" that would raise the security's market price by bringing the security's hidden value to light over time. According to the court, knowledge of the alleged fraud therefore would not have altered the defendants' decision to purchase Vivendi's stock unless it also affected their analysis of these two factors.

Under the US Supreme Court's 1988 decision in *Basic, Inc. v. Levinson*, an investor's reliance on a security's market price is presumed under what is known as the fraud on the market theory, but this presumption can be rebutted by evidence that the investor did not actually rely on the market price when transacting in the particular security at issue. The court here acknowledged that it would seem unlikely that an investor would purchase a security while aware that the issuer was committing fraud. But the court explained that, under the deferential standard of review that applies to the lower court's factual determinations, the evidence presented in this particular case was sufficient to support the lower court's conclusion that such knowledge would not have affected the plaintiffs' specific investment decision here. That evidence included an acknowledgment

by the plaintiffs that in rare circumstances they might purchase a stock inflated by fraud and other testimony that even after Vivendi's liquidity problems began to be disclosed, that information did not actually affect the plaintiffs' valuation of the company's securities or prevent the plaintiffs from increasing their holdings.

The court's decision here shows how an investor's individual investment strategy may preclude a finding that the investor relied on a security's market price, even when the investor has established that the defendants made material misstatements and the court has confirmed that a plaintiff class in a related case is entitled to the benefit of the fraud on the market presumption. While arguments based on investment decisions by individual plaintiffs are not likely to succeed in the class action setting, where reliance is presumed on a class-wide basis, defendants should raise these issues where applicable when litigating against individual plaintiffs who are not part of a class.

Recent Regulatory Enforcement Matters

SEC v. RPM International Inc.: SEC Alleges Loss Contingency Accrual and Disclosure Failures in Connection With a Prior DOJ Enforcement Action

On 9 September 2016, the SEC filed a complaint against RPM International Inc. ("**RPM**") and its General Counsel and Chief Compliance Officer in the United States District Court for the District of Columbia, alleging that the company failed to properly accrue a contingent liability and disclose material facts concerning a prior Department of Justice ("**DOJ**") investigation. That investigation, which began in early 2011, resulted in a $61 million settlement with the DOJ in August 2013.

The SEC alleges that the General Counsel failed to inform RPM's CEO, CFO, audit committee and independent auditors of updates in the investigation that should have led to an earlier increase in the company's contingent settlement costs (from $11 million to $68.8 million). As a result, according to the SEC, RPM failed to accrue and disclose the liability and restated three quarters of financial results when the liability was ultimately disclosed.

The SEC is seeking monetary penalties, disgorgement and interest against both RPM and the General Counsel personally. This ongoing enforcement action shows that parties cannot simply assume that, once regulatory enforcement matters have been resolved, the parties have wiped themselves clean of those matters. Rather, the SEC has shown that, even after a company has settled with DOJ, the SEC under appropriate circumstances will not hesitate to review skeptically the company's pre-settlement estimates of its anticipated settlement costs.

In the Matter of Ernst & Young LLP, SEC File Nos. 3-17552 and 3-17553: First SEC Enforcement Actions for Auditor Independence Failure Due to Close Personal Relationships

On 19 September 2016, the SEC announced that it had reached a settlement with Ernst & Young ("**EY**") regarding the actions of two audit partners who violated the rules that are designed to maintain the objectivity and impartiality of auditors. When announcing this settlement, the Director of the SEC's Division of Enforcement noted that these were "the first SEC enforcement actions for auditor independent failures due to close personal relationships between auditors and client personnel." The SEC alleged that EY and its auditors violated several rules related to the requirement that auditors maintain independence from the companies that they audit, and caused its issuer clients to violate Section 13(a) of the Exchange Act by certifying that its audits were independent.

One sanctioned partner maintained an inappropriately close personal friendship with the CFO of the firm he was auditing, including joint family trips and nights spent in each other's houses, with expenses topping $100,000. However, this decision creates some uncertainty about what types of client engagement are appropriate for auditors. The other partner became romantically involved with the Chief Accounting Officer of the firm that she was auditing.

EY was sanctioned for deficiencies in the firm's internal controls and reporting procedures for preventing these types of relationships. Supervisory partners who were aware, or should have been aware, of the inappropriate relationships failed to take remedial action. The supervisory partners also continued to represent that the firm was independent in SEC and audit filings.

According to the SEC, while EY procedures required audit teams to assess their independence, those procedures did not specifically address non-familial close personal relationships.

This settlement included EY's agreement to pay a total of $9.3 million and the suspension of the individual parties involved (including the EY audit partners, an EY coordinating partner and the Chief Accounting Officer of the EY client who had a relationship with one of the EY partners) from practicing before the SEC for between one and three years. EY has also engaged in certain remedial efforts, including requiring a review of any close relationships between EY and client personnel, as well as the disclosure by audit team members of any such relationships and the certification that they have consulted with an EY independence leader if they have such a relationship. With these enforcement actions, the first of their kind, the SEC has announced that it is interested in interpersonal relationships that may undermine auditor independence. Auditors and issuers should take note and review their internal procedures accordingly.

Raymond J. Lucia Companies, Inc. v. Securities and Exchange Commission: Constitutionality of SEC's Administrative Judges Upheld by Federal Appeals Court

On 9 August 2016, in *Raymond J. Lucia Companies, Inc. v. Securities and Exchange Commission*, the federal appeals court based in Washington, D.C. held that the practice of having administrative law judges ("**ALJs**") preside over enforcement proceedings brought by the SEC does not violate the Appointments Clause of the United States Constitution. The court ruled that the SEC's ALJs are not "Officers of the United States" under the Appointments Clause, and thus need not be appointed by the procedures established by that provision of the Constitution.

In this case, the SEC brought an administrative enforcement action against Raymond J. Lucia and his investment company, Raymond J. Lucia Companies, Inc., for alleged violations of the Investment Advisers Act. The SEC claimed that Lucia and his company had deceptively presented their "Buckets of Money" retirement wealth-management strategy to prospective clients. As part of its enforcement action, the SEC ordered an ALJ to conduct a public hearing on these allegations. The ALJ found Lucia and his company liable on one of four alleged misrepresentations, fining them $300,000 in total, and imposed a lifetime ban from the industry on Lucia. After the petitioners appealed this decision to the SEC, the members of the SEC reviewed the decision *de novo* (that is, without deferring to the ALJ's opinion) and imposed the same penalties as the ALJ.

Under the Appointments Clause of the US Constitution, "Officers of the United States" must be appointed by the President or, in the case of inferior officers, by certain other methods that the Appointments Clause provides may be determined by statute. Because the SEC's ALJs are not appointed in accordance with the Appointments Clause, the court here had to determine whether they are considered "officers" subject to this constitutional provision, or, instead, mere employees who are not covered by these requirements. The court explained that based on precedent the primary criteria for determining whether a government official qualifies as an inferior officer as opposed to an employee are: "(1) the significance of the matters resolved by the officials, (2) the discretion they exercise in reaching their decisions and (3) the finality of those decisions." In applying this test to the ALJs here, the court, relying on its own precedent dealing with the method of appointment of the ALJs of a different governmental agency, focused entirely on the last of these factors — whether the ALJs issue final decisions. The court reasoned that, because the ALJs' decisions do not become final until the SEC issues a finality order affirming them, the ALJs do not make final decisions. The SEC "retained full decision-making powers" over the ALJs' decisions because "even when there is not full review by the Commission, it is the act of issuing the finality order that makes the initial decision the action of the Commission." The court explained that the "Commission can always grant review on its own initiative, and so it must consider every initial decision, including those in which it does not order review."

There have been several challenges in recent years to the SEC's reliance on ALJs that are not appointed in accordance with the Appointments Clause. The courts in these cases have generally ruled, either at the district court level or on appeal, that they lacked jurisdiction to hear these claims because the petitioners had not yet concluded their administrative proceedings before the SEC. The court's decision here is the first time that a federal appellate court has directly addressed the substantive issue of the constitutionality of the SEC's ALJs under the Appointments Clause. While federal appellate courts in other jurisdictions might

rule differently, and the Supreme Court will probably have to decide this issue at some point, this decision is important and potentially influential because of the expertise that the federal appellate court in Washington, D.C. has in administrative law.

For additional information about this case, please see our client notes:

- http://www.shearman.com/en/newsinsights/publications/2016/08/secs-use-of-administrative-proceedings
- http://www.shearman.com/en/newsinsights/publications/2016/09/sokenu-authors-article-on-constitutionality

In the Matter of Johnson Controls, Inc., SEC File No. 3-17337: SEC Settles FCPA Charges for $14.3 Million After Company's Extensive Cooperation

On 11 July 2016, the SEC reached a settlement with Johnson Controls, Inc. ("**Johnson Controls**") for alleged violations of the Foreign Corrupt Practices Act of 1977 ("**FCPA**"). Johnson Controls had to pay $14.3 million to settle the matter even though the company self-disclosed the violations, cooperated extensively with the SEC and DOJ and engaged in significant remedial steps. The DOJ, on the other hand, issued a letter declining to prosecute the matter, in line with its current "Pilot Program," which guides its enforcement of FCPA matters in which the subject provides the type of assistance that Johnson Controls did here.

Johnson Controls is a US-based global provider of automatic temperature control systems, among other businesses. In 2005, Johnson Controls acquired York International ("**York**") while York was under investigation by the SEC for potential FCPA violations. York entered into a settlement with the SEC in 2007 for improper payments by a York subsidiary called York Refrigeration Marine (China) Ltd. ("**YRMC**") to Chinese government officials. YRMC is now part of a group of Johnson Controls entities known as "China Marine," which is located within Johnson Controls' "Global Marine" business. After it acquired York, Johnson Controls undertook remediation efforts to correct the problems at China Marine, including hiring additional compliance personnel, conducting extensive training, implementing risk-based internal controls and terminating the employees involved in the alleged bribery. According to the SEC, however, from 2007 to 2013, China Marine employees, despite these compliance efforts, made illicit payments through sham vendors and took steps to evade internal audit procedures. This new fraud was so pervasive that it involved coordination among virtually all of China Marine's employees and was masterminded by its managing director.

In 2012, Johnson Controls discovered the scheme, initiated an internal investigation, and then promptly self-reported the conduct to the SEC and DOJ. The investigation showed that the company had made over $4.9 million in improper payments in order to procure $11.8 million in contracts. Johnson Controls "provided thorough, complete and timely cooperation" and implemented substantial remediation to correct the problems. These remediation efforts included providing supporting evidence, making foreign employees available for interviews, terminating the employees it identified as associated with the scheme, placing suspect vendors on a "do not use" list, enhancing its integrity testing and internal audits and implementing random site audits that might have detected the improper payments. Although the SEC praised Johnson Controls' extensive cooperation and remediation, it still required the company to disgorge $11.8 million in ill-gotten gains, pay a civil monetary penalty of $1,180,000 and pay $1.4 million in prejudgment interest. The SEC also noted several failings in Johnson Controls' internal controls, including its reliance on China Marine's newly hired managing director — who turned out to be the architect of the corrupt scheme — to police China Marine's business operations, and the fact that even where China Marine's transactions were reviewed internally, the office charged with that review did not understand the company's business well enough to detect the corrupt activity.

This matter highlights how US regulators continue to focus on FCPA enforcement. Even though companies are generally given credit for self-reporting FCPA violations, cooperating with regulators and undertaking meaningful remediation measures, those steps will not prevent the SEC from levying fines to penalise the underlying violations and flaws in internal controls.

EU DEVELOPMENTS

Resolution of Proposal for New Prospectus Regulation

On 15 September 2016, the European Parliament resolved to adopt amendments to the European Commission's proposal for a new Prospectus Regulation to replace the current Prospectus Directive. The principal amendments relate to the following areas:

- Scope: the Regulation shall not apply to offers of securities to fewer than 350 persons per Member State and to a total of no more than 4,000 persons across all Member States. The Regulation shall also not apply to offers of securities where the total consideration in the EU is less than €1,000,000, calculated over a 12 month time period.
- Exemptions: where the total consideration of an offer of securities in the EU does not exceed €5,000,000, calculated over a 12 month time period, a Member State can decide to exempt such an offer from the prospectus requirement.
- Prospectus Summary: a competent authority, in exceptional circumstances, may allow an issuer to produce a longer summary of up to ten (instead of sx) sides of A4 paper where the complexity of the issuer's activities so requires. Further, there will be no requirement for a summary for a prospectus relating to the admission of non-equity securities on a regulated market to qualified investors only.
- EU Growth Prospectus: the new Regulation introduces a new concept of an 'EU growth prospectus' for the proportionate disclosure regime set out in Article 15. An EU growth prospectus will be in a standardised format and have fewer content requirements.

The European Parliament's full proposal can be accessed here:

- http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+TA+P8-TA-2016-0353+0+DOC+PDF+V0//EN

Prospectuses: ESMA Updates Q&A

On 15 July 2016, the European Securities and Markets Authority ("**ESMA**") published an updated version of its Q&A to include two new questions.

The first new question concerns the applicability of the requirements under Article 11(3) of Commission Delegated Regulation (EU) 2016/301. ESMA clarified that a new roadshow would not have to be organised in order to deliver an amended version of the information provided in the original, but the general requirement to amend the roadshow advertisement still applies. ESMA added it is the responsibility of the issuer, offeror or person asking for admission to trading to disseminate the amended version of the information by the most suitable means.

The second new question concerns how an issuer, offeror or person asking for admission to trading should proceed when a participant at a live presentation requests information about an alternative performance measure that is not included in the prospectus. ESMA clarified that such an issuer, offeror or person asking for admission to trading should decline to provide an answer, as otherwise there would be a breach of Article 12 of Commission Delegated Regulation (EU) 2016/301.

Version 25 of ESMA's Q&A on prospectuses can be accessed here:

- https://www.esma.europa.eu/press-news/esma-news/esma-updates-its-qa-document-prospectus-related-issues-1

ESMA: Overview of Prospectus Activity in the EEA

On 28 July 2016, ESMA published statistical data on prospectuses falling with the EU prospectus regime approved and passported by national competent authorities in the European Economic Area ("**EEA**"). The report covered areas such as general approval activity, structures of approved prospectuses, the number of equity vs. non-equity prospectuses and the type of securities offered and passporting activity.

The full report can be accessed here:

- https://www.esma.europa.eu/press-news/esma-news/esma-issues-overview-european-prospectus-activity

IPOs: AFME Guidance

On 4 July 2016, the Association for Financial Markets in Europe ("**AFME**") published guidance on research meetings and material prior to the award of a capital markets mandate. AFME provided commentary on how meetings should be conducted and structured so as to avoid the view that research analysts were not objective. AFME also described certain topics as inappropriate for such research meetings, such as asking research analysts' specific views on a potential IPO.

AFME's guidance can be accessed here:

- http://www.afme.eu/WorkArea/DownloadAsset.aspx?id=14288

Market Abuse Regulation

On 3 July 2016, the key operative provisions of the Market Abuse Regulation ("**MAR**") took effect. MAR addresses areas such as insider dealing, unlawful disclosure of inside information and market manipulation (all of which constitute market abuse for MAR purposes), disclosure requirements in relation to inside information and arrangements between ESMA and national competent authorities. The Regulatory Technical Standards ("**RTS**") and Implemented Technical Standards ("**ITS**") also came into force. The RTS and ITS cover areas such as:

- the conditions, restrictions, disclosure and reporting obligations for buyback programmes and stabilisation measures;
- the arrangements procedures and record-keeping requirements for persons conducting market soundings;
- the systems and notification templates to be used in market soundings and the means for appropriate communications;
- the establishment, maintenance and termination of accepted market practices;
- the arrangements, systems, procedures and notification templates to report suspicious orders and transactions;
- the technical means for public disclosure of inside information and circumstances where delay is legitimate;
- the precise format of insider lists;
- the format and template for the notification of managers' transactions; and
- the technical arrangements for the objective presentation of investment recommendations.

Our briefing on MAR can be accessed here:

- http://www.shearman.com/~/media/Files/NewsInsights/Publications/2016/06/EU-Market-Abuse-Regulation-Implications-for-Non-EU-Issuers-with-Securities-Traded-on-an-EU-Market-CM-06232016.pdf

MAR: Market Soundings and Delays to Disclosure of Inside Information

On 13 July 2016, ESMA published final guidelines on persons receiving market soundings and delay of disclosure of inside information.

The guidelines on market soundings detail internal procedures and staff training of persons receiving a market sounding, written minutes or notes of unrecorded meetings or telephone conversations, assessment of possession of inside information and record keeping requirements.

The guidelines on legitimate interests of issuers to delay disclosure of inside information and on situations in which the delay of disclosure is likely to mislead the public provide a non-exhaustive list of situations where the delay of disclosure is likely to mislead the public and examples of cases where the immediate disclosure of inside information may prejudice the legitimate interests of issuers (e.g. where disclosure might prejudice the outcome of negotiations being conducted by the issuer).

ESMA's final guidelines can be accessed here:

- https://www.esma.europa.eu/sites/default/files/library/2016-1130_final_report_on_mar_guidelines.pdf

MAR: ESMA Updates Q&A on Closed Periods

On 13 July 2016, ESMA published an updated version of its Q&A on MAR on closed periods, i.e. where persons discharging managerial responsibilities are prohibited from dealing in shares and debt instruments of the issuers, unless certain specified circumstances are met. ESMA provides that the announcement of preliminary financial results agreed by the management of the issuer constitutes the announcement marking the end date of a closed period under the MAR regime. ESMA clarifies that where the information announced changes after the publication, a closed period will not be triggered but the event should be addressed in accordance with Article 17 of MAR.

The updated Q&A can be accessed here:

- https://www.esma.europa.eu/sites/default/files/library/2016-1129_mar_qa.pdf

GERMAN DEVELOPMENTS

German Legislator Publishes Draft Legislation in the Wake of the Civil Supreme Court's 'So-Called' Netting Decision

On 9 June 2016, the German Civil Supreme Court (*Bundesgerichtshof*) decided that close-out netting provisions contained in German law-governed framework agreements for financial derivative transactions (*Finanztermingeschäfte*), which provide for automatic termination and settlement of underlying contracts in the case of insolvency of one counterparty (close-out netting), are invalid because they deviate from the mandatory Section 104 of the German Insolvency Code (*Insolvenzordnung - InsO*). In the case at hand, the netting clause was contained in a German law-governed future contract dealing with share options.

The court decision prompted, amongst others, the German Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht - BaFin*) to issue a general ruling (*Allgemeinverfügung*) on the subject, stating that for the time being all existing netting clauses are to be executed as set out in the respective agreements. The general ruling remains in force only until 31 December 2016.

With a view to achieving a permanent solution, a draft bill amending the German Insolvency Code was presented in early September 2016, pursuant to which netting clauses contained in framework agreements, or as part of the rules of a central counterparty as defined in Section 1 Paragraph 31 of the German Banking Act (*Kreditwesengesetz*), would be, again, in compliance with Section 104 of InsO. However, as the process is at an early stage and the draft bill is still subject to review by the German Parliament, it is too early to predict any details of the future legislation and its impact on contractual close-out netting as well as how German courts would react to the new legislation.

ITALIAN DEVELOPMENTS

New Regulation on "T+2" Settlement Among Other Rules on the Central Depositary System for Financial Instruments

The Italian legislative decree No. 176 of 12 August 2016 has amended the Legislative Decree No. 58 dated 24 February 1998 (the Italian Securities Act) introducing a new regulation relating to the central depositary system for financial instruments and post-trading services with a view to aligning the national rules with the Regulation No. 909/2014 (Central Securities Depositories Regulation).

In particular, the new rules implemented the following changes to the existing legislative framework: (i) alignment of the settlement date of transactions performed during trading, which cannot occur later than the second business day after the trading date (the so-called "T+2"); and (ii) introduction of specific measures in case of settlement defaults, as well as cash penalties, buy-in procedures and suspension procedures in case of systemic breach of delivery obligations.

Amendments to the Rules of Markets and the Related Instructions (*Regolamento dei Mercati e Relative Istruzioni*)

With resolution No. 19704, adopted on 3 August 2016 (the "Resolution"), CONSOB (*Commissione Nazionale per le Società e la Borsa*) approved amendments to the rules of the markets managed and organised by Borsa Italiana (the "Rules"). The Instructions to the Rules (the "Instructions") have been consequently amended on several matters. These amendments entered into force on 26 September 2016 and they concern, among others: (i) the MTA Market trading admission requirements for issuers operating mainly in the property rental sector and for *Società di Investimento Immobiliare Quotata* ("SIIQ"); and (ii) the MTA Market trading admission requirements for investment companies.

The MTA Market Trading Admission Requirements for Issuers Operating Mainly in the Property Rental Sector and for SIIQ

In the light of experiences regarding the listing of certain companies that have exercised their right to utilise the concessional tax regime pursuant to Article 1, paragraph 120, of Italian Law no. 296 of 27 December 2006 (SIIQs - the equivalent of a real estate investment trust), Borsa Italiana provided amendments to the Rules and Instructions on the requirements for the listing of such real estate listed companies. In particular, the following changes have been made:

Minimum Initial Investment and Business Plan

The issuer is required to (i) dispose of an initial portfolio invested in real estate or similar assets with a net asset value amounting to at least €200 million, or (ii) comply with a given ratio of invested capital to capital to be collected, as indicated in the Instructions. Should the issuer fail to meet such requirements, it may nevertheless submit an application for admission to trading on the professional segment of the Market for Investment Vehicles ("**MIV**"). Secondly, the business plan must include information concerning also the issuer's investment strategies indicating, among other things, the geographical location, the use of the assets and its policy on indebtedness.

Measures to be Taken in Regard of Conflicts of Interest

Borsa Italiana amended the rules governing the aforementioned issuers that could mitigate problems relating to potential conflicts of interest within the SIIQs, by requiring: (i) the adoption of an adequate company policy for the management of conflicts of interest; and (ii) the setting up of an investment committee within the management body, called upon to express a mandatory, non-binding opinion on the most important investments.

The MTA Market Trading Admission Requirements for Investment Companies

Following completion of the process of implementation of Directive (EU) 2011/61 ("**AIFMD**"), Borsa Italiana rationalised the regulatory framework of the MIV in order to dedicate this segment mainly to alternative investment funds ("**AIFs**"), of a corporate or contractual nature, both Italian and foreign, open to the public as well as reserved to professional investors.

Investment companies already traded in the MIV have been maintained in this market even if they do not fall within the scope of the AIFMD. Should certain requirements concerning the diversification of investments, or the limits on the concentration of risk, not be met for a period of more than 12 months, such issuers would be transferred to a special segment of the MIV dedicated to professional investors, which includes companies other than the AIFs, including special purpose acquisition companies and issuers with an investment strategy that has yet to be implemented or completed and/or is characterised by its particularly complex character.

Furthermore, it also provided for a specific procedure in the case of application for admission to trading on the MTA market of investment companies traded on the MIV and subject to the previous regulatory systems.

In addition to the above, it introduced a derogation from the foreseeable market capitalisation requirement (i.e., at least €40 million), on the basis of the overlapping requirements for admission to trading on the MIV and those for admission to trading on the MTA.

New Italian Banking Rules Impose Post-Trade Reporting Requirements on Bond Offerings

The Bank of Italy introduced in 2015, and then amended on 10 August 2016, new reporting requirements in connection with the placement or offering of certain securities (including debt securities, such as high yield or plain vanilla bonds) in Italy, in furtherance of Article 129 of Legislative Decree No. 385 dated 1 September 1993 (the Italian Banking Act). The new rules entered into force on 1 October 2016, with a phase-in period applicable to banks.

UK DEVELOPMENTS

Market Abuse Regulation

City of London Law Society and Law Society Company Law Committees' Joint Working Parties on Market Abuse, Share Plans and Takeover Code Q&As on MAR

On 5 July 2016, the City of London Law Society ("**CLLS**") and the Law Society issued a Q&A on the implementation of MAR. This paper includes questions on the topics of:

- persons discharging managerial responsibilities ("**PDMR**") dealings;
- share buy-backs;
- disclosure;
- insider lists; and
- investment recommendations.

The first Q&A paper can be accessed here:

- http://www.citysolicitors.org.uk/attachments/category/114/MAR%20QA%20Revised%20-%205%20July%202016.pdf

On 17 August 2016, the CLLS and the Law Society issued a further paper on the implementation of MAR. This paper includes questions on the topics of: market soundings, stake-building and PDMR dealings.

The second Q&A paper can be accessed here:

- http://www.citysolicitors.org.uk/attachments/category/114/MAR%20Takeover%20QA%20Final%20538882375_4.pdf

ICSA, QCA and GC100 Guidance on Dealing Codes

On 24 June 2016, the Institute of Chartered Secretaries & Administrators ("**ICSA**"), the Quoted Companies Alliance ("**QCA**") and GC100 published guidance on dealing codes under MAR and submitted these to the Financial Conduct Authority ("**FCA**") and London Stock Exchange ("**LSE**") for review and comment. The guidance features a policy that explains the relevant provisions of MAR to directors and employees in an easily-digestible format.

The guidance includes a specimen code that contains clearance procedures for PDMRs and further information on the obligations of the company in relation to refusing clearance, notification of PDMR transactions and the obligations that exist with regard to PDMRs' connected persons.

The guidance also features a dealing procedures manual, which sets out the process to be followed by the company in relation to dealings.

A copy of the guidance can be accessed here (registration required):

- https://www.icsa.org.uk/knowledge/resources/mar-dealing-code

GC100 Insider Lists

On 7 July 2016, the GC100 published guidance in relation to maintaining insider lists under MAR. Article 18 of MAR requires companies, or persons acting on their account, such as advisers, to produce and maintain a list of all persons who have access to inside information. The publication includes a section on FAQs and extensive practical guidance on complying with Article 18.

The guidance can be accessed via the Practical Law website (subscription required) here:

- http://uk.practicallaw.com/2-629-0375

LSE: Inside AIM

On 2 August 2016, the LSE issued a statement regarding the amendment of the AIM Rules with respect to the FCA's supervisory role in relation to closed periods and preliminary results under MAR. Following ESMA's guidance published on 13 July 2016, the LSE noted that it viewed any amendment to the AIM Rules as unnecessary.

The LSE has also published FAQs on MAR, which address a number of issues that arise from the overlapping market abuse rules that AIM companies face, both under MAR and under certain provisions of the AIM Rules for Companies (e.g. those requiring disclosure of price sensitive information without delay (c.f. to the MAR requirement for the disclosure of inside information promptly) and those requiring an AIM company to have in place a "reasonable and effective dealing policy" (c.f. to the MAR requirement that directors and certain other senior managers do not deal in issuer securities during "closed periods")).

These FAQs are available here:

- http://www.londonstockexchange.com/companies-and-advisors/aim/faq/mar-faqs.htm

FCA Market Watch Newsletter No. 51: MAR Issues

On 27 September 2016, the FCA published issue no. 51 of its regular Market Watch newsletter, in which it addressed a number of MAR-related issues, including: market abuse risk as managed by information barriers and wall-crossing procedures and insider lists.

The newsletter comments on a review of a sample of firms that are registered market makers in small and mid-cap equities.

In relation to market abuse risk as managed by information barriers, the newsletter notes that where physical segregation of teams is not possible, extra steps should be taken to ensure that information barriers are properly managed and maintained. These can include: specific training for staff with access to inside information, and ensuring that compliance representatives are properly integrated with front line operations to improve surveillance capabilities and information management.

The review found the level of documented wall-crossing procedures to be generally poor across the firms reviewed and noted this was of concern in view of the provisions for wall-crossed and non-wall-crossed market soundings in Article 11 of MAR.

The newsletter concludes that the most effective approach in this area is that followed by those firms that use the compliance team as "gatekeepers" in all wall-crossings, deciding whether a wall-crossing is necessary, who is the correct person to wall-cross and the most appropriate time to do this. This encourages a consistent approach and reduces the risks of inadvertent wall-crossing.

In relation to insider lists, the review came across several examples where details recorded on insider lists were either inaccurate or missing entirely. The FCA encourages firms to consider the "need to know principle" when deciding which individuals should be wall-crossed and so included on the insider list, so that inside information is only disclosed where it is information in the "normal exercise of an employment, a profession or duties" (see Article 10.1 of MAR (unlawful disclosure of inside information)).

The newsletter can be accessed here:

- https://www.fca.org.uk/sites/default/files/marketwatch-51.pdf

PSC Register

Impact of the Fourth Money Laundering Directive

On 15 September 2016, HM Treasury launched a consultation into the transposition of the Fourth Money Laundering Directive ("**MLD4**") into UK law. MLD4 requires Member States to create a central register that holds information on the beneficial ownership of corporate and other legal entities. The transposition deadline for MLD4 is currently 26 June 2017, but the Commission has proposed expediting this to 1 January 2017.

There are questions remaining over the sufficiency of the present arrangements in the UK. Under the new Part 21A of the Companies Act 2006, companies, limited liability partnerships and *Societas Europaeae* are now obliged to file a Persons of Significant Control Register at Companies House on an annual basis.

However, MLD4 broadens the requirements. Under MLD4, the information held at the central register must be kept 'current,' i.e. it must be updated when there is a change in beneficial ownership, rather than on an annual basis, as is the case with the PSC Register.

The consultation is open to comments until 10 November 2016. The consultation paper can be accessed here:

- https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/553409/4mld_final_15_sept_2016.pdf

Securities

Investment Association: Share Capital Management Guidelines

On 4 July 2016, the Investment Association ("**IA**") published a revised version of its share capital management guidelines. The previous version was published in July 2014.

Section 1 (*Directors' Power to Allot Shares*) has been amended to recognise that IA members support the Pre-Emption Group's position that there is a need for two separate resolutions for the disapplication of pre-emption rights and to expect a company seeking to disapply the pre-emption rights, which in aggregate is equal to or greater than 10% of the issued share capital to follow the Pre-Emption Group's model resolutions in doing so. The guidance also states that IA members have asked the Institutional Voting Information Service ("**IVIS**"), which provides corporate governance research and a member of the IA, to place an 'amber top' warning from 1 August 2016 and a 'red top' warning from 1 January 2017 for any companies that fail to follow the guidance's recommendations. IVIS produces reports highlighting breaches of best practice, with amber tops raising awareness of an issue and red tops being matters of strongest concern.

Section 4 (*Issuance of Shares by Investment Trusts*) has also been amended to clarify that Treasury shares should only be re-issued at a discount that is lower than the weighted average discount (not the average discount as before) at which all shares held in Treasury have been repurchased.

The guidelines can be accessed here:

- https://www.ivis.co.uk/media/12250/Share-Capital-Management-Guidelines-July-2016.pdf

FCA Handbook Notice No. 35 and Response to CP16/8

On 29 July 2016, the FCA published Handbook Notice No. 35 which contains its replies to feedback received on its quarterly consultation paper no. 2 (CP16/8) and the final instrument.

The instrument amends the definition of reverse takeovers to prevent issuers from artificially breaking up a transaction to avoid its classification as a reverse takeover. It also prescribes the reporting format for reports on payments to governments at DTR 4.3.10. It also amends the Prospectus Rule 1 to reflect ESMA's April 2016 guidance on prospectuses.

The instrument comes into force on 29 July 2016, and the new version of DTR 4.3A.10 comes into force for financial years commencing on or after 1 August 2016.

The Handbook Notice can be accessed here:

- https://www.fca.org.uk/publication/handbook/fca-handbook-notice-35.pdf

FCA Quarterly Consultation No. 13

On 4 July 2016, the FCA published its quarterly consultation paper. Amongst other things, the FCA proposes the introduction of a new DTR (7.2.8AR) which sets out the new corporate governance statement requirement for issuers to disclose their diversity policy in the corporate governance statement. Small and medium-sized issuers would be exempt; as would listed companies that are obliged to comply with DTR 7.2 as if they were an issuer to which DTR 7.2 applies.

The consultation period closed on 1 September 2016 and the consultation paper can be accessed here:

- https://www.fca.org.uk/publication/consultation/cp16-17.pdf

ICAP Securities & Derivatives Exchange: Final Revised Growth Market Rules for Issuers

On 1 July 2016 the revised ICAP Securities & Derivatives Exchange ("**ISDX**") Growth Market Rules for Issuers came into force. This follows its consultation in June 2016. The final version includes the following amendments to the draft proposed in the consultation:

- The guidance note to Rule 32 (price sensitive information) has been deleted. The note referred to an issuer's disclosure obligations under MAR.
- Rule 43 (disclosure of dealings by PDMRs) has been deleted.
- Rule 71 (code of dealing) has been amended to remove any duplication of the provisions of MAR.
- Throughout the document, "director" has been replaced by "PDMR".

The rules can be accessed here:

- http://www.isdx.com/assets/pdfs/ISDX%20Growth%20Market%20Rules%20July%202016.pdf

Corporate Governance

FRC Corporate Governance Report

On 20 July 2016, The Financial Reporting Council ("**FRC**") published a report on the relationship between corporate culture and sustainable growth. This forms part of the FRC's Culture Project. The report recognised the importance and value of a strong, healthy corporate culture. It noted that the board of directors and particularly the chief executive of a company must demonstrate leadership in instilling that culture into all levels of the company. The report also noted the importance of openness and accountability in companies, and how values and incentives must be aligned.

Aiming to improve the perception of corporates amongst the general population, the report also notes how the duty owed by directors to act in the best interests of the company must not be viewed in isolation.

The report offers practical methods for corporates to monitor corporate culture, highlight issues with corporate culture and improve accordingly.

The report can be accessed here:

- https://www.frc.org.uk/Our-Work/Publications.aspx?searchtext=&searchmode=anyword&searchfilter=0%3b&searchfilter1=0%3b&searchfilter2=0%3b&searchfilter3=0%3b&frcdaterangesmartsearchfilter=190001010000%3b209912312359&page=2

QCA: Guide to Remuneration Committees

On 20 July 2016, the QCA published its Remuneration Committee Guide for Small and Mid-Size Quoted Companies. The guide has been updated since its last version in 2012 to include the changes to the Companies Act 2006 "say-on-pay" requirements

introduced in 2013 for Main Market companies, clawback arrangements and an expansion on the roles of those involved in remuneration committees.

The guide can be accessed here (membership of the QCA required, or £55+ VAT for non-members):

- http://www.theqca.com/shop/guides/118376/remuneration-committee-guide-for-small-and-midsize-quoted-companies-2016-downloadable-pdf.thtml

GC100 and Investor Group: Guidance on Directors' Remuneration Reporting

On 15 August 2016, the GC100 and Investor Group published a revised version of its directors' remuneration reporting guidance, which was originally published in 2013. The guidance has been published following the Investor Group's analysis of AGMs held between 2014 and 2016 and also in anticipation of AGMs in 2017, where many companies will be required to gain shareholder approval of executive pay policy as the validity of current policies expires.

Particular issues clarified by the report include the discretion held by remuneration committees, non-disclosure of targets or performance measures on the grounds of commercial sensitivity. The report also states that when reporting the percentage change in the CEO's remuneration, investors will expect any comparator group to be meaningful, rather than simply consisting of senior managers.

The guidance can be accessed via the Practical Law website (subscription required) here:

- http://uk.practicallaw.com/2-632-2324

Executive Remuneration Working Group Final Report

On 26 July 2016, the Investment Association's Executive Remuneration Working Group published its final report. The report recommends increased flexibility for companies in choosing a remuneration structure that suits their business. The report criticises the current uniform approach that presently exists in the UK and suggests alternative models.

The report can be accessed here:

- http://www.theinvestmentassociation.org/assets/files/press/2016/ERWG%20Final%20Report%20July%202016.pdf

ICSA Guidance on Minute Taking

On 19 September 2016, ICSA published a guidance note on minute taking. The note follows a consultation by ICSA conducted between May and June 2016 into minute taking practice amongst UK companies. The research found that minute taking is an often undervalued exercise, and that there is no 'one size fits all' approach to minute taking. The note provides practical guidance on how to produce minutes effectively.

The guidance note can be accessed here (registration required):

- https://www.icsa.org.uk/knowledge/minutetaking

BIS: Inquiry into Corporate Governance and Pay

On 16 September 2016, the Business, Innovation and Skills Committee launched an inquiry into corporate governance. This follows the Committee's previous inquiries into BHS and Sports Direct, in which the Committee concluded that there had been serious corporate governance failings. The Prime Minister also named corporate governance reform as a key objective during the campaign for the leadership of the Conservative Party. The inquiry will have a particular focus on executive pay, directors' duties and the composition of board rooms. The deadline for providing written submissions is 26 October 2016.

Further information can be found here:

- https://www.parliament.uk/business/committees/committees-a-z/commons-select/business-innovation-and-skills/inquiries/parliament-2015/corporate-governance-inquiry/

Institute of Directors: Good Governance Report

On 7 September 2016, the Institute of Directors ("**IoD**") produced its annual Good Governance Report. The report follows research by the IoD into corporate governance in UK-listed companies with the aim of highlighting the importance of effective corporate governance and encouraging debate about improving the public image of the UK corporate sphere. The report ranks the constituent members of the FTSE100 from best to worst according to the IoD's analysis.

The report can be found here:

- https://www.iod.com/Portals/0/PDFs/Campaigns%20and%20Reports/Corporate%20Governance/The%202016%20Good%20Governance%20Report.pdf?ver=2016-09-07-102637-003

Replacement of Annual Return With Confirmation Statement

From 30 June 2016, the annual return was replaced by confirmation statements. Confirmation statements must be submitted at least once a year, even for dormant companies. Failure to submit a confirmation statement may result in the registrar of companies striking down the relevant company from the register, resulting in the transferal of all of the assets of that company to the Crown. The company, its directors and other officers could also be prosecuted for failing to submit a confirmation statement.

On 26 August 2016, Companies House issued guidance in relation to confirmation statements. The guidance concerns: practical advice on making a confirmation statement, the PSC register, share capital statements, company registers and legacy filings of annual returns.

The guidance can be accessed here:

- https://www.gov.uk/government/publications/confirmation-statement/confirmation-statement

Takeover Code

New Edition of the Takeover Code

On 12 September 2016, the 12th edition of the Takeover Code came into effect. This new edition includes amendments in relation to the communication and distribution of information on which the Takeover Panel consulted on in February 2016 and which were discussed in the April 2016 edition of this newsletter. It also includes Terms of Reference and Rules of Procedure for the Hearings Committee. There are also new procedures for the amendment of the Takeover Code and various minor amendments to certain Practice Statements in relation to the Code issued by the Takeover Panel.

The new edition of the Takeover Code can be accessed here:

- http://www.thetakeoverpanel.org.uk/wp-content/uploads/2016/09/The-Takeover-Code-September-2016.pdf

UK Litigation Developments

UK Government to Consult on Extending the Scope of Section 7 Bribery Act 2010

In May 2016, as revealed in our last edition, the UK Government announced that it was considering whether to extend the scope of the UK Bribery Act's section 7 offence of a corporate failing to prevent bribery to other economic crimes, such as fraud, false accounting and money laundering.

On 5 September 2016, in a speech to the Cambridge Symposium on Economic Crime, the UK Attorney General stated that the Government would "*soon consult on [those] plans*" and commented that the UK's "*current system of limited corporate liability incentivises a company's board to distance itself from the company's operations. In this way, it operates in precisely the opposite way to the Bribery Act 2010, one of whose underlying policy rationales was to secure a change in corporate culture by ensuring boards set an appropriate tone from the top.*" The Attorney General concluded his remarks stating that when "*considering the question 'where does the buck stop?' and who is responsible for economic crime, it is clear that the answer is to be found at every level, from the boardroom down. Both corporates and individuals are responsible.*"

Following this address, there has been speculation that the Government intends to make individual directors and officers personally liable for the acts of company employees, agents, subsidiaries, contractors and other representatives. However, we consider that this is unlikely and that the new offence will continue to focus on corporate liability only.

The Government has yet to announce any details of or timetable for the consultation.

SFO Admits One Third Discounts on DPA Penalties Insufficient to Incentivise Self-Reporting

The Joint Head of Bribery and Corruption at the UK Serious Fraud Office ("**SFO**") has conceded that the one third penalty discount given to companies entering into DPAs is insufficient to adequately incentivise companies to self-report. Speaking at the Global Investigations Review: Live, New York City on 15 September 2016, Ben Morgan commented that it: "*has long been said that the one third discount on a penalty, being equivalent to the maximum available on a guilty plea, is not sufficiently attractive. As it happens, at the SFO we can see the force in that argument. It is clear…that in the right circumstances the [English] court will support a deeper discount up to 50%, and separately, might take into account other relevant financial matters. If taken together with the other benefits of a DPA, these have the effect of more companies coming forward, then that can only be a good thing in the overall interests of justice. [The SFO] fully support[s] it and in the right cases would look to build overall resolutions that include more than one third discounts on the financial penalty component.*"

Discussing recent developments in corporate culture and companies' relationships with the SFO, Mr Morgan noted that there has been a "*pronounced*" change "*in the way companies are routinely approaching*" the SFO, and that more companies are self-reporting to the SFO "*now than at any time in the last four years.*" Nevertheless, the SFO continues to self-generate the majority of its cases and investigations. The question therefore remains — what, if any, further incentives can the SFO offer to encourage companies to self-report promptly and cooperate fully?

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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