OCTOBER 2019/EUROPE

CORPORATE GOVERNANCE AND SECURITIES LAW UPDATE

Below is a summary of the main developments in US and EU corporate governance and securities law and certain financial markets regulation developments since our last update in July 2019.

Financial regulatory developments are available here.

IN THIS ISSUE

EU DEVELOPMENTS

Transparency Directive: ESMA Issues Updated Reporting Manual on the European Single Electronic Format

On 12 July 2019, ESMA updated its reporting manual containing technical guidance on the preparation of annual financial reports in accordance with the European Single Electronic Format (**ESEF**).

We discussed the Single Electronic Format at page 4 of the January 2019 edition of this newsletter.

Under the Directive 2013/50/EU on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market (**Transparency Directive**), as supplemented by Commission Delegated Regulation (EU) 2019/815, all annual financial reports containing financial statements for financial years beginning on or after 1 January 2020 must be prepared in accordance with ESEF. ESEF is intended to set a standard for the preparation of machine-readable financial reporting. This involves the use of Inline XBRL.

The reporting manual is in large part intended for a technical audience. It offers guidance on the use of Inline XBRL, in particular the syntax, structure and extension taxonomies that ESMA expects in Inline XBRL reports.

The update also covers common problems issuers face when preparing reports in Inline XBRL and offers guidance on resolving them.

ESMA is inviting questions and feedback on the reporting manual by email to esef@esma.europa.eu.

The updated reporting manual containing the technical guidance is available here.

ESMA Updates its Questions and Answers on the Prospectus Regulation

On 12 July 2019, ESMA updated its Questions and Answers (**Q&As**) in relation to the publication of prospectuses in response to the coming into full force of the Prospectus Regulation.

ESMA added three new Q&As in the update, relating to:

- Continuing an offer that had initially been made using a base prospectus approved pursuant to national laws implementing the Prospectus Directive, after the entry into application of the Prospectus Regulation.
  - This relates to so-called "bridging offers." The Q&A confirms it is possible to continue an offer after the end of the validity of a base prospectus that was approved under the national laws implementing the Prospectus Directive by using a base prospectus that is approved under the new Prospectus Regulation.
  - This requires the inclusion of a new set of final terms and a revised summary, which must themselves comply with the Prospectus Regulation.
- The application of Article 23(3) of the Prospectus Regulation to financial intermediaries. Article 23(3) relates to the requirement to issue supplementary prospectuses in case of a significant new factor or material mistake or inaccuracy in a previously published prospectus. Specifically, the Q&A states that financial intermediaries should comply with the obligations under Article 23(3) when they distribute securities for third parties and when they issue securities themselves.
- The application of Articles 23(1) & (2) of the Prospectus Regulation to financial intermediaries. These provisions also relate to supplementary prospectuses.
  - Article 23(1) should be fulfilled only at the time when investors accept through a financial intermediary to purchase or subscribe the security; and

- Article 23(2) should be fulfilled on the day on which the supplement is published.

ESMA amended 22 of its Q&As to refer to the Prospectus Regulation rather than the old Prospectus Directive. A number of other Q&As relating to the Prospectus Directive have been removed.

ESMA also states that it will continue to publish the existing Q&As relating to the Prospectus Directive during the period in which prospectuses approved under the Prospectus Directive may continue to be valid, that is until 21 July 2020. After that period those Q&As will no longer apply.

The Q&As can be found here.

ESMA Updates its Practical Guide for the Notification of Major Holding Under the Transparency Directive

On 31 July 2019, ESMA published an updated version of its Practical Guide to the national rules on notifications of major holdings under the Transparency Directive. This aims to act as an aid to market participants as it summarises the main rules across the EEA in relation to notifications of major holdings required under the Transparency Directive. It should be particularly helpful to shareholders that have notification obligations under the Transparency Directive.

Part I of the Practical Guide summarises the rules in relation to marketing and publishing notifications of major holdings under national law in relation to the Transparency Directive. The information is set out on a country by country basis so that participants can easily identify any relevant jurisdictions.

Part II of the Practical Guide presents key information that participants may find useful. It is organised in transversal tables, allowing participants to compare the rules of different jurisdictions. The information in Part II includes:

- information on notification thresholds;
- the triggering event;
- the deadline for learning of the triggering event;
- the deadline for making a notification; and
- the deadline for publishing a notification.

The updated version of the practical guide can be found here.

European Commission Mission Letter

On 10 September 2019, the President-elect of the European Commission, Ursula von der Leyen, wrote a mission letter to the Executive Vice-President-designate, Valdis Dombrovskis, for “An Economy that Works for People.” The mission letter set out the objectives for strengthening the Economic and Monetary Union over the next five years. These are to preserve and improve financial stability, protect savers and investors, and ensure the flow of capital to where it is needed. The objectives include the following:

- Finishing the Capital Markets Union to diversify sources of finance for companies and challenge barriers to the flow of capital. Cross-border investment should be made easier, the supervisory system should be improved and tax and insolvency proceedings should be harmonised.
- Developing a green finance strategy to improve the investment and financing of a climate-neutral economy. Work should begin with the Commission’s partners to lead a global effort to scale up sustainable financing.
- A FinTech Strategy should be developed to support new digital technologies in the financial system.
- A new private-public fund should be developed which specialises in IPOs for SMEs.

- A new, comprehensive approach towards fighting money laundering and the financing of terrorist activities should be introduced. The focus should be towards improved enforcement of legislation, better supervision, understanding the risks of new technologies and having a stronger role in setting international standards.
- There should be a common approach to cryptocurrencies across Member States to ensure that the opportunities and risks they bring can be appropriately addressed.

The full letter can be found here.

UK DEVELOPMENTS

Updates to Hampton-Alexander Review Published

On 1 July 2019 the Government published an update to the Hampton-Alexander Review into the number of women directors on FTSE 350 boards.

We covered the third annual report of the Hampton-Alexander Review in the January 2019 edition of this bulletin.

Key findings reported in the update include:

- 32.1% of FTSE 100 board positions are held by women (up from 12.5% in 2011) and 27.5% of FTSE 250 board positions are now held by women;
- the FTSE 100 is on track to reach the target of 33% board positions going to women by 2020;
- there are four all male FTSE 350 boards (down from 152 in 2011); and
- fourteen FTSE 350 companies have one woman or less on their board.

The full Hampton-Alexander Report will be published on November 13, 2019 and will be covered in the Q4 edition of this newsletter.

The update is available here.

Government's Response and Consultation on the CMA's Recommendations for Statutory Audit Services

In the first quarter of 2019, the CMA issued a report on competition issues in the statutory audit market. We covered the launch of the CMA's study in the January 2019 edition of this bulletin.

On 3 July 2019, the Government published a response from Greg Clark, the Secretary of State for BEIS, to Rachel Reeves MP's letter requesting information on the Government's proposed consultation on the CMA's recommendations. The consultation aims to address competition problems in the U.K. audit industry set out in the CMA's final report. Mr Clark stated the Government intended to publish the CMA consultation within 90 days of the report, with the consultation remaining open for two months.

The CMA's proposals include:

- increased regulatory oversight of audit committees (endorsing the Government's acceptance of Sir John Kingman's recommendation to form a new Audit, Reporting and Governance Authority (**ARGA**));
- joint audits for FTSE 350 companies, and peer reviews of audits for firms not caught by the joint audit proposals;
- measures to mitigate the effects of the distress or failure of a member of the "Big Four;"
- giving ARGA powers to design an "operational split" between the audit and non-audit practices of the "Big Four;" and

- requiring a five-year review of progress by ARGA.

The Government published the initial consultation on the recommendations made by the CMA in its final report on its market study into statutory audit services on 19 July 2019. The Government responded that it:

- Agrees that audit committees require clear expectations and standards to ensure that shareholders are given the best results, and that the regulator replacing the Financial Reporting Council will have a role to play in this.
- Recognises the importance of ensuring meaningful and effective competition and choice for audit clients in the statutory audit market.
- Agrees that the functions of the regulator can be increased to monitor and act on the health of audit firms, and that it wants to implement a monitoring function that can support the market in an effective and competitive way.
- Recognises the high risk of actual and perceived conflicts of interest present in audit firms providing non-audit services to their audit clients. It aims to identify and implement a powerful and proportionate package of measures to increase variety and capacity in the audit market.

The Government therefore requested views on:

- the scrutiny of audit committees, particularly in relation to the new regulator's powers;
- joint audits and peer reviews of the audit engagements of those companies that are not subject to the joint audit requirements;
- actions which can mitigate the effects of the distress or failure of a "Big Four" Firm; and
- an operational split between audit and non-audit practices.

The consultation closed on 13 September 2019.

The CMA's original report can be found here.

The Government's webpage on the consultation can be found here.

Understanding the Value of Transparency and Accountability: The Corporate Reporting Dialogue

The Corporate Reporting Dialogue is a platform which combines the major international reporting frameworks. It aims to advance corporate reporting by encouraging discussion between participants on their frameworks.

On 4 July 2019, it published the "Understanding the value of transparency and accountability" paper, comparing regulatory frameworks and listing the common principles that organisations should follow in order to promote accountability and transparency in their corporate disclosures. The common principles are:

- materiality – the information must be relevant to ensure the user has a base upon which to make its decisions;
- completeness – all material matters should be reported;
- accuracy – all information should be accurate and should not contain any errors;
- balance – the information presented should be free from bias;
- clarity – the information should be clear, concise and accessible;
- comparability – all information should be reported on the same basis and apply the same methodologies to ensure that a fair comparison can be made against other organisations; and

- reliability – all information should be of a high quality and examination of the reported information should be allowed.

The full paper can be found here.

FATF Publishes Guidance on Terrorist Financing Risk Assessment

On 5 July 2019, the Financial Action Task Force (**FATF**), an inter-governmental organisation that seeks to set standards and encourage implementation of anti-money laundering and terrorist financing measures, published new guidance on terrorist financing risk assessments. It is particularly involved in improving standards in lower capacity countries.

Adding to its 2013 guidance, the new guidance covers:

- key considerations for scoping terrorist financing risk assessment and practical examples to overcome information sharing challenges related to terrorism financing;
- sources of information for assessing terrorist financing risk and considerations for specific country contexts (e.g. financial and trade centres, lower capacity jurisdictions, jurisdictions bordering a conflict zone, etc.); and
- sources of information for practitioners considering cross-border transactions, as well as terrorist financing risks within the banking and money or value transfer sectors.

The new guidance is available here.

Government Publishes Response to Independent Review of Modern Slavery Act

On 9 July 2019 the Government issued its response to an independent review of the Modern Slavery Act 2015. The review focussed on section 54 of the Act, which requires large commercial organisations to prepare a slavery and human trafficking statement.

We discussed the results of the independent review at page 16 of the July 2019 edition of this bulletin.

The main recommendations of the review, and the Government's responses, are as follows:

- the review argued that organisations should have a designated board member held accountable for the production of their modern slavery statement. The Government stated that it considers approval of slavery reporting to be a collective responsibility of the board;
- the review argued that the Companies Act 2006 should be amended to place a duty on companies to refer to their modern slavery statement in their annual report to Companies House, as well as the imposition of reporting requirements on non-listed companies meeting the section 54 MSA financial threshold. In response, the Government stated its belief that this would lead to a compliance-driven approach which would lead to limited or high-level disclosures by companies; and
- the review recommended the creation of an offence under the Company Directors Disqualification Act 1986 applying to companies and their directors who do not meet their slavery reporting requirements or act when they are aware of slavery issues. Again the Government argued that this would result in a minimal, compliance-driven approach which would limit disclosures.

The Government wishes to address the issue of modern slavery primarily outside of the company law regime. It is considering a proposal to create a central registry of modern slavery statements.

The Government's response can be found here.

Law Society and CLLS Response to ISCA's Consultation on the Effectiveness of Independent Boards

On 10 July 2019, the City of London Law Society (**CLLS**) and the Law Society published a joint response to the Chartered Governance Institute's (**ICSA**) consultation on the effectiveness of independent boards in the U.K. listed sector.

The CLLS and the Law Society were both supportive of some of ICSA's proposals, including establishing disclosure guidance and good practice principles for listed companies, and the development of a code of practice for board reviewers. However, the CLLS and Law Society highlighted that the changes introduced by the U.K. Corporate Governance Code 2018 applied only to the financial years beginning 1 January 2019 and that companies would not have published their 2019 annual reports. They therefore believe that before imposing significant additional requirements on companies, a full cycle of compliance with the Code should be completed to see what changes resulted from the updated Code.

The joint response can be found here.

The Risk Coalition Launches Consultation on Principles and Guidance for Board Risk Committees

The Risk Coalition is a network of not-for-profit professional bodies and membership organisations that aims to improve standards of risk governance and risk management in the U.K. On 12 July 2019, they published for consultation draft principles and guidance for board risk committees and risk functions in the U.K. financial services sector.

The main aim of the guidance is to provide coherent and authoritative principles-based good practice guidance for board risk committees and risk functions. It also aims to improve and promote good practice of risk oversight, provide a benchmark against which board risk committees and risk functions can be assessed objectively, and develop a common understanding of board risk committees and risk functions.

Eight key principles are defined in the first part of the guidance, along with supporting guidance, which mature board risk committees are expected to meet. These include board risk committee and board accountability, risk culture and remuneration, risk management and internal control systems.

Despite the scope of the guidance being limited to financial services, the Risk Coalition believes they can be extended to other sectors and encourages those outside the financial sector to provide feedback during the consultation.

During the consultation process respondents are asked to consider nine specific questions on certain areas of the draft guidance where the Risk Coalition believed there would be a mix of opinions. The consultation closed on 20 September 2019 and a final version of the guidance is expected to be published in December 2019.

The consultation can be found here.

FRC's Consultation on Ethical and Auditing Standards and the BVCA's Response

On 15 July 2019, the FRC published a consultation paper detailing its proposed changes to its Ethical and Auditing Standards. The changes were based on the FRC's recent review of the efficacy of the standards and the FRC's March 2019 position paper which summarised the outcome of the review. The FRC proposes to set more stringent ethical rules for auditors based on recent audit enforcement cases and from audit inspections. It also proposes to enhance the quality and content of auditors' reports to improve transparency based on responses from investors.

The key changes proposed to the Ethical and Auditing Standards are:

- A clearer and stronger "objective, reasonable and informed third party test," which relates to the independence of audit firms when considering whether a proposed action would affect the perspective of public interest stakeholders. Additional rules provide further support for this test, such as encouraging wide-range assessment.
- Enhancing the authority of the Ethics Partner function within audit firms. This will ensure that firms focus on ethical matters and the public interest. Firms will be required to report to those in charge of governance where an Ethics Partner's advice is not followed by an audit firm.
- The list of prohibited non-audit services which cannot be provided by auditors of public interest entities has been replaced with a shorter list of permitted services. All of the services are required by law and/or regulation (such as reporting on client assets or Solvency II), or are closely related to an audit (such as review of interim information).
- Auditors of U.K. listed entities are required to include in their published auditor's reports the performance materiality threshold used in the audit.

The proposals aim to improve the Ethical and Auditing standards based on the experience since the last major revision in 2016. The proposals also aim to promote public confidence in audit and to improve the quality of audits being carried out in the U.K.

The British Private Equity and Venture Capital Association (**BVCA**) highlighted its strong concerns in relation to the limited list of services which can be provided by auditors of public interest entities and the expansion of the requirements to certain non-public interest entities. The BVCA believes this will lead to a reduction in the variety of accounting firms able to provide services to private equity and venture capital firms. They believe there is no public interest benefit in these changes as there will not be a material reduction of the threat to audit independence. The BVCA believes these changes will particularly affect private equity and venture capital funds due to their structure and the way in which they invest and manage businesses.

The revised standards are intended to apply to the audit financial periods commencing on or after 15 December 2019. The final revisions will be updated as necessary to reflect the relevant legal position in relation to Brexit at the end of the year.

The consultation can be found here.

Revised U.K. Stewardship Code to be Published by the End of the Year

The FRC's U.K. Stewardship homepage has been updated to state that it will publish a revised version of the U.K. Stewardship Code by the end of 2019. The Code sets out good practice for institutional investors when engaging with investee companies. The publication date contained in the original consultation timetable was 16 July 2019. In July, the FRC updated its homepage to state it would publish a revised version of the Code in October.

The FRC's U.K. Stewardship Code webpage can be found here.

BEIS Publishes Response to Joint Committee Report on Draft Registration of Overseas Entity Bill

The draft Overseas Entity Bill proposes a public register of beneficial owners of overseas entities that own or purchase U.K. property. On 18 July 2019 BEIS published its response to the Joint Committee report on the draft Bill.

Important points in the Government's response include:

- the Government does not currently intend to lower the 25% ownership and voting threshold in the definition of beneficial ownership, although this will be kept under review;
- the Government considers the definitions of "overseas entity" and "legal entity" are sufficiently wide, clear and flexible in the draft bill. It is against the idea of a pre-clearance mechanism for determining whether an entity is registrable, on the basis that a U.K. agency should not make decisions on the legal personality of foreign entities;
- the Government is against listing the types of entities that may be eligible for exemptions on the basis that this would limit the adaptability of the draft bill. It agrees with the Joint Committee that the power to exempt types of entity should be subject to affirmative resolution, and confirms that the power would only be used in exceptional circumstances relating to the U.K.'s economic wellbeing, the detection and prevention of serious crime, and national security;
- the Government agrees with the Joint Committee that a mechanism for flagging suspicious or incorrect information to Companies House should be included in the draft bill;
- the Government will consider how the accuracy of the register can be ensured at the point of disposition of land, and whether it is viable to require regulated professionals to verify beneficial ownership information on submission; and
- the Government will also consider the inclusion of civil as well as criminal penalties for breach.

The Government response is available here.

EU Prospectus Regulation Applies in Full

The EU Prospectus Regulation has applied in full in the U.K. since 21 July 2019. Its provisions previously applied on a staggered basis since it came into force in June 2017.

The Prospectus Regulation directly applies in the U.K. It repeals and replaces the EU Prospectus Directive.

It is accompanied by two delegated acts which also came into force on 21 July 2019:

- commission Delegated Regulation (EU) 2019/979, which sets out technical standards relating to the contents and publication of prospectus summaries, advertisements for securities, supplements to a prospectus and the notification portal;
- commission Delegated Regulation (EU) 2019/980, which sets out standards for prospectuses where securities are offered to the public or admitted to a regulated market.

A third delegated act is expected, which will set out the minimum technical content of an exemption document. An exemption document must be published by issuers using the takeover, merger and division exemption from the requirement to publish a prospectus. At the time of this bulletin, this delegated act has not been published to the Official Journal.

The provisions of the Prospectus Regulation are different from the Prospectus Directive in several important respects, including:

- changes to the prospectus summary and the removal of the former "elements" based modular format of a prospectus;
- changes to the prospectus risk factor requirements;

- updates to the methods of publication of a prospectus;
- the introduction of new bespoke types of prospectus, including a simplified disclosure prospectus for secondary issues and a new EU growth prospectus; and
- the ability for issuers to file a universal registration document and achieve frequent issuer status.

The Prospectus Regulation is available here.

Delegated Regulation 2019/979 is available here.

Delegated Regulation 2019/980 is available here.

FCA Updates Materials to Reflect Application of Prospectus Regulation

On 15 July 2019, in advance of the full application of the Prospectus Regulation the FCA published the Prospectus Regulation Rules Instrument 2019.

We covered the FCA's consultation on the proposed changes on page 13 of our July 2019 edition of this bulletin.

Its purpose is to update the FCA Handbook to reflect the full application of the Prospectus Regulation.

In particular:

- the Prospectus Rules sourcebook has been replaced with the Prospectus Regulation Rules sourcebook, which reflects the provisions of the Prospectus Regulation; and
- amendments have also been made to the Listing Rules and Disclosure Guidance and Transparency Rules to align them with the Prospectus Regulation.

The Instrument is available here.

The FCA Handbook is available here.

On 19 July 2019, the FCA also updated its Forms and Checklists and Knowledge Base resources to reflect the application of the Prospectus Regulation. Of particular importance is the inclusion of "Form A," which is an application for the approval of a prospectus in accordance with Part VI FSMA 2000 and the Prospectus Regulation.

We covered previous updates to the FCA's materials in light of the prospectus regulation in the July 2019 edition of this bulletin.

AFME Updates its Equity Selling Restriction for Prospectus Regulation

On 26 July 2019, the Association for Financial Markets in Europe (**AFME**) updated its model equity selling restrictions to reflect the coming into force of the Prospectus Regulation.

The new version replaces references to the Prospectus Directive with references to the Prospectus Regulation, and is amended to account for the Prospectus Regulation's direct effect in EU member states.

The model EEA selling restrictions now include distinct versions for insertion into prospectuses and transaction documents, for example underwriting agreements.

AFME recognises that the selling restrictions operate on the basis that the U.K. remains an EU member state. It states that a further update may follow when there is greater certainty as to the timing and nature of the U.K.'s departure from the EU.

The 26 July 2019 updated model selling restrictions are available here.

AFME's model selling restrictions for use after Brexit (whether with a deal or without) are available here.

GC100 and Investor Group Publish Updated Directors' Remuneration Reporting Guidance

On 22 July 2019, the GC100 and Investor Group published an updated version of its Directors' Remuneration Reporting Guidance. The update incorporates the Companies (Directors' Remuneration Policy and Directors' Remuneration Report) Regulations 2019. These regulations implement regulatory changes including changes to the reporting of directors' remuneration brought in by the Shareholder Rights Amending Directive.

The main changes to the reporting of directors' remuneration are:

- to include regulatory definitions for the employee comparator group and directors that are required when calculating percentage change in pay;
- a discussion of measures taken to avoid or manage conflicts of interest in relation to determination, review and implementation of the remuneration policy; and
- an extension of coverage to include those considered to be the CEO or deputy CEO, even where they are not appointed as directors.

The updated version of the guidance can be found here.

Update to Best Practice Principles for Providers of Shareholder Voting Research and Analysis

On 22 July 2019, the Best Practice Principles Group updated its Best Practice Principles for Providers of Shareholder Voting Research and Analysis (**Principles**). The Principles apply on a voluntary basis to providers of research who elect to become signatories to the Principles.

The revised Principles incorporate insights from a review of updated global stewardship codes, the requirements of the revised EU Shareholder Rights Directive II (**SRD II**) and the ESMA 2015 Follow-Up Report on the Development of the Best Practice Principles for Providers of Shareholder Voting Research and Analysis.

Major changes in the updated Principles include:

- application of the principles on an "apply and explain" (rather than "comply and explain") basis, to reflect Article 3j of SRD II;
- principle One (Service Quality) now includes detailed requirements for disclosures relating to "house" voting policies and research methodology;
- principle Two (Conflicts-of-Interest Avoidance or Management) now includes a requirement that conflicts policies cover the avoidance of conflicts in addition to their management. Processes must also be in place for the identification, mitigation and disclosure of conflicts that may influence the preparation of analysis, advice and voting recommendations; and
- principle Three (Communications Policy) has been amended so that research reports must set out the approach to and nature of any communication between the signatory and any relevant parties.

The revised Principles also establish an oversight committee, with responsibilities including:

- annual reviews into each signatory's public compliance statement;
- the sanctioning of non-compliant signatories; and
- the monitoring of the progress and impact of the Principles.

The revised Principles are available here.

Takeover Panel Annual Report and Accounts 2018/19

On 23 July 2019, the Takeover Panel issued a statement announcing the publication of its Annual Report and Accounts for the year ended 31 March 2019.

The report found that investigations of potential breaches of the City Code on Takeovers and Mergers (**Takeover Code**) , particularly against the alleged existence of undisclosed concerted parties, and enforcement actions required a great deal of the Panel's time. The reason for this work, and any subsequent enforcement action, being particularly time consuming is due to it often being forensic in nature. This has resulted in the Executive creating a more focussed investigations and enforcement team, and adding dedicated seconded resources to support the work.

Despite M&A activity being high in the first half of the year, the report found that it reduced during the second half of the year, reflecting historical levels of activity. There were 51 firm takeover offers during the year, all of which became unconditional in all respects or the scheme became effective or lapsed or was withdrawn. There were 14 firm offers announced with a value of over £1 billion in 2018-19, compared with 13 in the previous year. Despite the drop in activity, the Panel noted the following trends:

- A larger number of hostile bids launched when compared with previous years. These place greater stresses on the Takeover Code and the Panel's system of regulation. The Panel reported the hostile takeovers concluded without major incident.
- A rise in the number of deals involving an interplay between the Takeover Code and the insolvency regime.
- The mandatory bid made by Laird Investments (Pty) Limited on behalf of Mr David King for Rangers brought an end to the case in which the Panel, for the first time, applied to the court under s.955 CA 2006 for an order enforcing a ruling of the Panel.

There have been complex issues faced by the Executive due to the large number of bids and the number of hostile bids. This is because of the substantial amount of work completed by the Executive in relation to Takeover Code whitewashes, concert parties queries, re-registrations and general enquiries of the application of the Takeover Code. Most of this work does not become public.

No letters of private censure were issued by the Executive during the year. Six educational/warning letters were issued.

The full report can be found here.

Consultation Launched by the Government on Financial Services Future Regulatory Framework

On 29 July 2019, HM Treasury launched a consultation seeking views on regulatory coordination in the financial services sector. The consultation will remain open for three months and will close on 18 October 2019.

The consultation was announced in the Chancellor's 2019 Spring Statement and marks the first stage of the Government's review of the regulatory framework for financial services. The wider review will cover the general approach to regulation of the financial services sector, including how the regulatory framework will adapt to future changes such as the U.K. leaving the EU.

The consultation will determine the long-term effectiveness of the regulatory regime and will examine how the coordination of the work of each regulator can be improved. It will consider the roles of the current regulators and request views on how existing cooperation between these authorities and the Government can be improved. The improvement of cooperation aims to ensure the overall impact of regulatory interventions on firms and their consumers is well understood and managed.

The full review can be found here.

Significant Increase in Sanctions and Settlements Found in FRC's First Annual Enforcement Review

On 31 July 2019, the FRC announced that it published its first Annual Enforcement Review. The report aims to provide a standard against which future performance can be measured as the FRC transitions into the Audit, Reporting and Governance Authority. It also highlights challenges identified in enforcement cases and actions taken to prevent them. The review identifies a significant rise in the number of sanctions and settlements in 2018/19.

Key findings from the review include:

- close to a three-fold increase in annul fines from £15.5 million in 2017/18 to £42.9 million in 2018/19;
- an increase in the use and range of non-financial sanctions, rising from 11 in 2017/18 to 38 in 2018/19;
- a significant reduction in "legacy" cases;
- an increased use of horizon scanning techniques to identify issues requiring investigation; and
- A 25% growth of the Enforcement Division of the FRC compared to the previous year. The Enforcement Division conducts investigations and can bring prosecutions against auditors, accountants, accountancy firms and actuaries for breaching professional standards.

The review sets out the enforcement action taken over the past year and the sanctions imposed. It also sets out the context and use of exclusions and other non-financial sanctions where there has been an emphasis on increasing the quality and reliability of future financial reporting. The review highlights issues brought to light in enforcement cases and sets out the actions taken to address them with the aim of improving behaviour.

The FRC prioritises delivering consistency and the Review shows that there has been progress made in concluding legacy cases. Improving the speed of investigations was another key focus. The Review highlights that resourcing has significantly increased and the process has been streamlined.

The Review also emphasises the importance of co-operation, including the need for early acknowledgement of errors to ensure they can be correctly addressed.

The press release can be found here.

The full annual enforcement review can be found here.

FCA Publishes Market Watch No. 60

On 1 August 2019, the FCA published Market Watch No. 60. The edition focussed on Article 18 of the Market Abuse Regulation, which relates to inside information and insider lists.

The edition comes in the context of the high-profile conviction and imprisonment of the former compliance officer of a major investment bank for insider trading. The FCA has also recently conducted a review into the management of inside information at a number of firms.

The edition highlights the deficiencies in insider lists the FCA encountered in its review and when investigating suspected insider dealing. Issues include:

- large and disproportionate numbers of support staff having access to inside information;
- failure to regularly review rights of access to inside information;
- the inclusion of personnel on insider lists who did not in fact have access to the insider information, rendering the lists unfit for purpose;

- poor electronic organisation of insider lists and information; and
- in serious cases, no monitoring at all.

The FCA considers it essential that a reliable record is available of who knew what, and when, in order to carry out investigations. It argues that deficient insider lists are a symptom of the systematic failure of firms' policies and procedures.

The FCA reiterated that it expects firms to take reasonable steps to identify and mitigate the risks of mishandling inside information.

The Market Watch is available here.

Government Review of the PSC Register

On 2 August 2019, the Government published a report on the People with Significant Control (**PSC**) register. The PSC register aims to increase corporate transparency by listing the beneficial owners of U.K. companies, thereby facilitating economic growth and helping to prevent the misuse of companies. The report examines the costs, benefits and effectiveness of the register in enhancing corporate transparency.

Generally, the report found businesses were engaged with the PSC register regulations. Only 66% of businesses kept records of their beneficial owners before the PSC register. Nearly all businesses in the survey (92%) had PSCs. 43% of companies reported having one PSC, 37% had two PSCs and only 13% had three or more PSCs.

The review found the compliance cost to be relatively small, with a mean overall cost of £287 and a median overall cost of £125. This cost did vary depending on the size and complexity of the ownership structure. In relation to non-financial costs, most businesses did not believe the PSC register had impacted the way they operate.

22% of businesses used the PSC register to look up information on other businesses and most of these considered the register to be useful for this purpose. The majority of these companies (64%) used the PSC register to look up information on clients and customers. The PSC register was also found to be widely used by stakeholder organisations, with law enforcement organisations using the register at least weekly. However, due to concerns about data quality, some stakeholders did not feel as though they could rely on the PSC register as a source of information.

The "Protection Regime" is a system which suppresses information relating to PSCs from the PSC register. Some of the exceptional circumstances under which the regime can be used include where an individual would be placed at serious risk of violence or intimidation if their details were made public. 903 applications were received by Companies House for information about the PSC to be suppressed from the register between April 2016 and January 2019. Roughly half of these applications were approved. Companies House staff suggested that the Protection Regime was fulfilling its purpose but could be improved by including a wider range of risks and by having an online application.

The full report can be found here.

Law Commission Calls for Evidence on Intermediated Securities

On 27 August 2019, the Law Commission launched a call for evidence, following its announcement in June 2019 that it started a review of the system of intermediated securities at the request of the Department for Business, Energy and Industrial Strategy. Intermediated securities are shares and bonds held electronically through computerized credit entries. The ease with which they are traded has raised concerns around corporate governance, transparency and the certainty of legal redress for such securities. This was detailed in our Financial Regulation blog, which can be found here.

The Law Commission is currently requesting views from stakeholders on their experiences of the intermediated securities system. The Law Commission sets out some of the legal issues which are raised when using intermediated securities which it has become aware of from previous studies and discussions. These include areas of voting rights, insolvency, schemes of arrangement and dematerialisation. Consultees are asked about the practical problems that arise from these issues and whether they have any suggestions for reform.

The call for evidence closes on 5 November 2019 and will be used to inform the Commission's scoping study, which it aims to publish in Autumn 2019.

The current status of the project can be found here.

NEX Exchange Updates its Growth Market Rules for Issuers and Corporate Adviser Handbook

On 2 September 2019, NEX Exchange issued updates to its Rules for Issuers and Corporate Adviser Handbook.

We discussed the launch of NEX's consultation on the Growth Market Rules at page 14 of the July 2019 edition of this bulletin.

The Rules for Issuers form the admission and disclosure responsibilities of companies admitted to the NEX Growth Market. Changes in the update include:

- incorporating and updating the suitability review process that was previously contained in the Applicant Suitability for the NEX Exchange Growth Market practice note;
- updating the suitability factors relating to individuals contained in the Guidance Note to Rule 27, in particular altering the meaning of "relevant individuals" to include "shareholders with significant control," rather than "substantial shareholders," and discussing how certain criminal convictions and disciplinary actions taken against relevant individuals will bear on suitability decisions; and
- revision of the procedure for submitting application documents, stating that a pre-admission announcement must be made by the applicant at least 10 days before the intended admission date.

With a view to improving NEX Exchange's anti-money laundering measures the Corporate Adviser Handbook features an updated declaration for Corporate Advisers at Appendix B.

The updated Rules for Issuers can be found here.

The updated Corporate Adviser Handbook can be found here.

FCA Launches New Webpage on Polling and MAR

On 3 September 2019, the FCA launched a new webpage covering polling and the Market Abuse Regulation (**MAR**). It is a response to new questions relating to how MAR might apply to electoral polling information.

Information is inside information if:

- it is precise;
- it is not publicly available;
- it relates to an issuer of financial instruments; and
- if the information were made public, it would significantly affect the price of the financial instrument to which it relates.

If the above definition of MAR is met, disclosing that information other than in compliance with MAR would be an offence. Whether the information is inside information would be determined on a case-by-case basis. This applies to all individuals and firms, regardless of whether they carry out regulated financial services activities.

The webpage sets out how inside information could be obtained in relation to polling. It gives the example of a polling firm which is due to publish polling results. In the example, the results are likely to affect the price of government bonds and the information meets the requirements of being inside information. In those circumstances, it would be an offence to share that information with anyone before its official publication unless it was necessary in the normal exercise of employment, profession or duties.

It could also be an offence if a person in possession of the inside information used it to trade the relevant government bonds in advance of the publication of the results. If the definition of inside information is not met, there would be no restriction under MAR on individuals and firms collecting or receiving polling information which could affect financial market prices. This applies whether or not the polls are still open.

Although trading in spot foreign exchange (FX) is not covered by the insider dealing provisions under MAR, other FCA rules such as the Principles for Business may apply. Such trading may also be covered by the market manipulation offence under MAR where the trading has an impact on relevant financial instruments, such as certain spot FX options.

The FCA webpage can be found here.

The QCA Publishes a Report on Non-Executive Directors in Growth Companies

On 6 September 2019, the Quoted Company Alliance (**QCA**) published a report examining the role of non-executive directors (**NEDs**) in growth companies compared to the role of NEDs in large companies. The report is the result of interviews and focus groups with investors, Chairs, NEDs, CEOs, CFOs, company secretaries and nominated advisors. It aims to clarify the role of NEDs within a company and enable boards to be more effective.

The report found there to be significant differences between the role of NEDs depending on whether they were in a growth or large company. In particular, the report highlighted the varied role NEDs can have in a growth company depending on the company's characteristics, such as size, stage of development, business and operating model complexity and ownership structure.

The report highlighted three key aspects of NEDs' role in and contribution to growth companies.

- It found that although the implementation of sound governance practice created by the Chair is necessary for NED effectiveness, an NED's individual skill, experience and will factor remains the decisive factor.
- It also found there to be four basic company types of NED role: keep the business on track; keep the CEO on track; develop the team; and making sense of complexity. Whilst there is a wide variation in how an NED can carry out their role, each company type identifies a particular approach taken by an NED which requires specific experience, skills and behaviour. It will also require a specific approach to be taken by the Chair.
- It found that when compared to all NEDs, those in growth companies achieved monitoring of others through engaged stewardship by bringing together their experience, specific and general business skills and their links to key stakeholders. This is one of the ways NEDs add value, as well as by supporting the company's ambitions.

The report found that Chairs are essential to creating an environment for NEDs' effectiveness by carefully implementing a set of practices in context. Key chair practices include board composition and succession planning, board policies on NED engagement with the business and regular board evaluations. The key to making the most of this environment is the NED's individual skill, experience and drive.

The full report can be found here.

FRC Publishes 2018/19 Annual Report

On 6 September 2019, the FRC published its 2018/19 Annual Report, having been laid before Parliament the previous day.

The FRC highlighted its significant activities during the year, including:

- substantial revisions to the Corporate Governance Code, which may be accessed here;
- a consultation process on the Stewardship Code, which may be accessed here;
- various new policies initiatives in response to the independent review conducted by Sir John Kingman, which may be accessed here;
- a 25% increase in resources for its enforcement activities; and
- the establishment of the Investor Advisory Group.

The Annual Report can be found here.

QCA Updates its Audit Committee Guide

On 12 September 2019, the QCA updated its Audit Committee Guide. Alongside its Corporate Governance Code, the Guide sets out QCA's position on best practice.

The Guide covers:

- the important role of independent non-executive directors (**INEDs**) in forming effective audit committees, recommending that an audit committee contains at least two INEDs. It also discusses the need for a balance of skills and continuing improvement;
- the roles and responsibilities of the audit committee. The update expands the roles of the chair, the finance director and the company secretary. It also states that the company secretary should not normally also be the finance director or on the audit committee;
- significant expansion of the guidelines on risk management, emphasising the need for committees to be responsive to new threats;
- guidance on the appointment of external auditors, including new provisions on the tendering process;
- additional guidance on the audit opinion, the payment of dividends and new accounting policies;
- the audit committee report, including the tendering, appointment and rotation of auditors, risk and control, and internal assurance and audit; and
- the Guide also updates its work programme for the audit committee, including an additional item for the approval of audit fees.

The Guide is available from the QCA here.

The FRC Publishes Disclosures by Companies on the Sources and Uses of Cash Report

On 25 September 2019, the FRC published its latest project report considering company disclosures on the sources and uses of cash. This report follows on from the FRC's project, which started on 5 December 2018, where investors and companies of all sizes were asked to help explore best practice disclosures around the sources and uses of cash.

The report examines how companies can answer investors' questions about how a company generates cash and how it uses that cash. The report provides guidance on how companies can provide more information and context around cash disclosures. This goes beyond the disclosures given in the cash flow statement and includes business model disclosures, capital allocation frameworks, reverse factoring arrangements and others. This will expand the discussion, as requested by investors, on a company's cash drivers supported by appropriate metrics. By combining the information provided on the sources and uses of cash generated by the company, investors can see how future cash generation is underpinned by current cash generation.

Investors identified the key metrics and ratios which are important as those which focus on the generation of cash, the availability of cash resource and the use of cash. Investors' belief of what makes useful information mirrored the five principles found in the Financial Reporting Lab's original performance metrics project: alliance to the company's strategy; transparency; contextual; reliable; and consistent.

Investors want disclosures that provide details of the *sources* of cash in the present and the future. As well as understanding how companies generate cash, investors also need to look at a company's working capital to understand the health of the business. Areas of concern in relation to working capital listed in the report were:

- businesses within a single company that have different working capital requirements or approaches;
- where changes to working capital were driving overall cash generation; and
- where a specific approach to financing needed to be understood to properly comprehend the company's approach to working capital.

Investors want disclosures that provide details of the past and future *use* of cash. The report considers a number of suggestions in relation to shareholder distributions and listed the following areas as having room for particular improvement:

- disclosure on the timing and size of any shareholder returns;
- disclosure on the availability and nature of dividend resources currently accessible to the parent company; and
- details about risks, restrictions and variabilities that might impact future returns.

The report also discusses the Lab's previous "Disclosure of dividends – policy and practice" report, which showed that disclosures allowing investors to understand dividend policy and the company's ability to maintain the policy in the long term were central to their assessment of stewardship and the long-term sustainability and value of the company. The IA is expected to provide further guidance in Autumn 2019.

The full report can be found here.

Encouraging Diversity and Inclusion: Men as Change Agents 'Lead the Change' Board

The Men As Change Agents (**MACA**) "Lead the Change" Board is a new Government-backed initiative aiming to increase equality at the senior levels of companies and promote diversity and inclusion. The "Lead the Change" Board is comprised of senior industry leaders who will act as "change agents" to promote equality of opportunity at organisations across the U.K. The Government announced the first meeting of the "Lead the Change" Board on 25 September 2019.

The "Lead the Change" Board will work to encourage business leaders to make pledges to increase diversity within their organisation. Industry leaders will be asked to take personal responsibility for encouraging diversity and inclusion. They will be encouraged support the target set out in the Hampton-Alexander Review, which aims to have 33% of executive level FTSE 350 business leaders as women by the end of 2020. They also support the targets set out in the Parker Review, which aims to have at least one ethnic minority director on each FTSE 100 board by 2021, and each FTSE 250 board by 2024. Business leaders are also invited to pledge to sponsor one to three individuals from underrepresented backgrounds who will be encouraged to secure an executive role within three years. They will also be asked to be part of the wider conversation encouraging diversity and inclusion.

The MACA Board's website can be found here.

Investment Association Issues New Guidelines on Executive Directors' Pension Contributions

On 27 September 2019, the Investment Association (**IA**) announced new guidelines in relation to the pension contributions of executive directors. The guidelines follow changes the FRC made to the U.K. Corporate Governance Code in July 2018 and the IA's Principles of Remuneration, which was published in November 2018. The changes aim to align the pension contributions of executives with the rest of the workforce. The IA highlighted the scrutiny faced by executive pensions in the 2019 AGM season, resulting in 33 FTSE 100 companies making significant changes to their executive directors' pension contributions.

The new guidelines apply to companies with year-end starts on or after 31 December 2019. The IA will use its Institutional Voting Information Service from the start of the 2020 AGM season to encourage companies to follow the guidelines. Any company that has a director with a pension contribution of over 25% of their salary will be amber topped if they have a credible plan to reduce the pension to reflect the majority of the workforce by 2022, and red topped if they do not. Companies will also be red topped if they appoint a new executive director or a director changes role with a pension contribution out of line with the majority of the rest of the workforce.

The IA do not consider fixing the monetary value of pension contributions over time to be a credible action plan to bring the pension contributions in line with the majority of the workforce. Companies are requested to list the pension contribution rate which they consider to be given to the majority of the workforce in their remuneration report and the remuneration committee should explain how this rate has been derived.

In relation to defined benefit contribution schemes, companies face being amber topped where they fail to keep future accrual open to other employees on the same terms as the executive directors. The same applies for cash supplements paid in lieu of further accruals above an earning limit, as other employees must also be paid the cash supplements on an equivalent basis. If they are not, the remuneration report will be amber topped.

The press release can be found here.

FRC Revises Going Concern Standard

On 30 September 2019, following a consultation process, the FRC issued a revised International Standard on Auditing (U.K.) 570 - Going Concern.

The revised standard addresses concerns about the quality of audit, brought into relief by instances of entities collapsing shortly after auditors' reports were issued that failed to identify problems. The FRC had also encountered problematic practices from auditors in the course of its enforcement proceedings.

The revised standard introduces more stringent requirements on assessment of going concern than international standards currently require. New requirements include:

- auditors of public companies, large private companies and public interest entities must give a clear conclusion on their view of management's assessment of going concern. They must set out the work done to arrive at this conclusion;

- auditors must evaluate the evidence management provide in support of their assessment of going concern and address the possibility of management bias. The viability statement is to play an increased role in this; and
- auditors must take a comprehensive view of all the evidence available when giving a conclusion on going concern.

The revised Going Concern Standard can be found here.

The Feedback Statement on the consultation process can be found here.

US DEVELOPMENTS

SEC and NYSE/Nasdaq Developments

SEC Adopts New Rule to Allow All Issuers to Make Pre-Offering Communications

On 25 September 2019, the Securities and Exchange Commission (**SEC**) adopted a new rule to allow all issuers to "test the waters" prior to publicly filing a registration statement. Previously, this was available only to emerging growth companies (**EGCs**). The new Rule 163B under the Securities Act of 1933 (**Securities Act**) will enable all issuers (and their authorised representatives, including underwriters) to engage in communications with potential investors that are, or are reasonably believed to be, qualified institutional buyers, "QIBs", or institutional accredited investors, "**IAIs**", either prior to or following the filing of a registration statement.

Generally, companies with annual gross revenues in excess of U.S.$1.07 billion have not qualified as EGCs, and as a result, have been prohibited from making any written or oral offers prior to the filing of a registration statement with the SEC, under Section 5 of the Securities Act.

Under new Rule 163B, issuers will not be required to file or include specific legends on testing-the-waters communications. However, communications will be subject to review by the SEC to ensure that testing-the-waters communications do not conflict with any material information included in the registration statement, in line with the SEC's current practice for EGCs. Moreover, such communications will continue to be considered "offers" under the Securities Act, and will consequently be subject to potential liability under the Securities Act and other federal anti-fraud provisions.

Furthermore, companies subject to Regulation FD will need to consider whether testing-the-waters communications will be considered selective disclosure of material non-public information and whether the issuer has an obligation to simultaneously make such information public. Under Regulation FD, if the investors in testing-the-waters meetings enter into confidentiality agreements, the issuer may in certain circumstances conclude that public disclosure is not required at that time.

The new rule is non-exclusive and an issuer may rely on other Securities Act communications rules or exemptions when assessing the means and timing of communication with potential investors prior to a contemplated offering.

The rule will become effective on 3 December 2019.

View the final release adopting the new rule here.

View our related client publication here.

Business Roundtable Proposes a New Paradigm on the Purpose of a Corporation

On 19 August 2019, the Business Roundtable, a group of some of America's most prominent business leaders, released a Statement on the Purpose of a Corporation, which calls on businesses to consider the interests of their employees, suppliers, customers and communities, in addition to their shareholders. This is a marked departure from the paradigm that has prevailed in American business for the past several decades, which has enshrined the primacy of maximising the interests of a corporation's shareholders.

In signing the statement, the heads of nearly 200 of America's largest businesses committed themselves to investing in employees, dealing fairly and ethically with suppliers, supporting the communities in which they work, delivering value to customers and generating long-term value for shareholders.

It is important to note, however, that the statement is largely aspirational in nature, and does not modify the current law regarding the rights and responsibilities of directors and corporations. Before making decisions in furtherance of the principles espoused in the statement, directors should carefully consider the relevant corporate law applicable to their company.

Over time, it remains to be seen whether the statement will have any effect on the actions of corporate boards and the duties that directors owe to their corporations.

The *Statement on the Purpose of a Corporation* is available here.

Shearman Releases 17th Annual Corporate Governance & Executive Compensation Survey

On 11 September 2019, Shearman & Sterling released its 17th annual *Corporate Governance & Executive Compensation Survey*, which features a special focus on environmental, social and governance (**ESG**) issues.

The survey provides insights on issues including human capital management, gender pay disparity, board diversity and corporate culture. Other topics covered in the survey include proxy access, shareholder activism, shareholder proposals, governance practices of newly public companies, CEO pay ratio and cybersecurity. Additionally, the survey reviews key governance characteristics of the 100 largest public companies listed on the NYSE or Nasdaq.

The survey is a useful resource to help companies consider the leading governance issues and develop their approach and framework to the ESG issues that are relevant to them. While this publication focuses on developments and best practices for U.S. domestic companies, it may also be of interest to foreign issuers.

View the *Corporate Governance & Executive Compensation Survey* here.

SEC Proposes to Update Industry-Specific Disclosure Requirements for Banks

On 17 September 2019, the SEC issued a rulemaking proposal aimed at updating existing rules requiring banks to provide certain statistical disclosures in their periodic reports and registration statements filed with the SEC. The proposed amendments largely seek to rationalise the existing rules by updating and codifying certain existing disclosures contained in Industry Guide 3, Statistical Disclosure by Bank Holding Companies (**Guide 3**) and by eliminating disclosures that overlap with other SEC rules, U.S. GAAP or IFRS.

The new rules, if adopted, would replace Guide 3 with updated industry-specific disclosure requirements for banks contained in a new subpart of Regulation S-K. Guide 3 has not been substantively updated in over 30 years.

The SEC's proposed rules would apply to bank holding companies, banks, savings and loan holding companies and savings and loan associations, and would require disclosure about the following:

- distribution of assets, liabilities and stockholders' equity, the related interest income and expense, and interest rates and interest differential;
- weighted average yield of investments in debt securities by maturity;
- maturity analysis of the loan portfolio, including the amounts that have predetermined interest rates and floating or adjustable interest rates;
- an allocation of the allowance for credit losses and certain credit ratios; and
- information about bank deposits including amounts that are uninsured.

While, for the most part, the proposed rule streamlines existing disclosure requirements and does not add any new substantive disclosures, it would add the following credit ratios, which are already disclosed by many banks in their regulatory reporting:

- allowance for credit losses to total loans;
- nonaccrual loans to total loans;
- allowance for credit losses to nonaccrual loans; and
- net charge-offs to average loans (disclosed by loan category as presented in the financial statements).

The proposed rule would allow banks to omit any of these credit ratios that is unknown and not reasonably available.

The proposed rule would apply to foreign issuers, but provides certain accommodations recognising the differences between IFRS and U.S. GAAP—for example, by requiring disclosure by categories or classes of financial instruments aligned with how such categories are presented under IFRS in the company's financial statements and by exempting certain disclosures that are not applicable under IFRS.

The deadline for submitting comments on the proposed rule is 60 days after its publication in the Federal Register.

The proposed rule release is available here.

SEC Proposes to Modernise Risk Factor, Business Description and Legal Proceedings Disclosure Rules

On 8 August 2019, the SEC proposed amendments to modernise its existing requirements for how companies disclose risk factors and describe their business and developments in their business and legal (including environmental) proceedings in their periodic reports and registration statements filed with the SEC. The rule proposal would update Regulation S-K, which contains the line-item requirements for non-financial statement disclosures in SEC filings. The proposal is the latest in a series of SEC rulemakings aimed at modernising the disclosure regime for public companies through following a more principles-based, as opposed to prescriptive, approach to disclosure and through formally adopting best practices and existing SEC interpretative guidance.

Only the proposed changes to risk factor disclosure requirements would affect foreign companies. Notably, the proposed rule would align U.S. risk factor disclosures more closely with the recent changes in Europe under the new EU Prospectus Regulation (Regulation (EU) 2017/1129) that took effect in July 2019. In an attempt to balance the protection risk factor disclosure provides against litigation with the aim of encouraging better disclosure—that is, disclosure that is clearer, better organised and that makes it easier for investors to understand a company's risk profile—the proposed amendments would require companies to:

- *Include a risk factor summary if the risk factors section exceeds 15 pages*—The summary, which would be located in the forepart of the document, would consist of a series of short, concise, bulleted or numbered statements summarising the principal factors that make an investment in the company or offering speculative or risky.

- *Disclose "material" risks*—The current rule and SEC guidance requires companies to disclose in the risk factors section the "most significant" risks relating to an investment in the company's securities. The rule proposal would amend this to instead refer to "material" risks, with the aim of encouraging companies to focus on risks to which reasonable investors would attach importance in making investment decisions.
- *Organise risk factors under relevant headings*—The proposed rule would codify a best practice already followed by many companies by requiring similar risk factors to be grouped together under relevant headings in an effort to help readers better comprehend lengthy risk factor disclosures. To the extent a company chooses to include generic risk factors that are not specifically tailored to the company's risk profile, these would need to be grouped together at the end of the risk factors section under the heading "General Risk Factors."

The proposed rule would amend the risk factor disclosure requirements for registration statements on Forms F-1, F-3 and F-4 (the forms used by foreign private issuers to make offerings of securities). While the SEC is not proposing to change Form 20-F (the form used by foreign private issuers to file annual reports), the SEC is soliciting comments on whether the Form 20-F rules should be similarly amended. Changes to the SEC disclosure standards applicable to foreign private issuers may also, by analogy, affect disclosure practice in exempt offerings under Securities Act Rule 144A.

The deadline for submitting comments on the Proposed Rule is 22 October 2019. The SEC will consider the comments received from the public on the proposed amendments, and any changes will take effect only once the SEC publishes a final rule release.

View the SEC's proposed rule here.

SEC Guidance on LIBOR Transition

On 12 July 2019, the SEC's staff issued a statement regarding the anticipated transition away from LIBOR as a benchmark interest rate in 2021. The statement encourages market participants to begin the process of identifying existing contracts that extend past 2021 to determine any material risks posed by the expected transition away from LIBOR.

The SEC's Division of Corporation Finance emphasised that companies should consider their disclosure obligations relating to risks facing the company arising from the expected discontinuation of LIBOR. Specifically, the company's risk factors (Item 3.D of Form 20-F), operating and financial review and prospects (Item 5 of Form 20-F) and financial statements may require LIBOR related disclosure.

In deciding which disclosures are relevant and appropriate, the staff provided the following guidance:

- The evaluation and mitigation of risks related to the expected discontinuation of LIBOR may span several reporting periods. Companies should consider disclosing the status of efforts to date and the significant matters yet to be addressed.
- When a company has identified a material exposure to LIBOR but does not yet know or cannot yet reasonably estimate the expected impact, it should consider disclosing that fact.
- Disclosures that allow investors to see LIBOR related issues through the eyes of management are likely to be the most useful for investors. This may entail sharing information used by management and the board in assessing and monitoring how transitioning from LIBOR to an alternative reference rate may affect the

company. This could include qualitative disclosures and, when material, quantitative disclosures, such as the notional value of contracts referencing LIBOR and extending past 2021.

The SEC's public statement is available here.

SEC Staff Issues Guidance on Inline XBRL

On 20 August 2019, the SEC's Division of Corporation Finance staff published nine compliance and disclosure interpretations (**C&DIs**) regarding the inline XBRL rules adopted in June 2018 and March 2019. The C&DIs provide clarifications on how companies should list exhibits in SEC filings and the impact of voluntarily filing documents that contain inline XBRL, as well as transition issues for foreign private issuers. Presently, only large accelerated filers are subject to the inline XBRL rules.

Exhibits/Exhibit Index

Interactive data files should be identified as Exhibit 101 in the exhibit index. Further, the cover page interactive data file must be identified as Exhibit 104 in the exhibit index. The exhibit index must include the word "inline" in the title description for each inline XBRL exhibit.

Company Name Cover Page Discrepancies

Where a company's name on the cover page of a form differs from its conformed name in EDGAR, the SEC clarified that the inline XBRL tagged company name shown on the cover page may vary from the EDGAR conformed name in several ways. While such variations will usually not prevent the filing from being accepted, certain variations may result in a notice of suspension. The EDGAR Filer Technical Support should be contacted in such instances.

Foreign Private Issuers Phase-In

Foreign private issuers will be required to comply with the inline XBRL requirements based on their filer status and basis of accounting:

- *Foreign private issuers using U.S. GAAP*—The phase-in of the inline XBRL requirements is determined based on filer status:
  - Large accelerated filers are required to comply with inline XBRL for financial statements for fiscal periods ending on or after 15 June 2019.
  - Accelerated filers will be required to comply with the inline XBRL requirements for financial statements for fiscal periods ending on or after 15 June 2020.
- All other filers, including foreign private issuers that prepare their financial statements in accordance with IFRS will be required to comply with inline XBRL for financial statements for fiscal periods ending on or after 15 June 2021.

View the Interactive Data C&DIs here.

SEC Announces Filing Fees for Fiscal Year 2020

On 23 August 2019, the SEC announced that in fiscal year 2020 the fees that public companies and other issuers pay to register their securities with the SEC will be set at $129.80 per million dollars.

Effective 1 October 2020, the Section 6(b) fee rate applicable to the registration of securities, the Section 13(e) fee rate applicable to the repurchase of securities and the Section 14(g) rates applicable to proxy solicitations and statements in corporate control transactions increased approximately 7.1 per cent from $121.20 per million dollars to $129.80 million dollars.

SEC Staff Updates Financial Reporting Manual

The SEC's Division of Corporation Finance has published an update to its Financial Reporting Manual. The revisions include:

- removing guidance regarding the impact of adopting new accounting standards on the presentation of selected financial data;
- clarifying the application of Regulation S-X Rule 3-13, including (1) the use of the Rule 3-13 waiver process for requests to omit financial statements and (2) that the staff may require other financial statements of any entity whose financial statements are either required or otherwise necessary for the protection of investors;
- updating references to conform to the updated revenue threshold for an EGC of total annual gross revenues of less than $1.07 billion during its most recently completed fiscal year; and
- making additional technical amendments to consolidate certain information and update certain codification references.

View the Division of Corporation Finance's Financial Reporting Manual here.

Noteworthy US Securities Litigation and Enforcement

Northern District of California Dismisses Putative Class Action Against Digital Payments Company for Failure to Allege Scienter

On 18 September 2019, a federal district judge in California dismissed a putative class action against a digital payment services company and certain of its officers asserting claims under Section 10(b) of the Securities Exchange Act (**Exchange Act**). The plaintiffs in *Sgarlata v. PayPal Holdings, Inc.* had alleged that the company made misrepresentations in a series of press releases regarding a data breach. The court held that plaintiffs' allegations were insufficient to raise a strong inference of scienter.

Specifically, the plaintiffs claimed that the company failed to fully disclose the seriousness of a security breach related to a subsidiary, and that the corporate defendants were aware of a breach that exposed the personal information of customers, bill-pay clients and employees. While the company initially issued a statement that it had suspended services at the subsidiary upon finding "security vulnerabilities," it disclosed weeks later that 1.6 million users' confidential information potentially had been compromised.

In a prior decision, the court had determined that the plaintiffs had adequately alleged falsity, as the initial announcement "could plausibly have created an impression that only a potential vulnerability and not an actual breach had been discovered, and certainly not one which threatened the privacy of 1.6 million users." The court rejected the defendants' request to reconsider that prior ruling. While the defendants argued that it was not enough for allegations to be "plausib[le]" based on the heightened pleading standard of the Private Securities Litigation Reform Act, the court held that the complaint satisfied the higher standard as well because it specifically alleged with detail why the initial announcement was misleading—because "current or potential investors understood the security vulnerability to be minor."

However, the court held that the plaintiffs' scienter allegations, which were primarily based on the statements of confidential witnesses, were insufficient. They failed to demonstrate that the person who made the allegedly misleading statement knew it was false. The court also noted that the weakness of the inference of scienter was underscored by the lack of "any obvious incentive to mislead." The plaintiffs did not provide a motive allegation—like the sale of stock during the class period—showing that any individual defendant stood to profit from the alleged misrepresentation.

The court also rejected the plaintiffs' attempt to bolster their scienter allegations by using a cybersecurity expert to opine on "what information was likely available to [the company] regarding the scope of a potential [data] compromise." The court emphasized that, within the Ninth Circuit (which covers Alaska, Arizona, California, Hawaii, Idaho, Montana, Nevada, Oregon and Washington), courts can consider allegations from experts at the motion to dismiss stage of a case only if they "satisfy the same standard applied to confidential informants."

Here, the court found that the security expert was neither familiar with, nor had knowledge of, the specific security architecture of defendants' network. Moreover, unlike in other cases in which courts had considered expert opinions for purposes of assessing scienter allegations, the court noted that here the expert did not speak with any employees or review any documents that in themselves were supportive of an inference of scienter. The court concluded that the plaintiffs' allegations with respect to the expert witness were similar to allegations "made on information and belief without disclosing the actual basis for its findings." Thus, even considered "holistically" with the rest of the scienter allegations in the complaint, the court held that the plaintiffs had failed to adequately plead a strong inference of scienter.

Second Circuit Finds New Private Right of Action Under Investment Company Act of 1940

Rejecting a widely held consensus, on 5 August 2019, the U.S. Court of Appeals for the Second Circuit held that Section 47(b)(2) of the Investment Company Act (**ICA**) creates an implied private right of action for rescission in favour of a party to a contract that allegedly violates the ICA (or whose performance allegedly violates the ICA).

The action, *Oxford University Bank v. Lansuppe Feeder, Inc*., concerned a dispute between the plaintiff, which held the majority of senior notes issued pursuant to an indenture for a special purpose vehicle, and junior noteholders for the same trust. The plaintiff brought an action to direct the trustee to liquidate the trust and distribute its remaining assets pursuant to the indenture's waterfall provision. The junior noteholders moved to intervene and to bring claims for rescission, objecting that the trust had violated the ICA by not preventing the transfer of notes to a purchaser who was not a "Qualified Purchaser" within the meaning of the ICA. The district court rejected the intervenors' claims on the grounds that the ICA did not create a private right of action, and also determined that the claims failed on the merits. The Second Circuit (which covers Connecticut, New York and Vermont) held that the ICA did create a private right of action, but affirmed the grant of summary judgment for the senior noteholders because the junior noteholders' claims failed on the merits.

In holding that the ICA did, in fact, create a private right of action, the Second Circuit determined that the text of the ICA "unambiguously evinces Congressional intent to authorize a private action." In particular, Section 47(b)(1) of the ICA provides that a contract that violates the ICA "is unenforceable by either party," and Section 47(b)(2) then provides, in pertinent part, that "a court may not deny rescission [of such a contract] at the instance of any party." Pointing to that language of Section 47(b)(2), the Second Circuit emphasized that while "Congress did not expressly state that a party to an illegal contract may sue to rescind it," the clause's language "necessarily presupposes that a party may seek rescission in court by filing suit." The Second Circuit also highlighted that Section 47(b)(2) identifies a "class of persons" who benefit from the availability of the right of action, providing further support for the existence of a private right of action.

The Second Circuit rejected the argument that the provision should be interpreted to provide an enforcement right to the SEC alone. The court determined that the reference to rescission sought by "any party" could not reasonably be interpreted to mean that rescission could only be sought by the SEC. Moreover, while the provision of specific enforcement mechanisms could "suggest" that Congress intended to preclude a private right of action, the court held that the text here was clear and unambiguous that a private right to rescission exists. In addition, the Court pointed to a Supreme Court decision, *Transamerica Mortgage Advisors (TAMA) v. Lewis*, which interpreted a similar provision of the Investment Advisors Act to provide a private right of action, and legislative history in the form of a Congressional committee report from the ICA's amendment in 1980 which stated that the committee "wishes to make plain that it expects the courts to imply private rights of action under this legislation."

Despite finding the existence of a private right of action, however, the court affirmed the district court's determination that intervenors failed to state a claim under the ICA. The court emphasized that the indenture was the only contract at issue, and neither its terms nor its performance allegedly violated the ICA (indeed, the Court commented that the indenture's terms specifically prohibit ownership of notes by non-Qualified Purchasers and so were drafted to reflect good faith compliance with the ICA). While noting that the intervenors "may well be correct" that the sale of unregistered notes to non-Qualified Purchasers violated the ICA, this could only provide a basis to rescind the contracts of sale for those purchases—not to rescind or modify the terms of the indenture, as intervenors sought.

The Second Circuit's holding that Section 47(b)(2) creates an implied private right of action for rescission conflicts with the decision of the Third Circuit in *Santomenno ex rel. John Hancock Trust v. John Hancock Life Ins. Co.*, which held that the same provision of the ICA did not permit a private right of action. The Second Circuit found the reasoning of the Third Circuit "unpersuasive," because it "relied on interpretive canons that are intended to help resolve ambiguity" and did not address the language, which the Second Circuit found to be clear and unambiguous. The Second Circuit also rejected the reasoning of various district courts that had declined to find an implied private right of action under Section 47(b)(2) as "effectively read[ing] § 47(b)(2) out of the ICA."

The holding of the Second Circuit is limited to parties to a contract that allegedly violates the ICA; it thus does not address many potential follow-on questions, such as whether that holding might be extended to allow investors to pursue claims with respect to fund-related contracts to which investors are not parties. As the law under Section 47(b) was considered settled for many years, with no prospect for individual, private claims, development of the law in this area will be important to monitor going forward. It also will be important to watch for a case that may present an opportunity for the Supreme Court to resolve the conflict between the Second and Third Circuits, as the *Oxford* case itself is unlikely to present such an opportunity, given the affirmance of summary judgment on alternative grounds.

Facebook Settles with SEC for $100 Million for Allegedly Misleading Consumers on Risks to Data

On 24 July 2019, the SEC announced charges against Facebook, Inc. for making misleading disclosures regarding the risk of misuse of Facebook data. For over two years, the company made public disclosures in which it discussed a hypothetical risk to user data, the SEC claimed, even while the company was aware that the risk was not just hypothetical. A third-party developer had already misused Facebook user data.

In the same announcement, the SEC announced that Facebook had agreed to settle the charges and pay a fine of $100 million. The company also is permanently enjoined from violating certain provisions of the Exchange Act and the Securities Act. The company did not admit or deny the charges.

SEC Announces Significant Shift in Considering Requests to Waive Collateral Consequences in Connection with Settlement Offers

On 3 July 2019, SEC Chairman Jay Clayton issued a Statement Regarding Offers of Settlement to announce a significant shift in the SEC's process of considering requests to waive collateral consequences in connection with settlement offers.

By way of background, successful enforcement actions brought by the SEC can automatically trigger significant collateral consequences for the settling entity, often extending far beyond the scope of any sanctions imposed in the enforcement action itself. These collateral consequences can include: (1) loss of well-known seasoned issuer status for the purposes of securities offerings; (2) disqualification under Section 9(a) of the Investment Company Act of 1940, which bars the affected entity and its affiliates from serving as an investment adviser, depositor or principal underwriter of certain registered investment companies; (3) loss of statutory safe harbors under the Securities Act and the Exchange Act for forward-looking statements; (4) loss of private offering exemptions provided by Regulations A and D under the Securities Act; (5) loss of the exemption from registration under the Securities Act for securities issued by certain small business investment companies and business development companies provided by Regulation E; and (6) the prohibition on a registered investment adviser from receiving cash fees for solicitation under Rule 206(4)-3 of the Investment Advisers Act of 1940.

While otherwise automatic, the SEC has the ability to waive these collateral consequences when requested if it is "necessary or appropriate in the public interest, and is consistent with the protection of investors." But historically, firms had to negotiate and apply for these waivers independent of any negotiations regarding the underlying enforcement action that triggered the disqualifications. That created significant uncertainty for firms, making it difficult, in many instances, to assess whether or not it made sense to settle a threatened enforcement action.

In his recent public statement, Chairman Clayton stated that he recognized "that a segregated process for considering contemporaneous settlement offers and waiver requests may not produce the best outcome for investors in all circumstances," and thus announced, "that a settling entity can request that the Commission consider an offer of settlement that simultaneously addresses both the underlying enforcement action and any related collateral disqualifications."

This significant announcement came nearly a month to the day after Representative Maxine Waters, Chair of the U.S. House of Representatives Committee on Financial Services, distributed a discussion draft of a bill entitled the Bad Actor Disqualification Act of 2019. Rather than streamline the waiver process, as Chairman Clayton has now done, the draft bill proposes to create new procedures for the SEC to follow in connection with its consideration of waivers to automatic disqualifications under federal securities laws. Indeed, it would create numerous additional steps, including a notice and comment process that would potentially take certain waiver decisions outside of the hands of decision-makers at the SEC. While only a discussion draft, which faces numerous hurdles before it could become law, the passage of such a bill would impose significant challenges on the ability for companies—and financial institutions, in particular—to settle actions with the SEC, given the uncertainty it would inject into the waiver process.

For now, in light of Chairman Clayton's announcement, companies may be pleased that the SEC is moving toward a more predictable process. But companies would still do well to pay close attention to this space, as momentum in Washington, D.C. could quickly swing in a different direction.

SEC Awards $3 Million to Two Whistleblowers Who First Made Internal Reports, Even Though Reporting to SEC Was Not "Voluntary"

On 3 June 2019, the SEC announced a joint award of $3 million to two whistleblowers who the SEC stated provided information that led to a successful enforcement action aimed at protecting retail investors. According to the SEC, both whistleblowers reported the alleged violations internally before reporting to the SEC. Interestingly, the SEC found that neither whistleblower was legally entitled to the award because their submissions were not "voluntary," but the SEC relied on its discretion to issue the joint award in an apparently conscious effort to further incentivise whistleblowing.

Under Section 21F(b)(1) of the Exchange Act, whistleblowers are not eligible for awards unless they "voluntarily" make their submissions to the SEC. For a submission to be voluntary, it must be made before any request or inquiry related to the subject matter of the submission is issued by the SEC or another government or regulatory authority. According to the SEC, before the whistleblowers reported their tip, a query letter had been sent to their employer by a different government agency. Due to the nature of their employment, both whistleblowers were required to respond to such a query letter. As a result, the SEC found that the whistleblowers technically did not voluntarily submit their information to the SEC.

Nevertheless, the SEC determined that it was "appropriate in the public interest and consistent with the protection of investors" to waive the voluntariness requirement and issue an award to the two whistleblowers. In support, it noted that the claimants were not made aware of the query letter, nor did they learn of the investigation by the other agency, until months after reporting to the SEC. Also significant was the fact that the SEC concluded that the whistleblowers' candid internal reporting was, in part, what caused the other agency to begin its investigation in the first place.

This award highlights not only the SEC's willingness to waive certain requirements for whistleblower awards, but also gives insight into the factors that cause the SEC to favour granting whistleblower awards. Specifically, the SEC noted that it viewed the following favourably: the whistleblowers reported the alleged violation through their company's internal system repeatedly and with "great tenacity," they experienced hardships as a result of their reporting, they advocated internally for public disclosure of the alleged violations and took steps to remediate the effect of the violations, and they actively assisted the SEC's investigation by meeting with staff in-person and identifying potential witnesses. The SEC also noted that it was particularly interested in deterring violations of the sort the whistleblowers reported because the violations posed harm primarily to retail investors.

ITALIAN DEVELOPMENTS

CONSOB Amends Regulation on Issuers to Implement Provisions Relating to the Prospectus to be Published for IPOs, Rights Offerings or Other Capital Markets Transactions

On 10 July 2019, the consultation process to implement provisions of the new EU Prospectus Regulation ended.

The amendments define a new regulatory regime compliant with the Prospectus Regulation's provisions relating to, among other things, (i) the process for approval and publication of prospectuses and (ii) the content of the exemption document to be published in the context of significant acquisitions, mergers or demergers involving a listed company, takeover bids or exchange tender offerings.

In particular, certain provisions relating to the filing with the Italian securities and exchange commission (*Commissione Nazionale per le Società e la Borsa*, **CONSOB**), the approval and publication of prospectuses have been repealed or amended due to fact the Prospectus Regulation became directly applicable on 21 July 2019.

In addition, CONSOB implemented the Prospectus Regulation with respect to the exemptions from the obligation to publish a prospectus.

CONSOB Amends Markets Regulation

With resolution No. 21028, dated 3 September 2019, CONSOB amended its market regulation No. 20249, dated 28 December 2017 (the **Markets Regulation**). The amendments related to, among other things, (i) the amount of shareholding that entities such as Borsa Italiana that manage markets in Italy can hold and the relevant disclosure and (ii) the term for newly listed companies, and/or companies that become, subject to direction and coordination pursuant to Italian law to comply to disclosure and other obligations set forth by the applicable law and regulations.

Borsa Italiana Amends Rules of the Market and the Related Instructions

Borsa Italiana S.p.A., the managing company of the Italian stock exchange (**Borsa Italiana**), amended its Rules of the Market and the related Instructions (resolution No. 21018 of 31 July 2019, amendments entering into force on all the markets on 23 September 2019–except for the IDEM market, for which the amendments will enter into force following the publication of a separate notice).

Borsa Italiana introduced a new method of direct access to the market to allow market intermediaries to authorize their customers to submit orders to the market electronically without using the technological infrastructure of the market intermediary (sponsored access).

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