SHEARMAN & STERLING

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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 April 2019.

Financial regulatory developments are available here.

IN THIS ISSUE

US DEVELOPMENTS

SEC and NYSE/Nasdaq Developments

SEC Proposes Improvements to Disclosure Rules Relating to Acquisitions and Dispositions of Businesses

On May 3, 2019, the Securities and Exchange Commission (SEC) proposed for public comment amendments to its rules related to the financial statements required to be disclosed by SEC reporting companies or in initial public offerings in connection with an acquisition or disposal of a business. These proposed rule changes are intended to improve the information that investors receive regarding the acquisition and disposition of businesses, to facilitate more timely access to capital and to reduce complexity and compliance costs.

The proposal would principally amend the following rules of Regulation S-X:

- Rule 3-05, which requires financial statements of businesses acquired or to be acquired by the company for varying periods, depending on the significance of the business.
- Article 11, which sets out the requirements for pro forma financial information relating to significant acquisitions and dispositions.

The proposed amendments would not apply to financial statements related to the acquisition of a business that is the subject of a proxy statement or registration statement on Form S-4 or Form F-4.

Comments on the proposed rule were due by July 29, 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.

For more information, the SEC's press release is available here.

Our related client publication is available here.

SEC Seeks Public Comment on Ways to Harmonize Private Securities Offering Exemptions

On June 18, the SEC issued a concept release requesting input from investors, entrepreneurs and others on how to simplify, harmonize and improve the current framework of exemptions for private placements from the registration requirements of the Securities Act of 1933 (Securities Act).

The private placement exemptions are intended to balance the goal of expanding investment opportunities with maintaining investor protections and promoting capital formation. With this in mind, the concept release specifically requests input from start-ups and investors pertaining to whether changes should be made to reduce overlap or gaps in the existing framework, and whether the SEC should change the framework to enhance the consistency, accessibility and effectiveness of the exemptions.

Specifically, the concept release invites comments on, among other things, whether:

- limitations on who is permitted to invest in certain exempt offerings and the amount they can invest are appropriate under the current framework, or whether these limitations pose an undue obstacle to capital raising or investor access to investment opportunities;
- the SEC should create rules to facilitate a company's ability to transition from one type of offering to another, or from an unregistered to a registered offering;
- the SEC should expand companies' access to pooled investment funds for capital raising;

- retail investors should be allowed greater exposure to growth-stage companies through pooled investment funds; and
- amendments should be made to the exemptions governing the secondary trading of securities initially issued in exempt offerings.

The concept release also contains relevant findings from a staff report analyzing the impact of Regulation Crowdfunding on capital formation and investor protection.

Comments on the concept release are due by September 24, 2019.

The SEC press release and concept release are available here.

SEC Proposes Amendments to Accelerated / Large Accelerated Filer Definitions

On May 9, 2019, the SEC proposed amendments to the definitions for "accelerated filer" and "large accelerated filer." The proposal seeks to realign those categories in order to lower compliance costs for specific companies with lower revenues while maintaining investor protections. In particular, under the proposed amendments, companies with annual revenues below $100 million would no longer be subject to the requirement to obtain an auditor's attestation of management's assessment of the effectiveness of internal control over financing reporting (ICFR).

The proposed rule release is available here.

New SEC Mining Disclosure Rules: Companies May Voluntarily Comply Prior to 2021

In October 2018, the SEC adopted a new framework for reporting reserves and other disclosures by mining companies, which are codified in Subpart 1300 of Regulation S-K. The new rules take effect beginning with a company's first fiscal year beginning on January 1, 2021 or later. The SEC had previously stated that companies could elect to voluntarily early adopt compliance with the new rules, subject to the SEC completing the necessary tweaks to EDGAR to accommodate the new disclosures, and so long as the company complies with all of Subpart 1300's requirements.

On May 7, 2019, the SEC issued a statement clarifying that, even though the changes to the EDGAR system are still ongoing, companies may immediately elect to comply with the new mining disclosure requirements during the transition period. Any technical report summary required should be filed as an additional exhibit under Item 601(b)(99) of Regulation S-K or Exhibit No. 15 of Form 20-F. Any maps, diagrams or other graphic material included in the technical report summary must meet EDGAR's technical specification requirements.

Our client publication on the new mining disclosure rules is available here.

The SEC press release regarding voluntary compliance with Subpart 1300 of Regulation S-K during the transition period can be found here.

New Streamlined Procedure for Confidential Treatment Extensions

On April 16, 2019, the SEC announced that companies that have previously obtained a confidential treatment order for a material contract will need to continue to file extension applications under Rules 406 or 24b-2 to maintain protections for confidential information from public release. The streamlined process adopted earlier this year allowing companies to redact confidential information from exhibit filings (our related client publication is available here) does not apply to such extensions. The SEC has developed a short-form application to help streamline applications for extension of confidential treatment.

For further details, see the SEC announcement here.

Shearman Publishes Recent Trends and Patterns in the Enforcement of the FCPA

On July 10, 2018, Shearman & Sterling published its bi-annual *FCPA Digest: Recent Trends and Patterns in the Enforcement of the Foreign Corrupt Practices Act* (FCPA Enforcement Report), which provides insightful analysis of recent enforcement trends and patterns in the United States, the U.K. and elsewhere, as well as helpful guidance on emerging best practices in Foreign Corrupt Practices Act (FCPA) and global anti-corruption compliance programs.

Although the Department of Justice (DOJ) and SEC brought a relatively low number of FCPA enforcement actions in the first half of 2019, an unusually large portion of those enforcement actions resulted in penalties over $100 million. In the past, we have repeatedly noted that although the large FCPA enforcement actions grab the headlines, the bulk of enforcement actions are actually relatively small (often under $30 million in penalties). The first half of 2019 has been an exception, resulting in some of the highest penalty statistics of any half-year of FCPA enforcement.

As we explain in this mid-year Trends & Patterns, among the highlights from the first half of 2019 were:

- Six corporate enforcement actions, with total sanctions of approximately $1.69 billion, make the first half of 2019 a fairly typical year in terms of number of enforcement actions, but significantly above-average in terms of total assessed sanctions;
- One of the longest-running and most expensive FCPA investigations finally came to a close when Walmart agreed to pay nearly $300 million to settle charges that it violated the FCPA, this after spending over $900 million on the multi-year investigation;
- As in recent years, one outlier enforcement action (MTS) and three other large enforcement actions distort the picture, raising the average corporate sanction thus far in 2019 to $282.1 million, whereas the true average, with the MTS outlier excluded, is significantly less than this figure ($168.5 million). Even the average excluding the outlier, however, is unusually high, and is indicative of the lack of small enforcement actions thus far in 2019;
- The DOJ brought charges against (or charges were unsealed against) 20 individuals, while the SEC brought claims against two individuals, making the first half of 2019 very active in terms of FCPA-related cases brought against individuals; and
- The DOJ continued its recent practice of providing guidance to companies by revising its FCPA Corporate Enforcement Policy and providing guidance on the evaluation of compliance programs.

The FCPA Enforcement Report is available here.

Noteworthy US Securities Litigation and Enforcement

DOJ Criminal Division Provides Updated Guidance for Corporate Compliance Programs

On April 30, 2019, the DOJ released an update of its guidance on "Evaluation of Corporate Compliance Programs" (Compliance Program Guidance or Guidance). This replaces an earlier version issued by the Fraud Section in February 2017. The newly released version provides more detail for what DOJ prosecutors expect effective corporate compliance programs to entail.

During a speech made on the day the Compliance Program Guidance was released, Assistant Attorney General Brian A. Benczkowski explained that the purpose of the Guidance was to "better harmonize the prior Fraud Section publication with other Department guidance and legal standards." The Guidance centers around three key questions:

- "Is the corporation's compliance program well designed?"
- "Is the program being applied earnestly and in good faith?"
- "Does the corporation's compliance program work in practice?"

For each of these questions, the DOJ outlined key areas of focus for prosecutors and provided general standards and specific factors for consideration. Notably, one of the main topics in the program design section of the Compliance Program Guidance concerns third party management. The section on "Analysis and Remediation of Any Underlying Misconduct" provides a basic outline of measures companies seeking to obtain remediation credit in a settlement agreement should take, including conducting a root cause analysis, identifying control failures, and holding individuals accountable through disciplinary actions and termination.

Prosecutors are still instructed to examine a company's compliance program based on its individual risk profile and unique circumstances, limiting how specific the Compliance Program Guidance can be. Every company will have to make company-specific choices about what is appropriate, and compliance programs will continue to receive the most DOJ scrutiny only in hindsight after a violation has been identified.

The new Compliance Program Guidance does not represent a major substantive shift for the DOJ, but the increased detail is consistent with several other recent efforts by the DOJ to refine its enforcement policies and guidance, including its updates to the Policy on Corporate Monitors in October 2018, and the release of the new Policy on Coordination of Corporate Resolution Penalties in May 2018.

OFAC Releases Guidance on Sanctions Compliance Programs

On May 2, 2019, the Office of Foreign Assets Control (OFAC) issued "A Framework for OFAC Compliance Commitments" which outlines the principles and factors that inform the development of a risk-based sanctions compliance program (SCP). According to OFAC, an appropriate SCP contains at least five essential components: (1) management commitment; (2) risk assessment; (3) internal controls; (4) testing and auditing; and (5) training.

Under OFAC's framework, an adequate SCP will be "favorably" considered in the determination of a civil monetary penalty. Likewise, OFAC may consider the lack of an effective SCP as a factor in determining whether a case is "egregious."

The appendix to the OFAC's framework lists root causes of sanctions violations and includes a non-exhaustive list of deficiencies that OFAC has identified in enforcement actions. A few noteworthy items include the absence of a formal SCP, failure to update sanctions screening software to include additions to the Specially Designated Nationals and Blocked Persons List and the Sectoral Sanctions Identifications List, and decentralized compliance programs.

The publication of the framework reflects OFAC's increasing assertiveness with respect to enforcement. Notably, OFAC's guidance was published only a few days after the DOJ released its update to the "Evaluation of Corporate Compliance Programs," discussed above. When read together, the guidance documents from OFAC and the DOJ send a message that regulators intend to put companies on notice of the importance of training and establishing a "culture of compliance."

Supreme Court Dismisses Emulex Appeal, Prompting Speculation as to Court's View of Private Right of Action under Section 14(e)

On April 23, 2019, in *Emulex Corporation, et al. v. Varjabedian*, the United States Supreme Court dismissed the writ of certiorari as "improvidently granted" in a closely-watched appeal about securities claims alleging a misstatement in connection with a tender offer under Section 14(e) of the Securities Exchange Act. In particular, the case addressed whether an assertion of mere negligence is sufficient to plead and prove a claim under Section 14(e) and—perhaps—whether a private right of action exists under that provision at all.

Most of the oral argument concerned whether a private right of action under Section 14(e) exists, but some justices expressed concern over whether the Court should weigh in on that question because it was not adequately presented below. The dismissal raises the possibility that a majority of the Court may have been inclined to find no private right of action, but felt that the question was not properly before the Court, and did not want to address the required state of mind for a cause of action whose very existence the Court questioned. The result from this unusual step is that, although the Court took the appeal to resolve a significant Circuit split regarding the required mental state under Section 14(e), the split still remains.

Given the Court's apparent interest in addressing whether a private right of action under Section 14(e) exists, it seems the Court may be inclined to take up the issue in a case properly preserving and presenting the question. A number of Circuits—including the First (Maine, Massachusetts, New Hampshire, Puerto Rico and Rhode Island), Fourth (North Carolina, South Carolina, Virginia and West Virginia), Eighth (Arkansas, Iowa, Minnesota, Missouri, Nebraska and South Dakota) and District of Columbia Circuits—have not yet addressed whether there is a private right of action under Section 14(e). The most promising path for a return to the Supreme Court would appear to be a Section 14(e) case brought in one of these circuits, provided that the corporate defendant has the fortitude to fight about this issue through multiple appeals.

Supreme Court Denies Cert Petition in Toshiba, Leaving Circuit Split Regarding Extraterritorial Reach of Section 10(b)

On June 24, 2019, the United States Supreme Court denied a petition for certiorari to review a decision from the United States Court of Appeals for the Ninth Circuit (which covers Alaska, Arizona, California, Hawaii, Idaho, Montana, Nevada, Oregon and Washington) holding that a foreign issuer with no involvement in establishing or selling American Depositary Receipts (ADRs) for its shares can be subject to liability under Section 10(b) of the Exchange Act as long as the plaintiff purchased or sold the ADRs in a domestic transaction. The case is *Toshiba Corp. v. Auto. Indus. Pension Trust Fund, et al*. and, pursuant to its typical practice, the Court did not publicly comment on its reasons for denying the petition.

The petition for certiorari and the underlying decision by the Ninth Circuit were discussed in a previous newsletter, in connection with the Supreme Court's invitation to the Solicitor General to file a brief expressing the views of the United States. The Solicitor General recommended that the Court deny certiorari because, according to the Solicitor General, the Ninth Circuit had correctly found that Toshiba could be subject to liability because the investors' ADR purchases were undisputedly "domestic." The denial of certiorari leaves in place a holding that subjects non-U.S. issuers to potential liability in the Ninth Circuit under Section 10(b) even if they are not involved in establishing the securities at issue, as in the case of unsponsored ADRs, and do not participate in the securities transactions that form the basis of the claim.

In addition, the denial leaves in place an arguable circuit split between the Ninth Circuit and the Second Circuit (which covers Connecticut, New York and Vermont) regarding the extraterritorial reach of Section 10(b). In *Parkcentral Global Hub Ltd. v. Porsche Auto Holdings SE*, the Second Circuit held that a domestic transaction "is not alone sufficient to state a properly domestic claim under [Section 10(b)]." The Court's decision not to grant certiorari at this time allows an opportunity for additional development of the case law on this issue at the Court of Appeals level.

Eastern District of New York Dismisses Putative Class Action Regarding Mutual Fund Disclosure for Failure to Adequately Allege Misstatements and Omissions

On June 25, 2019, a federal judge for the Eastern District of New York dismissed with prejudice a putative securities class action brought by investors in a mutual fund asserting violations of the Securities Act by the fund's registrant, certain executives, investment advisor and underwriter.

In *Emerson v. Mutual Fund Series Trust*, the plaintiffs had alleged that the fund's offering materials misrepresented that the fund was low-risk, when in fact it engaged in speculative investments that exposed the fund to substantial downside risk in rising markets. In particular, the plaintiffs claimed that the fund sold uncovered call options in early 2017 as a directional bet that the S&P 500 would not rise significantly in value. When the S&P 500 rose dramatically during the first half of February 2017, the fund lost a significant portion of its value. *The plaintiffs* further alleged that the fund's strategy had rendered portions of its offering materials materially misleading, including in particular with respect to the fund's "(1) stated objective of capital preservation and portrayal as a low-risk, low-volatility investment with low correlation to equity markets; (2) options strategies and risks; (3) purportedly robust risk management procedures; and (4) past performance." The court concluded with respect to each category of statements, however, that the plaintiffs failed to identify any actionable misstatements or omissions and dismissed the case with prejudice.

First, the court rejected the plaintiffs' argument that the defendants misrepresented the fund's investment strategy—by stating, for example, that its objective was "capital appreciation and capital preservation in all market conditions, with low volatility and low correlation to the U.S. equity market," and that the strategy was "designed to produce returns that are not correlated with equity market returns." The court concluded that these statements "merely articulate[d] the goals of the Fund, rather than promise[d] a particular investment strategy." The court also noted that, although the term "capital preservation" might connote that principal would be protected from loss, when combined with the term "capital appreciation," it reflected "the aspiration of nearly all mutual funds"—to increase returns while avoiding losses. Moreover, the court pointed to risk disclosures regarding "upside risk" (*i.e.*, losses in bull markets) and that the use of options meant there was risk based on the direction of the stock market.

For similar reasons, the court rejected the plaintiffs' argument that the use of uncovered call options rendered inaccurate a statement that the fund "places a strong focus on risk management that is intended to provide consistency of returns and to mitigate the extent of losses." The court concluded that "[n]o reasonable investor would consider an abstract promise to mitigate losses, untethered from any specific form of hedging, material to their investment decision in light of the numerous [risk] disclosures."

The court also rejected the argument that the defendants falsely represented that the fund did not write uncovered call options. While noting that language in the fund's risk disclosures regarding covered call options might imply that the fund did not write uncovered call options, and that this interpretation "may be reasonable in a vacuum," the totality of the disclosures made clear that the fund could, and did, write uncovered call options. In addition to risk disclosures regarding uncovered call options, the court emphasized that the fund made quarterly disclosures reflecting "every single investment in its portfolio" and that "it was plainly apparent from these itemized lists that the Fund's portfolio consisted of a significant number of uncovered call options." The court rejected the plaintiffs' arguments that these quarterly disclosures were outside the total mix of information that would be considered by a reasonable investor, or that the investors could not reasonably understand how to interpret them.

Finally, the court rejected the plaintiffs' argument that the fund's prospectus misrepresented its past performance history by highlighting returns that pre-dated its existence as a mutual fund, from the period when the fund was structured as a hedge fund and had substantially fewer assets under management. The court held that the fund adequately disclosed the material differences between the fund's prior operations and its current structure as a mutual fund, including the different legal requirements. Moreover, while the plaintiffs argued that the prospectus omitted how the mutual fund's larger size limited its ability to execute its strategy, the court held that the plaintiffs' theory went well beyond an omission and would require the fund to criticize its own strategy, which it had no duty to do.

EU DEVELOPMENTS

Accounting Directive: European Parliament Resolution on Proposed Country-By-Country Tax Reporting Directive

On March 27, 2019, the European Parliament resolved to adopt, with amendments, the Commission's proposal for a directive to amend the Accounting Directive (2013/34/EU) as regards disclosure of income tax information by certain undertakings and branches.

The amendments to the Commission's proposal include:

- Clarification that ultimate parent undertakings with a consolidated turnover of at least EUR 750 million (rather than over EUR 750 million) must publish reports.
- All subsidiaries (as opposed to only medium or large subsidiaries) controlled by an ultimate parent undertaking which has on its balance sheet in a financial year a consolidated net turnover of at least EUR 750 million must publish reports.
- The report must be published in a common template in at least one of the official languages of the EU and must be made available free of charge. On the date of publication, the relevant undertaking must also file the report in a public registry managed by the Commission.
- Additional information to be contained in the report, including:
  - the name of the undertaking and a list of its subsidiaries (where applicable) and a brief description of the nature of their activities and their respective geographical location;
  - fixed assets other than cash or cash equivalents;
  - a distinction between the net turnover made with related parties and that made with unrelated parties;
  - stated capital;
  - details of subsidies received and donations made; and
  - whether undertakings, subsidiaries or branches benefit from preferential tax treatment, from a patent box or from equivalent regimes.
- The information must be presented separately for each tax jurisdiction.
- Member States may approve the temporary omission of specific items of commercially sensitive information from the report. Such omissions must be indicated in the report and explained and must receive prior authorization from the national competent authority.

The European Parliament's resolution and adopted text are available here.

The Commission's proposal is available here.

ESMA Publishes Updated Q&A on the Market Abuse Regulation and the Alternative Investment Fund Manager Directive

On March 29, 2019, ESMA updated its Q&A documents in relation to the implementation of the Market Abuse Regulation (MAR) and the Alternative Investment Fund Manager Directive (AIFMD).

The updated MAR Q&A clarifies the scope of firms subject to MAR provisions to detect and report suspicious orders and transactions and provide new detailed answers on:

- the meaning of parents and related undertaking; and
- disclosure of inside information concerning emission allowances.

The updated AIFMD Q&A has two new Q&As on calculation of leverage under the Directive.

The updated MAR Q&A is available here.

The updated AIFMD Q&A is available here.

ESMA Updates the Q&A on Prospectuses

On April 11, 2019, ESMA published an updated version of its Q&A on prospectuses.

Questions 103 and 104 have been modified to remove references to March 29, 2019 as being the date on which the U.K. leaves so that the Q&A will apply if the U.K. leaves the EU without a withdrawal agreement regardless of the actual date.

The updated Q&A is available here.

Market Abuse Regulation and Prospectus Regulation: European Parliament Resolution on SME Growth Market Reform

On April 18, 2019, the European Parliament resolved to adopt, with amendments, the European Commission's proposed Regulation to amend both MAR and the new Prospectus Regulation (PR) in relation to the promotion of the use of SME growth markets, as covered in our Q2 2018 G&SL newsletter on page 4.

The aim of the proposed Regulation is to promote the use of SME growth markets by relaxing the regulatory requirements that apply to it, thereby reducing compliance costs and the administrative burden.

The amendments to the Commission's proposal include:

- To MAR: Clarification that the obligation to establish insider lists rests with both issuers and persons acting on their behalf.
- To MAR: Giving member states the option to require SME growth market issuers to provide more extensive insider lists of all persons with access to information.
- To MAR: Giving issuers two business days from receipt of a PDMR (person discharging managerial responsibilities) notification to make public the information in that notice.
- To PR: The introduction of a requirement to draft a prospectus for a non-listed issuer seeking admission to trading following an exchange offer, merger or division.
- To PR: Extending the simplified prospectus regime to an issuer whose securities have been offered to the public and admitted to trading on an SME growth market continuously for at least two years with full compliance and which seeks admission to a regulated market of securities fungible with previously issued securities.

- To PR: The addition of a new category of entities who may opt to draw up an EU growth prospectus which includes issuers (other than SMEs) offering shares to the public at the same time as seeking the admission of those shares to an SME growth market, provided they have no shares already admitted to trading on an SME growth market and the product of the two stipulated components is less than EUR 200 million.

The European Parliament's resolution and adopted text are available here.

Commission Delegated Regulation to Increase SME Growth Markets Issued in the Official Journal of the EU

On June 21, 2019, the Official Journal published the Commission Delegated Regulation. The new Regulation is intended to work in conjunction with Directive 2014/65/EU of May 15, 2014 on markets in financial instruments (MiFID II) and promote the use of SME growth markets by encouraging diversification of funding sources for SMEs.

The new Regulation will be effective from October 11, 2019.

The full text of the Regulation is available here.

The European Commission Welcomes Adoption of CMU Proposals

On April 18, 2019, the European Commission issued a press release welcoming the European Parliament's final votes on the legislation that puts in place the building blocks of a Capital Markets Union (CMU) and noting that "this adoption of a substantial number of proposals constitutes another step forward in the completion of the CMU, one of the Juncker Commission's top political priorities."

The EU launched its action plan for creating a CMU on September 30, 2015, and published its latest progress report in November 2018, with an update in March 2019.

The CMU aims to boost growth in Europe, promote the EU's global competitiveness and drive investment in the Single Market by providing additional sources of financing for EU companies. Eleven out of 13 proposals have now been adopted and include:

- The adoption of new rules in SME growth markets which will make it cheaper and simpler for SMEs to access public markets, including through a category of trading venues dedicated to small issuers.
- Disclosure requirements on sustainable investments which aim to strengthen and improve the disclosure of "green" information by manufacturers of financial products and financial advisors towards end-investors.
- An investment firms review, introducing revised legislation which aims to ensure more proportionate rules and better supervision for all investment firms on capital, liquidity and other risk management requirements. The revised legislation aims to ensure a level playing field between large and systemic financial institutions.
- The European Supervisory Authorities review, which intends to make the European system of financial supervision more effective and efficient and which will ensure that rules are evenly enforced throughout the EU.
- The Collective Investment Funds proposal which removes regulatory barriers for investment funds and diverges national rules in order to increase competition and facilitate intra-EU distribution of investment funds.

The full press release is available here.

European Parliament Resolution on Commission's Proposal to Amend Directive Regarding Company Conversions, Mergers and Divisions

On April 18, 2019, the European Parliament resolved to adopt, with amendments, the European Commission's proposal for an amending Directive as regards cross-border conversions, mergers and divisions.

The Commission claims that the new rules on cross-border conversions, mergers and divisions of companies will generate savings for companies of between EUR 176 million and EUR 280 million over five years. The Commission's proposal would introduce a new legal institution: cross-border conversion. This would allow companies that wish to move from one Member State to another the possibility of changing their country of incorporation without losing their legal personality or having to re-negotiate their business contracts. The Commission argues that a conversion is a particularly attractive option for small companies that do not have enough financial resources to search for expensive legal advice and conduct a cross-border merger.

Currently, companies wishing to move their registered offices between Member States need to rely on national laws (if they exist). However, the laws are often incompatible and more than half of the Member States do not provide any specific rules allowing for cross-border conversions. Under the process of conversion, a company registered in one Member State could change its legal form in that Member State into a similar legal form of another Member State, without losing its legal personality, and without the need to dissolve or liquidate. The proposal also provides harmonized rules for protection of creditors and shareholders as regards cross-border mergers and divisions.

The amendments to the Commission's proposal include:

- Cross-border conversions: Alterations to the conditions for carrying out a cross-border conversion, such that not all insolvency proceedings will be an automatic bar; changes to the scope of the independent expert's report such that it will focus on the adequacy of the cash consideration offered to members rather than on whether the intended cross-border conversion constitutes an artificial arrangement and will be addressed to the members rather than to the competent authority; amended provisions concerning the protection of members and creditors; additional provisions concerning employee's information and consultation; and the replacement of measures to ensure that the relevant transaction is not an artificial arrangement with measures to prevent cross-border conversions set up for abusive or fraudulent purposes, aiming to evade or circumvent national or EU law, or for criminal purposes.
- Cross-border mergers: Alterations to the conditions and provisions for carrying out cross-border mergers as are made in respect of cross-border conversions, as well as the deletion of proposed provisions relating to accounting date, the addition of provisions relating to the transmission of the pre-merger certificate and the addition of certain provisions relating to registration.
- Cross-border divisions: Alterations to the conditions and provisions for carrying out cross-border divisions as are made in respect of cross-border conversions, as well as the deletion of proposed provisions relating to accounting date.

The European Parliament's resolution and adopted text are available here.

The Commission's proposal is available here.

European Parliament and EU Council Adopt the Commission's Proposal for a New Directive Regarding the Use of Digital Tools and Processes in Company Law

On April 26, 2019, the European Parliament adopted the Commission's proposal for a new directive which aims to facilitate and promote the use of online tools in the contacts between companies and public authorities throughout their lifestyle. The amending Directive was adopted by the EU Council on June 13, 2019.

The amending Directive ensures that:

- companies are able to set up new branches and file documents in the business register fully online;
- limited liability companies are capable of being registered;
- national model templates and information on national requirements are made available online and in a language broadly understood by the majority of cross-border users;
- fees for online formalities are transparent, applied in a non-discriminatory manner and do not exceed the overall costs incurred by the member state concerned;
- companies will only need to submit the same information to public authorities once;
- documents submitted by companies are stored and exchanged by national registers in machine-readable and searchable formats; and
- there are necessary safeguards against fraud and abuse in online procedures in place, including control of the identity and legal capacity of persons setting up the company and the possibility of requiring physical presence before a competent authority.

The Directive notes that there are "significant differences" between Member States when it comes to the availability of online tools enabling entrepreneurs, companies and other entities to communicate with authorities on matters of company law; whilst some Member States provide comprehensive and user-friendly services entirely online, others are unable to provide online solutions at certain major stages of a company's lifecycle at all.

The Directive will be published in the Official Journal and will enter into force on the 20th day following that of its publication. Parts of the Directive will apply two years from the date it comes into force, with the remaining provisions applying four years from the date it comes into force.

The EU Council's press release is available here. The full text of the adopted Directive is available here.

ESMA Publishes Updated Q&A on the Benchmarks Regulation

ESMA announced on May 23, 2019 that it has updated its Q&A on the Benchmarks Regulation. The update to the Benchmarks Regulation Q&A includes new Q&A clarifying: (i) the information included in the ESMA register of administrators of benchmarks; (ii) determination of the Member State of reference; and (iii) the role of IOSCO principles and of external audit in the recognition of third-country administrators.

The ESMA announcement is available here and the updated Q&A is available here.

European Commission Publishes Guidelines on Reporting Climate-Related Information

On June 18, 2019, the European Commission announced that, as part of its Sustainable Finance Action Plan, it has published new guidelines for companies on how to report climate-related information alongside an accompanying summary and FAQ document and three new reports by the Technical Expert Group on Sustainable Finance (TEG):

- a final report on the EU taxonomy, which links to the EU's proposed Regulation on the establishment of a framework to facilitate sustainable investment;
- a final report on the EU Green Bond Standard, which recommends the criteria for issuing a green bond; and
- an interim report on climate benchmarks, which sets out the methodology and minimum technical requirements for indices and disclosure requirements related to environmental, social and governance factors by benchmark providers.

The Commission's guidelines are built on the proposals made by the TEG in January 2019 in its first report on disclosure of climate-related information and the Commission's consultation that was launched in response.

The European Commission's announcement is available here and the new guidelines are available here.

The Sustainable Action Plan is available here.

The Commission's January consultation homepage is available here and the TEG's January 2019 report is available here. The Commission's summary report on the consultation is available here.

ESMA has established a Coordination Network on Sustainability (CNS) to support the Commission's Sustainable Finance Action Plan in the areas of investment services and investment funds and to foster the coordination of national competent authorities' work on sustainability. The CNS will be responsible for the development of policy in this area with a strategic view on issues related to integrating sustainability considerations into financial regulation.

ESMA's announcement is available here.

The International Capital Market Association (ICMA) has since published a paper which summarizes the TEG's report and identifies the key takeaway points for companies. For example, ICMA highlights that the TEG's guidelines on disclosure of environmental and social information aim to reflect the EU's regime on non-financial reporting and encourage companies to make voluntary disclosures in an effective manner.

Full access to ICMA's paper is available here.

The Delegated Regulation, which is substantively the same as ESMA's final draft submitted to the European Commission in September 2018, amends each of the RTSs by extending the exemption period to one unified expiry date of December 21, 2020. The Delegated Regulation entered into force on April 29, 2019 and is directly applicable across the EU.

The Delegated Regulation is available here.

UK DEVELOPMENTS

BEIS Committee Published Report Following Its Inquiry Into the Future of Audit

On April 2, 2019, the BEIS Committee published a report following its inquiry into the future of audit setting out its recommendations for audit reform. We discussed the BEIS Committee's inquiry into the future of audit in our Q4 2018 edition on page 5.

Amongst other things, the BEIS has recommended the following:

- Audit product: The detection of fraud should be a priority within an audit and audits must demonstrate how potential fraud has been investigated.
- Audit product: Auditors should be required to present at the AGM in order to generate shareholder engagement.

- Capital maintenance: The U.K. dividend regime should be tightened, and the Government and the FRC should produce a clear, simple and prudent definition of what counts as realized profits as a matter of urgency.
- Capital maintenance: The Government should adopt a complementary solvency-based system in which directors must state that dividend payments will not make the company insolvent or create cash flow problems.
- Fees: Greater reporting on audit fees should be required, potentially including the disclosure of audit hours, staff mix, and rate per hour.
- Independence: Audit rotations should be reduced to seven-year non-renewable terms that can only be terminated in exceptional circumstances.
- Regulation: Non-financial directors should have greater responsibility for financial reporting.

The report feeds into independent reviews of Sir Donald Brydon into U.K. audit standards (see our Q4 2018 G&SL newsletter, page 7), Sir John Kingman into the FRC (see our Q1 2019 G&SL newsletter, page 13) and the CMA's report into the U.K. audit industry (see our Q4 2018 G&SL newsletter, page 5).

The BEIS Committee report is available here.

On April 18, 2019, the Competition and Markets Authority (CMA) published its final report with recommendations to address competition problems in the U.K. audit industry.

CMA recommends the separation of audit from consulting services, a mandatory "joint audit" to enable firms outside the Big 4 to develop the capacity needed to review the U.K.'s biggest companies, and the introduction of statutory regulatory powers to increase accountability of companies' audit committees.

CMA's final report is available here. A summary of the report is available here.

BEIS Committee Publishes Government Response to Report on Future of Audit

On June 7, BEIS published the Government's response to the Committee's report on the future of audit mentioned above. The Government's response to many of the recommendations is that they are currently, or will shortly be, consulting on the issues raised in the BEIS' future of audit report.

The Government's response also notes that it will consult on the recommendations of the CMA in their report.

The full response is available here. The press release is available here.

The Brydon review consultation is available here.

Takeover Panel Publishes Takeover Code Amendments for Brexit

On April 4, 2019, the Takeover Panel published amendments to the Takeover Code that will take effect on exit day (*i.e.*, currently October 31, 2019).

Once the U.K. leaves the EU the Takeovers Directive will cease to apply in the U.K. The changes are, in the main, minor and technical in nature and are being made to ensure that the U.K.'s domestic takeover regime continues to operate effectively once the Takeovers Directive no longer applies.

The amendments include:

- removal of all references to the Takeover Directive, EEA companies and EEA supervisory authorities and replacing them (where necessary) with references that will work once the U.K. has left the EU;
- amendments to certain definitions (*e.g.*, regulated market); and

- removal of the shared jurisdiction regime, *i.e.*, the existing Code rules in respect of shared jurisdiction companies which either: (i) have their registered office in another EEA Member State and their securities admitted to trading in the U.K. (but not in the EEA Member State in which it is registered) or (ii) are U.K. registered companies with securities admitting to trading on a regulated market in an EEA Member State (but not in the U.K.), will no longer apply. Instead, the Code will apply to such U.K. registered companies if the Panel considers the company to have its place of central management and control in the U.K., the Channel Islands or the Isle of Man. If the company does not satisfy the residency test, the Code will not apply. If the company satisfies the residency test, the Code will apply in full. An offer for such a company may also be subject to the rules of the supervisory authority in the EEA Member State in which the company's securities are traded. This situation is known as "dual jurisdiction" and the Panel should be consulted at an early stage for guidance on how any conflicts between the relevant rules can be resolved.

Instrument 2019/3 is available here.

PLSA Publishes Response to Stewardship Code Consultation

On April 5, 2019, the Pensions and Lifetime Savings Association (PLSA) published its response to the draft 2019 U.K. Stewardship Code, as covered in our Q1 2019 newsletter on page 20.

The U.K. Stewardship Code was last updated in 2012 and is intended to assist institutional investors in the exercise of their stewardship responsibilities by providing principles which are expected to be followed in order to promote the long term success of companies.

In its response, the PLSA supports the general shift in approach with respect to the new Stewardship Code, particularly:

- the explicit reference to environmental, social and governance factors (ESG);
- the expansion of the Code to cover asset classes beyond equity; and
- the differentiated guidance for different parts of the investment chain (including for service providers).

The response notes that there may be tension between introducing this more stretching standard and the objective of the FRC to encourage more asset owners to become signatories, especially as many asset owners or managers are reluctant to become a signatory to the Code given the resource implications of full compliance. This is despite many non-signatory members of the PLSA being in support of the principles contained within the Code; 71% of respondents to the PLSA's 2019 stewardship survey indicated that they only select managers with a clear commitment to stewardship.

The PLSA suggests that the FRC should therefore consider means of encouraging asset owners to express their support for, and commitment to, the aims of the Stewardship Code, without the resource implications of becoming a signatory. The FRC should also acknowledge that schemes often delegate activity on stewardship issues to their managers.

The PLSA does not support the concept of different codes for different types of signatories, but does endorse a pragmatic approach which recognizes that not all signatories will be able to fulfill the new reporting requirements and commitments of the code, but encourages more signatories to engage with it.

The full response is available here. The consultation ended on March 29, 2019 but can be viewed here.

PLSA Launches ESG and Stewardship Guidance

On June 18, 2019, the PLSA published a new guide to help pension funds comply with the new ESG requirements coming into force from October 1, 2019, and support them in achieving good practice into the future.

The new ESG requirements stem from a new regulation that was initially proposed by the Department for Work and Pensions in September 2018. The regulations implement the Law Commission's proposals to clarify pension scheme trustees' fiduciary duties in statute and will require pension schemes to have a policy on financially material ESG factors including climate change.

The new rules will update the Occupational Pension Scheme (Investment) Regulations 2005 so that pension schemes will need to consider long-term risks and opportunities of ESG factors in their investments. Under the new requirements, if trustees disregard long-term financial risks or opportunities from ESG, climate change and stewardship factors, they will need to justify why this does not harm investment returns or outcomes for their members.

The guide is designed to support trustees of around 30,000 defined benefit and defined contribution pension schemes responsible for managing nearly GBP 2 trillion. The new guide has been developed by a cross-industry task force in response to significant demand from the PLSA membership. It is structured to reflect the typical process that trustees follow to ensure that ESG, climate change and stewardship factors are properly understood, formalized in a relevant policy and, where appropriate, reflected in broader decision-making.

The full guide is available here. The press release is available here.

Shareholder Rights Directive

On May 14, 2019, the Proxy Advisors (Shareholders' Rights) Regulations 2019 were published. The Regulations implement, in part, the Shareholder Rights Directive II (SRD II, which amends the original Shareholder Rights Directive (2007/36/EC) (SRD)) with a view to encouraging long-term shareholder engagement.

Under the Regulations, proxy advisors are required to make certain disclosures concerning the conduct of their business, including the obligation to:

- disclose the code of conduct which they apply, report on its application, explain any departures from the code's recommendations and indicate any alternative measures adopted and, if no code of conduct is applied, they must explain why this is the case;
- disclose certain information on their research capabilities and how they produce their advice and voting recommendations, including the essential features of the models and methodologies applied, as well as their main sources of information; and
- identify and disclose any actual or potential conflicts of interests or business.

These requirements apply to proxy advisors providing services in relation to any company whose registered office is in the U.K., Gibraltar or an EEA state and whose shares are traded on a regulated market in any of those territories, where either the proxy advisor's registered office is in the U.K. or, if its registered office or head office is not in the U.K., Gibraltar or an EEA state, it provides proxy advisor services through an establishment located in the U.K.

The Regulations give the FCA responsibility for enforcing these requirements and the power to sanction breaches through public censure and/or financial penalties.

The Regulations are available here. The explanatory memorandum is available here.

The SRD II is available here. The SRD is available here.

FCA Published Policy Statement on Stewardship Code

On May 31, 2019, the FCA published a policy statement introducing new requirements to improve shareholder engagement and increase transparency around stewardship.

This statement follows the FCA's consultation paper on proposals for how parts of the SRD II will be implemented in the U.K. and the FRC's consultation on the draft 2019 U.K. Stewardship Code. These consultations were covered in the Q1 2019 G&SL newsletter on page 20.

The main changes that the FCA has made in their final rules compared to the proposals put forward in their consultation paper earlier this year relate to the rules on related party transactions (RPTs), and include:

- the materiality threshold for RPTs covered by SRD II will be 5% as opposed to 25%;
- an introduction of provisions designed to lower the cost of meeting the new requirements due to the lower materiality threshold; and
- modification of the requirements as applicable to issuers that are not incorporated in an EU Member State meaning that they will no longer be exempted from the requirements, and such entities will be required to disclose RPTs albeit that they will be permitted to use either the definition of "related party" in IFRS or the definition in the equivalent accounting standards that they use to prepare their consolidated annual financial reports.

The rules have been put in place under the Shareholder Rights Directive (Asset Managers and Insurers) Instrument 2019 (available here) and the Listing and Disclosure Sourcebooks (Shareholder Rights Directive) Instrument 2019 (available here), both of which came into force on June 10, 2019.

The policy statement is available here.

Companies (Directors' Remuneration Policy and Directors' Remuneration Report) Regulations 2019

On May 29, 2019, the Companies (Directors' Remuneration Policy and Directors' Remuneration Report) Regulations 2019 (Remuneration Regulations) were published and on June 10, 2019, they came into force.

The Remuneration Regulations implement, in part, the SRD II. Whilst most of the directors' remuneration reporting requirements inserted by the SRD II already applied in U.K. law pursuant to the Companies Act 2006 (CA 2006) and the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (2008 Regulations), the scope of the requirements is slightly different.

The SRD II applies to companies whose shares carry voting rights and are admitted to trading on a regulated market in the EEA (traded companies), whereas the remuneration reporting requirements in the CA 2006 and the 2008 Regulations applied to "quoted companies" (*i.e.*, companies with an official listing of their equity in the U.K. or another EEA state or traded on NYSE or NASDAQ), which includes traded companies but not those that do not fall within the definition of "quoted companies" (*i.e.*, "unquoted traded companies"). The amendments extend the existing framework for directors' remuneration reporting to include unquoted traded companies. Transitional provisions apply to unquoted traded companies in existence before the Remuneration Regulations came into force. Such companies will be required to bring forward a remuneration policy for a shareholder vote in the financial year 2020.

The CA 2006 is amended to require that the date and details of the results of a shareholder resolution to approve the directors' remuneration policy be made available on the company's website as soon as reasonably applicable and kept available for as long as that information is applicable. The remuneration policy must:

- explain the decision-making process followed for its determination, review and implementation, including measures to avoid or manage conflicts of interest and, where applicable, the role of the remuneration committee or other committees concerned where such information is not found elsewhere in the directors' remuneration report; and

- provide details on vesting periods and any deferral and holding periods.

Further amendments include:

- the directors' remuneration report must be kept available for a period of ten years (and may be longer if it does not contain personal data) from when it is first made available;
- if a shareholder vote on a proposed remuneration policy is lost, the company must bring a new remuneration policy to a shareholder vote at the next accounts meeting or other general meeting; and
- any remuneration or loss of office payments to directors that are not consistent with the approved directors' remuneration policy may only be made if an amendment to the policy authorizing the company to make the payment has been approved by shareholders.

On June 14, 2019, BEIS published an explanatory document setting out how and when companies will be affected by the Remuneration Regulations. The explanatory document provides background on and addresses frequently asked questions on the new reporting requirements introduced by the Regulations, in particular: (i) scope and timing; (ii) new requirements in relation to the directors' remuneration report and directors' remuneration policy; and (iii) procedural changes covering shareholder approval of directors' remuneration payments.

The explanatory document also provides further detail on the implementation of other parts of SRD II, including changes to the FCA Handbook and the Proxy Advisors (Shareholders' Rights) Regulations 2019.

The Remuneration Regulations are available here. The explanatory memorandum is available here. The transposition notes are available here. BEIS' explanatory document is available here.

FCA Publishes New Listing Rule Checklists and Cross-Reference Lists for Prospectus Regulation

On April 26, 2019, the FCA published new cross-reference lists for issuers to show the FCA how they have complied with the applicable disclosure requirements when submitting documents for FCA approval under the Prospectus Regulation together with new Listing Rules checklists.

The Prospectus Regulation came into force on July 20, 2017, but its provisions have come into effect in intermittent stages. The Regulation began to apply in full on July 21, 2019.

The Listing Rules checklists are for issuers to show the FCA how they have complied with the applicable disclosure requirements when submitting documents for FCA approval under the Listing Rules. They are to be used to confirm and explain compliance with the Listing Rules' eligibility requirements for admission of securities to the Official List.

The new cross-reference lists are available here.

The new Listing Rules checklists are available here.

FCA Publishes Policy Statement on Changes to Align the FCA Handbook with the New Prospectus Regulation

On May 31, 2019, the FCA published a policy statement on amendments made to the FCA Handbook so as it aligns with the new Prospectus Regulation. The policy statement sets out the near-final rules and summarizes the feedback that the FCA received to its consultation paper on the proposed amendments that was published in January 2019 (as discussed in our Q1 2019 G&SL newsletter at page 18).

The near-final rules are pending anticipated changes to FSMA 2000 and the relevant EU legislation that is referred to in the rules. The new sourcebook will be named the Prospectus Regulation Rules sourcebook (PRR sourcebook).

The only change to the proposed rules is clarification that the FCA intends to send approved prospectuses to the U.K. National Storage Mechanism after 6 p.m. on the working day after it has approved a prospectus. The clarification is designed to ensure that the FCA does not publish a prospectus before the issuer had disclosed any inside information contained therein and published the prospectus itself.

The policy statement is available here.

LSE Announces Updates to AIM Rule Book to Align with New Prospectus Regulation

On June 20, 2019, the LSE published a Notice announcing updates to the Alternative Investment Market (AIM) rule book that began to apply once the new Prospectus Regulation came into effect on July 21, 2019.

The changes are minor, predominantly updating references to the updated FCA Prospectus Rules. The Notice is available here.

The amendments to the updated AIM rule books can be seen in track changes at the following links:

AIM Rules for Companies is available here.

AIM Note for Investing Companies is available here.

AIM Note for Mining, Oil and Gas Companies is available here.

NEX Exchange Launches Consultation on Growth Market Rules for Issuers

On April 30, 2019, a consultation was launched by the NEX Exchange regarding proposed changes to the Growth Market Rules for Issuers.

NEX Exchange has reviewed and amended the content requirements for the NEX Exchange Admission Document on the basis of the new EU Growth Market Prospectus regime which applies to SME companies, and which were brought about by the implementation of the final provisions of the Prospectus Regulation on July 21, 2019.

The new regime aims to implement a more proportionate EU Growth Prospectus regime with reduced requirements for SMEs and allows SMEs the option of drawing up an EU growth prospectus instead of a full prospectus under the Prospectus Regulation. NEX Exchange has broadly implemented the regime so that the new content requirements adopt “similar standards” to those for EU growth prospectuses as set out in the Annexes to the Prospectus Regulation, with the exception of the requirement for an issuer to state in its prospectus that, in its opinion, the working capital available to the issuer is sufficient for its present requirement (or, if not, how it proposes to provide additional working capital); which NEX has not included.

The consultation closed at the end of May 2019.

The market consultation and the new set of marked-up rules are available here.

The Annexes to the Prospectus Regulation are available here.

United Nations Environment Programme Finance Initiative Publishes New Investor Guidelines on the Impact of Climate Change on Portfolio Management

On May 10, 2019, the United Nations Environment Programme Finance Initiative published advice to investors to help identify the risks of climate change on investor portfolios and to encourage investors to profit from the move towards a more eco-friendly economy.

The report contains tools and methodologies implemented by investors to respond to climate change, as well as scenario-based risk assessments of the threat of climate change on investor portfolios.

A link to the guidance report is available here.

LSE Signs Memorandum of Understanding with Colombo Stock Exchange

On May 13, 2019, the London Stock Exchange (LSE) confirmed that it has signed a memorandum of understanding with the Colombo Stock Exchange (CSE) to facilitate further collaboration between the two groups.

The memorandum will provide a framework for the LSE to:

- support the CSE in its development of the domestic debt market, including the market for offshore Sri Lankan rupee bonds;
- provide technology support in upgrading capital market infrastructure and delivering technology solutions to the CSE;
- provide FTSE Russell guidance in capital market classification and index inclusion; and
- improve links to the international CSDs.

The memorandum follows the successful listing of Sri Lanka's USD 2.4 billion off-shore U.S. dollar bond on LSE's International Securities Market in March 2019.

The press release is available here.

FRC and ICAEW Publish Guide to Help Smaller Listed Companies Improve their Financial Reporting

On May 13, 2019, the FRC announced that it has published a guide jointly with the Institute of Chartered Accountants in England and Wales (ICAEW) to assist audit committees and boards of smaller listed or AIM quoted companies in their financial reporting. The guide addresses issues raised by the FRC about the quality of financial reporting in this sector, and provides practical tips and questions for audit committees to consider, with a view to driving up the quality of smaller quoted company financial reporting.

The guide offers practical tips in the areas of: (i) adequate time and resources available to produce a good quality annual report; (ii) early engagement on the annual report by those charged with governance; (iii) deeper understanding of relevant reporting standards and requirements; and (iv) appropriate rigour by the auditor in the audit of financial statements and review of annual reports. Practical tips include:

- reading the FRC's Annual Review of Corporate Reporting;
- focusing on generic areas of reporting that are a particular focus for investors in smaller quoted companies;
- produce a schedule of meetings as soon as the prior year financial statements have been signed off to ensure that key deadlines are met;
- considering whether the audit committee and board are composed of individuals of experiences of skills, beyond financial expertise, necessary to oversee the production of the annual report and accounts; and

- arranging regular contact with the external auditor throughout the year to ensure issues are dealt with promptly.

The press release is available here. The full guide is available here.

Government Publishes Response to Post-Legislative Report on Bribery Act 2010

On May 13, 2019, the Government published a response to the Scrutiny Report by the House of Lords Select Committee on the Bribery Act 2010, under the headings of: (i) corporate vicarious liability; (ii) facilitation payments; (iii) Brexit; and (iv) corruption issues abroad.

Regarding corporate vicarious viability, the Government noted that the Committee did not make a recommendation for a change in the law regarding a company's vicarious liability for offenses that go beyond the Bribery Act's offenses committed by their employees and agents.

Regarding facilitation payments, the Government noted that they have no plans to change the law in relation to facilitation payments which it considers a form of bribery and, as such, should not be legalized.

Regarding Brexit, the Government noted that in a deal scenario the draft Withdrawal Agreement would provide for an implementation period during which it would be able to use all the EU security tools currently in use. In the event of a "no-deal", the Government noted that non-EU law enforcement mechanisms would mean making more use of Interpol, Council of Europe Conventions and bilateral channels.

Regarding corruption issues abroad, the Government welcomed the recommendation that U.K. companies are provided with support on corruption issues in the countries to which they export.

The response is available here and the full Scrutiny Report is available here.

IA Publishes Report Setting Out Case for Distribution Policies for UK Listed Companies

On May 25, 2019, the Investment Association (IA) published a report regarding shareholder votes on dividend distributions in U.K. listed companies. The report follows on from concerns raised by IA and BEIS that an increasing number of companies are not seeking a shareholder vote on dividend payments.

The Report notes that:

- The vote is an important opportunity to engage shareholders as to distributions and the broader capital allocation framework.
- 22% of FTSE listed companies that pay dividends do not hold annual votes on the payment of the final dividend or are paying only interim dividends.
- A forced yearly vote might have an undesirable effect on both the company and shareholders; instead, the IA recommends that companies set out a "distribution policy."
- The distribution policy should state that the company's approach to making decisions on the amount, structure and timing of returns to shareholders, including dividends, share buy-backs and other capital distributions within the context of financial and legal constraints.
- The IA will establish a working group to develop best practice guidance on the distribution policy, and will seek to make recommendations to the Government as to whether a shareholder vote on this policy and/or their yearly distributions should be made mandatory.
- Avoiding a shareholder vote seems to happen for a variety of "legitimate" reasons, *e.g.*, because certain companies are paying a regular quarterly dividend to shareholders who are more attached to getting that

regular income stream that the possibility of being able to vote against a final dividend that would interrupt their monthly payments as for solvency/capital adequacy regulation or flexibility reasons.

The IA aims to publish its new distribution policy guidance in Autumn 2019.

The full report is available here.

Parliament Presented with the Final Report on the Independent Review of the Modern Slavery Act 2015

On May 22, 2019, Parliament received a final report of the independent review into the Modern Slavery Act 2015 (Act 2015), following the publication of an interim report on January 22, 2019.

The Act 2015 requires large companies in England and Wales to publish annual public statements to identify, amongst other things, policies and procedures which companies have introduced as part of the wider effort to tackle slavery and human trafficking in the workplace.

The final report assessed the effectiveness and implementation of the Act 2015 and outlined a series of recommendations to improve the operation of the Act 2015.

In its findings, the report criticized the non-prescriptive nature of the Act 2015, which currently does not require companies to include specific content and highlighted that many companies which are eligible to produce to the statement (eligibility is largely based on size and annual turnover) are not complying with the legislation.

To address this, the report sets out a list of recommendations which include that the government prepare a list of non-compliant companies and requires companies to publish the steps taken to address modern slavery; "no steps taken" responses should not be accepted as currently stands.

A full list of the government's recommendations, as well as access to the full final report, is available here.

Two New Inside AIM Editions Address the Staffing of Nomads and the AIM Designated Market Route

On May 28, 2019, the LSE published two editions of Inside AIM: Staffing of Nominated Advisers (Nomads) and AIM Designated Market Route.

Staffing of Nomads

On its application to AIM, a company must appoint a Nomad, to guide the company through the admission process and advise the company on the demands of being a public company. In its most recent publication, Inside AIM provides a series of responses to a range of frequently asked questions on the position of Nomads. Topics covered in the edition include:

- the scope of AIM Rule 5 (which sets out the definition of "Relevant Transactions") and the qualification requirements under this rule for Nomad's to be able to advise;
- the position of qualified executives if they change firms and join a firm which is applying to become a Nomad;
- clarification on a Nomad's working obligations, including a discussion on alternative working arrangements;
- compliance obligations of a Nomad; and
- training and experience of a Nomad.

Access to Inside AIM: Staffing of Nominated Advisers is available here.

AIM Designated Market Route

This edition of Inside AIM provides an update on the LSE's developments to the AIM Designation Market Route publication. To improve access to the market for SMEs, the LSE has created a more streamlined admission process for companies which are already trading on specific market platforms for a certain period of time. The AIM Designated Market Route streamlines the AIM admission process by dispensing with the requirement of producing an AIM admission document. It is available specifically to companies that have had their securities traded on an AIM Designated Market for at least 18 months prior to the date of admission to AIM.

An overview of the eligibility requirements for this market route is set out in the Inside AIM article which is available here.

FCA Fines Premium Listed Issuer and Directors for Breaches of Listing Principles and Disclosure Rules and Transparency Rules

On May 25, 2019, the FCA issued a notice fining a Hong Kong-based but U.K.-premium listed company, Cathay International Holdings (CIH) (no relation to Cathay Pacific), and its CEO and FD, for breaches of the Listing Principles, Disclosure Rules and Transparency Rules.

CIH was fined for breaching:

- Listing Principle 1: failing to have in place adequate procedures, systems and controls to enable it to comply with its listing, disclosure (MAR), transparency and corporate governance obligations;
- Premium Listing Principle 6: failing to communicate to its security holders in such a way so as to avoid the creation of a false market in its premium listed shares (as a result of the DTR breach);
- DTR 2.2.1R (as it then was, pre-MAR): failing to announce inside information ASAP; and
- Listing Principle 2: failing to deal with the FCA in an open and co-operative manner; it seems clear that the FCA considered a number of responses to its questions of CIH—especially with regards to the actual forecasts, projections and information it had on hand internally at certain key dates—to have been both inaccurate and misleading.

CIH announced that it disagrees with the FCA's findings and that the breaches it was found to have committed were committed recklessly but that the time, effort and costs involved in appealing the Decision Notices could not be justified.

Key points to note from the FCA's decision notice are:

- a reminder of the FCA's power (under s. 91(2) FSMA) to impose a fine on a director of a listed company who is knowingly concerned in the company's contravention of a "listing" rule;
- one of the most important purposes for which Listing Principle 1 exists is to ensure that an issuer is able to monitor its disclosure (in particular MAR) obligations on an on-going basis and so avoid misleading the market. The FCA ruled that it was the failure to have in place adequate forecasting systems and procedures–to enable CIH to track performance against market expectations as well as forecast trading performance and likely results, especially in the absence of forecasts/results from a major listed subsidiary–that contributed in a major way to a failure to discharge inside information disclosure obligations;
- the need for careful and complete minuting of any board/committee discussions about disclosure issues; and
- the MAR disclosure obligation rests with the issuer and is not discharged by pointing to analyst comment or estimates released at the same time as its results announcement.

The full decision for CIH is available here. The press release is available here.

ICSA Publishes Consultation on Independent Board Evaluation in UK Listed Sector

On May 29, 2019, at the request of BEIS, ICSA published a consultation, the purpose of which is to assess the quality of independent board evaluation in the U.K. listed sector and identify ways in which it might be improved.

The consultation seeks views on the purpose of board evaluation, and, in particular, on whether there is a need for:

- a mandatory or voluntary code of practice for the providers of independent board evaluation services, and formal arrangements for implementing and monitoring such a code;
- voluntary principles to be applied by listed companies when engaging external reviewers to undertake board evaluations; and
- guidance for listed companies on disclosure of the conduct and outcomes of their board evaluation, in accordance with the 2018 U.K. Corporate Governance Code.

The consultation is available here and closed on July 5, 2019.

FCA Publishes Thematic Review of Money Laundering Risks in the Capital Markets

On June 10, 2019, the FCA published their Thematic Review of money laundering risks in the capital markets. The aim of the thematic review was to "carry out a diagnostic piece of work looking at the money-laundering risks and vulnerabilities in the capital markets and, where possible, to develop case studies to help inform the industry." The review was carried out by visiting 19 participants covering different segments in the market, including investment banks, recognized investment exchanges, trade bodies, a custodian bank, clearing and settlement houses, inter-dealer brokers and trading firms.

The FCA's key findings were:

- The money-laundering risks identified were mitigated to an extent by the nature of the firms in the market; most are regulated, institutional firms, and the nature of some of the products and markets may be less attractive to launderers, given barriers to entry, levels of scrutiny or complexity of the product.
- However, there remained some risks particular to the capital markets, and participants needed to be more aware of these. The FCA's review highlights these risks. Many participants said they would find it helpful to have more examples of how money laundering might manifest itself to help inform transaction monitoring and training in particular. To assist with this, the Annex to the review contains a non-exhaustive set of typologies from a variety of intelligence sources which are intended to inform risk assessments, transaction monitoring and training. The Annex also includes questions that firms may want to consider.
- Participants were generally at the early stages of their thinking in relation to money-laundering risk and needed to do more to fully understand their exposure.
- The nature of transactions in this sector means that effective customer risk assessment and customer due diligence are key to reducing the opportunities for money laundering. The review highlights that transactions often involve a large number of firms in a transaction chain, and therefore it is important that each part of the chain meets their obligations.
- Participants' main focus was detecting market abuse, such as insider dealing or market manipulation. However, many participants had not considered that potential market-abuse suspicions could also be indicative of money-laundering suspicions.
- The FCA is considering its supervisory approach, including how it can use MiFID II data to identify and mitigate money laundering risk.

The full review is available here.

HM Treasury Publishes Updated Advisory Note on Money Laundering and Counter-Terrorist Financing

On June 25, 2019, HM Treasury published a note on the risks of ineffective money laundering and terrorist financing controls across a number of jurisdictions. The updated note includes comments from the Financial Action Task Force which that focus on the jurisdictions with unsatisfactory anti-money laundering and counter-terrorist financing regimes and the requirement for enhanced due diligence in higher-risk jurisdictions.

Further information on the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 operative within the U.K. and access to the government's advisory note is available here.

Law Commission Begins Intermediated Securities System Review

On June 11, 2019, the Law Commission has announced that it has begun reviewing the system of intermediated securities in order to identify potential issues for both investors and companies.

The Law Commission notes that shares and bonds are increasingly held through a system of "dematerialization" and "intermediation", such that paper certificates have been replaced by a system in which most investors "own" securities through computerized credit entries held through a chain of intermediaries.

The review is in response to concerns that have been raised about the effect of a system of intermediation on corporate governance and transparency, whilst there is uncertainty over what legal redress is available to investors, if issues with their securities arise.

The project forms part of the Law Commission's 13th Programme of Law Reform published on December 14, 2017.

The press release is available here.

BEIS Committee Publishes Government's Response to Report on Executive Pay Gap

On June 13, 2019, the BEIS Committee published the Response it had received from the Government to the BEIS' March 2019 report examining progress on the Government's attempts to address the gap between the pay of chief executive on the one hand and company performance and employee pay on the other.

In its Response, the Government notes that it has recently overseen the implementation of a package of reforms to strengthen the framework within which companies set executive pay which include the introduction of pay ratio reporting requirements and stronger U.K. Corporate Governance Code provisions requiring remuneration committees to engage with the wider workforce to explain how executive pay fits with wider employee pay. Therefore, the Government cites focusing on the effective implementation, and then assessment, of the most recent reforms before considering significant further changes as its immediate priority.

In particular, the Government rejected the committee's recommendations that:

- employees should sit on company pay committees, as the huge variety of U.K. companies and group structures means that one method will not suit all;
- pay ratio reporting should be expanded to include all employers with over 250 employees, as it wishes to monitor the impact of the new requirement of pay ratio reporting for quoted companies before considering any potential extension; and
- remuneration committees should set, publish and explain an absolute cap on total remuneration for executives in any year, as the Government believes that it is for those committees and shareholders to decide whether executive pay policies should set an absolute cap on total remuneration with the

shareholders having a say through the binding vote on executive pay policies which is required at least every three years.

The BEIS report is available here. The Government's response is available here.

New Anti-Money Laundering Guidance Published by the Law Commission Addresses the SARs Regime

On June 18, 2019, the Law Commission announced its publication of a new report entitled "Anti-money laundering: the SARs regime," following a year-long consultation.

The report addresses the trend in low quality suspicious activity reports (SARs) made each year, despite the high volume of reports which are submitted. The report attributes this to the wide definition of "criminal property" contained in section 340 of the Proceeds of Crime Act 2002, as well as a general inconsistency in the application of the legislation's definitions.

The report recommends that the Government provide statutory guidance on the legislation to assist industry-wide compliance, as well as the creation of an advisory board to oversee the regime and the introduction of a new online form to report suspicious behavior.

Full access to the report is available here.

ITALIAN DEVELOPMENTS

CONSOB to Implement Exemptions from Stakebuilding Disclosure Obligations

In February 2017, the Legislative Decree No. 58/1998 was amended in order to include disclosure rules for corporate takeovers, introducing Art. 120(4-*bis*).

In particular, when a shareholder of a listed company acquires a stake equal to or exceeding certain thresholds (10%, 20%, 25%), it must disclose to the public and to the Italian securities and exchange commission (*Commissione Nazionale per le Società e la Borsa*, CONSOB) its long-term objectives for the following six months from the triggering event (*i.e.* binding agreement or acknowledgement of the transaction that triggers the obligation), unless certain exemptions are available.

On June 27, 2019, CONSOB began the consultation process aimed at determining the exemptions from such disclosure obligations; the provisions relating to the exemptions from the stakebuilding disclosure obligations will be included in the CONSOB Regulation No. 11971 of May 14, 1999, as subsequently amended and supplemented.

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

On June 20, 2019, CONSOB began the consultation process to implement provisions of the Prospectus Regulation.

In particular, CONSOB's consultation is aimed at defining 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.

CONSOB Intervenes on "Safe Harbor" Market Practices

On April 3, 2019, CONSOB discontinued the safe harbor status for two of the three existing market practices in the context of transactions of own shares by a listed company. Such market practices constituted a safe harbor from the prohibition of market manipulation under MAR. The two market practices terminated related to the purchase of own shares for the creation of a “shares’ storage” and the buyback program for bonds. CONSOB also specified such practices can still be carried out provided that they are compliant with MAR.

On April 9, 2019, CONSOB formally asked ESMA to approve the market practice relating to liquidity support, generally carried out by listed companies by means of buyback programs.

Borsa Italiana Amends Rules of the Market and the Related Instructions

Borsa Italiana S.p.A., the managing company of the Italian stock exchange, amended its Rules of the Market and the related instructions (resolution No. 20906 of May 2, 2019, two tranches of amendments entering into force on June 3, 2019 and July 1, 2019).

The first tranche of amendments relates to, among other things, (i) the redetermination of the necessary requirements for the admission to trading of shares on the MIV market for units or shares of alternative investment funds and (ii) certain amendments affecting the professional segment of the MIV market.

The second tranche of amendments relates to the minimum quantity of requests for quotes on the MOT market that can now be entered for quantities at least equal to the minimum size envisaged in the guide to the parameters and in compliance with the minimum increases, where applicable.

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