SHEARMAN & STERLING LLP

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Governance & Securities Law Focus: Latin America Edition

In this newsletter, we provide a snapshot of the principal US, European and selected international governance and securities law developments of interest to Latin American corporations.

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US Developments

SEC and NYSE/Nasdaq Developments

SEC to Permit Confidential Submission of Draft Registration Statements for All IPOs and Spin-Offs, Including by Non-EGCs

On June 29, 2017, the US Securities and Exchange Commission's ("**SEC**") Division of Corporation Finance announced that, beginning on July 10, 2017, it will permit confidential submissions of draft registration statements for all initial public offerings, including by issuers that do not qualify as emerging growth companies ("**EGC**") under the Jumpstart Our Business Startups Act of 2012 (the "**JOBS Act**").

The confidential submission process will be available for all initial draft registration statements and related amendments filed either under the Securities Act of 1933, as amended (the "**Securities Act**"), or in connection with the initial registration of a class of securities pursuant to Section 12(b) of the Securities Exchange Act of 1934, as amended (the "**Exchange Act**"), including in respect of spin-offs.

To take advantage of the confidential submission process in connection with Securities Act registration statements, an issuer must confirm it will publicly file its registration statement, together with any confidential draft submissions, at least 15 days prior to its road show, if any, or otherwise before the requested effective date of the registration statement. Similarly, for Exchange Act registration statements, an issuer must confirm it will publicly file its registration statement, together with any confidential draft submissions, at least 15 days prior to the requested effective date of the registration statement.

Confidential submission will also be available for follow-on registrations within 12 months of the effective date of a Securities Act or Section 12(b) Exchange Act registration statement, provided the issuer confirms it will make available on EDGAR its registration statement and confidential draft submissions at least 48 hours prior to the requested effective time and date of registration. For follow-on registrations, confidential submission will be limited to the initial registration statement submission, and will not extend to any related amendments.

The Division's announcement clarified that foreign private issuers may elect to proceed in accordance with these procedures or those available to EGCs (if applicable). Alternatively, foreign private issuers may elect to continue to follow the guidance permitting foreign private issuers to submit draft registration statements for review on a confidential basis, provided that at the time they publicly file their registration statement, they also (1) publicly file their previously submitted draft registration statements, and (2) resubmit all previously submitted response letters to staff comments as correspondence on EDGAR.

The announcement also indicated that the Division would consider reasonable requests for accelerated registration statement review, and confirmed that it would not delay registration statement review on the basis of omitted financial information if the issuer reasonably believes such financial information will not be required at the time the registration statement is publicly filed.

Furthermore, on July 3, 2017, the SEC released Q&As addressing this new process, which include the following:

- Issuers that are not eligible to rely on Securities Act Section 6(e)(2), which is available to EGCs, should submit their draft registration statement using EDGAR submission type DRS and follow the instructions (which are not limited to EGCs) regarding preparation and submission of draft registration statements in Volume II of the EDGAR Filer Manual.
- An issuer relying on the SEC's policy should consider requesting confidential treatment for its draft registration statement and associated correspondence when seeking a nonpublic review. Issuers requesting confidential treatment under Rule 83 may do so electronically using submission type DRSLTR when they submit their

electronic draft registration statements. If they do so, issuers do not need to send paper copies of the request and the materials to the SEC's Corporate Finance or its Freedom of Information Act Office. Furthermore, issuers should include a legend at the top of each page of the electronically submitted draft registration statement indicating that confidential treatment under Rule 83 has been requested.

- Issuers should submit a cover letter conveying agreement with the public filing guidelines in the SEC's June 29, 2017 announcement.
- The Securities Act registration filing fee for a draft registration statement is due when the registration statement is first filed publicly on EDGAR.
- Responses to SEC staff comments on draft registration statements should identify information for which the issuer intends to seek confidential treatment upon public filing to ensure that the staff does not include that information in its comment letters.
- SEC staff will publicly release on EDGAR its comment letters and issuer responses to staff comment letters related to nonpublic draft submissions no earlier than 20 business days following the effective date of a registration statement. This is consistent with past practice.

Our related client publication is available at:

- http://www.shearman.com/en/newsinsights/publications/2017/06/confidential-submission-of-draft-registration

The SEC's announcement is available at:

- https://www.sec.gov/corpfin/announcement/draft-registration-statement-processing-procedures-expanded

The prior SEC staff guidance of May 30, 2012 is available at:

- https://www.sec.gov/divisions/corpfin/internatl/nonpublicsubmissions.htm

The SEC's FAQs is available at:

- https://www.sec.gov/corpfin/voluntary-submission-draft-registration-statements-faqs

SEC Continues Scrutiny of Non-GAAP Measures

In past quarterly updates of this memorandum, we have discussed the increased scrutiny with which the SEC has been reviewing companies' use of non GAAP financial measures, which are financial measures that do not conform either to US generally accepted accounting principles ("**GAAP**") or international financial reporting standards ("**IFRS**"), as applicable.

Since the SEC's updated its compliance and disclosure interpretations ("**C&DIs**") regarding the use of non-GAAP financial measures in May 2016, it has continued to focus on this topic and has to date publicly released approximately 300 comment letters dealing with misuses of non-GAAP measures. In addition to those areas discussed in past newsletters, recent comment letters have focused on:

- Inadequate presentation of tax effects on non-GAAP measures: the SEC frequently asks issuers to avoid presenting the required reconciliations from GAAP net of tax, asking instead for presentation of the income tax effect as a separate line item, with an explanation of the calculation if necessary.
- Individually tailored accounting principles: while non-GAAP measures by definition are not bound to accounting principles, the SEC has indicated that individually tailored application of accounting principles to non-GAAP measures may be misleading. Examples include only removing portions of depreciation expense, deferring

revenue and costs, adjusting assets for proportionate economic ownership and adjusting weighted average common shares.

- Use of per-share liquidity measures: the use of per-share liquidity measures is generally prohibited, but recent SEC comments indicate they are examining per-share non-GAAP measures to examine if they are in substance per-share liquidity measures, and are used by investors as such, rather than permitted per-share performance measures. Importantly for companies, EBITDA and EBIT are not permitted be presented on a per-share basis.

Our client publication describing trends in the first 150 comment letters is available at:

- http://www.shearman.com/~/media/Files/NewsInsights/Publications/2016/10/Updated-NonGAAP-Guidance-The-First-150-Comment-Letters-CM-101920163.pdf

PCAOB Adopts New Auditor Reporting Standard

On June 1, 2017, the Public Company Accounting Oversight Board ("**PCAOB**") adopted new standard S 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*. This standard generally imports reporting elements that have become standard outside the United States in recent years and is intended to make auditor's reports, which have been substantially the same since the 1940s, more informative and relevant to investors. The new standard requires auditors to disclose in their report:

- Critical audit matters, such as matters communicated or required to be communicated to the audit committee and that (i) relate to accounts or disclosures that are material to the financial statements, and (ii) involved especially challenging, subjective, or complex auditor judgment.
  - For each critical audit matter identified, auditors must describe the primary reasons the auditor believes it to be a critical audit matter, how it was addressed in the audit, and which financial statement accounts or disclosures are relevant to the matter.
- The year in which the auditor began serving consecutively as the company auditor.
- Improved formatting, including moving the opinion paragraph to the lead section, section titles, a statement of independence and the inclusion of shareholders and directors as addressees.

The communication of critical audit matters will apply to all audit reports filed with the SEC, including by foreign private issuers.

The new standard remains subject to SEC approval, and it is anticipated that the full standard will apply to audits of fiscal years ending after June 30, 2019 for large accelerated filers, and after December 15, 2020 for all other companies to which the requirements apply.

PCAOB Standard S 3101 is available at:

- https://pcaobus.org/Rulemaking/Docket034/2017-001-auditors-report-final-rule.pdf

NYSE Proposal to Require Advance Notice of All Dividend and Stock Distribution Announcements

On April 13, 2017, the New York Stock Exchange ("**NYSE**") filed a proposed rule change with the SEC that would amend (i) Section 204.12 of the NYSE's Listed Company Manual ("**Manual**") requiring listed companies to give prompt notice of any action relating to a dividend or stock distribution in respect of a listed stock and (ii) Section 204.21 of the Manual, which requires listed companies to give prompt notice of the fixing of a date for the taking of a record of shareholders, or for the closing of transfer books with respect to a listed security, for any purpose.

Pursuant to the proposed changes, listed companies would be required to provide ten minutes' advance notice to the NYSE before making any public announcement about a dividend or stock distribution, including outside the hours of operation of the NYSE's "immediate release policy," rather than just those made within the hours of operation of the "immediate release policy" as is currently the case. The Manual currently provides that between 7:00 a.m. ET and the time at which the NYSE closes (generally 4:00 p.m. ET), companies are required to call the NYSE's Market Watch team at least ten minutes before such announcement. In addition to this, companies must be prepared to discuss the content of their announcement and email a copy of this announcement to the NYSE.

The NYSE states in its proposal that the proposed rule change is aimed at avoiding confusion in the marketplace where there is contradictory information available from multiple sources, or uncertainty as to whether news reports of dividends are accurate. NYSE staff will now also be enabled to respond to questions from market participants relating to corporate actions.

The NYSE's proposal is subject to the approval of the SEC. When the proposed rule change becomes effective, NYSE-listed companies should take appropriate action to comply with the new notice requirements.

The NYSE's proposal to the SEC is available at:

- https://www.nyse.com/publicdocs/nyse/markets/nyse/rule-filings/filings/2017/NYSE-2017-17.pdf

SEC Revises Filing Cover Pages under JOBS Act

On April 12, 2017, the SEC adopted technical amendments which result in changes to the cover pages of certain forms to conform them to certain provisions of the JOBS Act, which, among other things, exempts an EGC from various disclosure and regulatory requirements of the Securities Act and the Exchange Act. The forms subject to these amendments are now required to include two check boxes allowing companies to indicate whether the company is an EGC, and if so, whether it has elected to use the extended transition period for complying with new or revised accounting standards pursuant to the Securities Act.

The cover pages of the following forms have been modified to conform to the JOBS Act requirements:

- Securities Act Forms S-1, S-3, S-4, S-8, S-11, F-1, F-3 and F-4; and
- Exchange Act Forms 10, 8-K, 10-Q, 10-K, 20-F and 40-F.

As the cover page changes apply to both ECGs and non-ECGs, all issuers are required to revise the cover page of the applicable forms to include the two new notification requirements.

The SEC's updated forms can be found at:

- https://www.sec.gov/forms

Shearman & Sterling Publishes H1 2017 Review of Sanctions Developments

On July 6, 2017, Shearman & Sterling published its *Sanctions Roundup: First Half of 2017*, covering developments in US sanctions over the first six months of 2017.

The first six months of the Trump Administration saw several notable developments for US sanctions, with particular implications for Russia (in particular the Nord Stream 2 gas pipeline to Germany, a break from the recent tradition of strong cooperation between the EU and US concerning Russian sanctions), Iran and North Korea. The Administration also declared a partial reversal in US policy toward Cuba. Meanwhile, OFAC concluded a major enforcement effort against the Chinese firm ZTE, imposing the largest fine ($1.192 billion) on record against a non-financial entity, for enabling transactions with Iran in the telecom industry.

Our client publication *Sanctions Round Up: First Half 2017* is available at:

- http://www.shearman.com/~/media/Files/NewsInsights/Publications/2017/07/Sanctions-Round-Up-First-Half-2017-LIT-07062017.pdf

Shearman & Sterling Publishes H1 2017 Review of FCPA Enforcement Activity

On July 5, 2017, Shearman & Sterling published its bi-annual *FCPA Digest: Recent Trends and Patterns in the Enforcement of the Foreign Corrupt Practices Act*, covering developments in FCPA and global anti-corruption enforcement over the first six months of 2017.

After a banner year in 2016 that included a record twenty-seven corporate enforcement actions, the two US enforcement agencies, the US Department of Justice and the SEC, continued this momentum over the course of the first three weeks of 2017. During this short span, the agencies brought six corporate enforcement actions and charges against six individuals. Following this spurt, however, there were no corporate FCPA enforcement actions until the declination with disgorgement in Linde announced on June 20, which was subsequently followed by the declination with disgorgement in CDM Smith announced ten days later on June 30. Although it is tempting to view this as a potential shift in enforcement practices under the Trump administration, the rest of 2017 will be more indicative of whether we are on the cusp of a new era of FCPA enforcement.

Among the highlights thus far from 2017 were:

- Eight corporate enforcement actions with total sanctions of $272 million. This represents a significant drop from the twelve enforcement actions with total sanctions of $920.8 million that had been brought at this time in 2016;
- Much like the VimpelCom penalty in 2016, the Rolls-Royce penalty greatly distorts the picture, raising the average corporate sanction for 2017 to $34 million, whereas the true average, with outliers excluded, is slightly over half of this figure ($16.4 million). The median sanction of $12.1 million is broadly in line with those from 2015 ($13.4 million) and 2016 ($14.4 million);
- The Supreme Court's decision in *Kokesh* has the potential to dramatically alter the way that the SEC brings FCPA enforcement actions by imposing a five-year statute of limitations on disgorgement; and
- Two of the year's enforcement actions have arisen out of breached deferred prosecution agreements ("**DPAs**"), a phenomenon that we may see more of given the large number of DPAs that have been entered into since FCPA enforcement actions significantly increased in the late 2000s.

Our client publication *FCPA Digest: Recent Trends and Patterns in the Enforcement of the Foreign Corrupt Practices Act* is available at:

- http://www.shearman.com/~/media/Files/NewsInsights/Publications/2017/07/Shearman--Sterlings-Recent-Trends-and-Patterns-in-the-Enforcement-of-t.pdf

Noteworthy US Securities Litigation

California Public Employees' Retirement System v. ANZ Securities, Inc.: US Supreme Court Rules That Statute of Repose for Securities Act Claims Is Not Tolled By Filing of Related Class Action

On June 26, 2017, in *California Public Employees' Retirement System v. ANZ Securities, Inc.*, the US Supreme Court resolved a dispute between the federal appellate courts over whether the filing of a class action tolls (or suspends) the three-year period for bringing claims under the Securities Act. In 1974, the Supreme Court ruled in *American Pipe & Construction Co. v. Utah* that the filing of a class action tolls the running of the statute of limitations for all members of the proposed class during the pendency of the case. That case did not address whether that same principle applies to the

separate three-year period under the Securities Act that courts refer to as a statute of repose. As we have pointed out in prior editions of this newsletter, the federal courts of appeals around the country have been divided over whether *American Pipe's* tolling doctrine applies to the Securities Act's three-year time bar. The Court here determined in a five-to-four decision that the *American Pipe* tolling doctrine does not apply to the Securities Act's three-year statute of repose.

This case dealt with claims brought by the California Public Employees' Retirement System ("**CalPERS**"), the country's largest public pension fund, under the Securities Act arising out of securities offerings by Lehman Brothers in 2007 and 2008. CalPERS was initially part of a class action bringing these claims. CalPERS later chose to opt out (or exclude itself) from the class action and filed the same claims in a separate action. Although the class action was timely filed, by the time CalPERS filed its own individual action, the Supreme Court ruled, the Securities Act's three-year bar had passed.

The Securities Act provides two time limitations. First, a one-year statute of limitations begins to run when the plaintiff discovers (or should have discovered) the untrue statement or omission at issue. Second, the statute provides that "in no event shall an action" be brought "more than three years after the security" was offered to the public. The Court determined that the Securities Act's three-year time bar is a statute of repose because it "reflects the legislative objective to give a defendant a complete defense to any suit after a certain period." Because the three-year repose period is intended "to grant complete peace to defendants," the Court reasoned, it is not subject to the equitable tolling that *American Pipe* applied to the statute of limitations while a class action is pending. The Court recognized a tension between allowing tolling to protect the ability of plaintiffs to file suit, and providing the "certainty and reliability" to defendants of a statute of repose. The statute's "two-tier structure" addresses this tension, according to the Court, by providing a one-year statute of limitations that does not start to run until discovery of the defendant's violation and is subject to equitable tolling, and a three-year repose period that starts to run "from the defendant's last culpable act" and "protects the defendant from an interminable threat of liability." Plaintiffs who are concerned about losing their ability to bring individual claims while a class action is pending, the Court noted, might be able to preserve their claims by filing "[a] simple motion to intervene or request[ing] to be included as a named plaintiff in the class action."

Four justices dissented from the Court's majority opinion. These justices concluded that when a plaintiff excludes itself from a class action and files separate claims, those claims should be considered a "continuation" of the class action for as long as the class action is still pending. The dissenting justices were concerned that under the majority's ruling, plaintiffs would be deprived of their constitutional right to opt out of class actions once the repose period passes. Other potential consequences of the Court's decision that the dissenters raised are that class members with a significant stake in the litigation will now have a strong reason to file separate claims to protect their rights, thus "increasing the costs and complexity of the litigation." In addition, defendants will now "have an incentive to slow walk" the litigation process "so the clock will run on potential opt-outs." Time will tell whether these concerns prove valid. On the other hand, the Court's decision provides defendants with the comfort that additional suits by individual defendants after the Securities Act's statute of repose has elapsed should not be allowed.

Stadnick v. Vivint Solar, Inc.: Federal Appeals Court Adopts Traditional Materiality Standard Over "Extreme Departure" Test for Assessing Whether an Issuer Has a Duty to Disclose Interim Financial Information

On June 21, 2017, in *Stadnick v. Vivint Solar, Inc.*, the federal appeals court based in New York affirmed a lower court's decision dismissing claims under Section 11 of the Securities Act. The plaintiff in this case argued that the defendants were obligated to disclose interim financial information in the offering materials for Vivint Solar, Inc.'s ("**Vivint**") initial public offering ("**IPO**") because, according to the plaintiff, those results constituted an "extreme departure" from past performance. The court here declined to follow the "extreme departure" standard set out by a federal appeals court from a different jurisdiction, and held instead that whether Vivint had an obligation to disclose the information is based on whether that disclosure would have "significantly altered the total mix of information made available."

Vivint installs and then leases solar energy systems to homeowners. A little over a month after Vivint's October 1, 2014 IPO, Vivint announced a net income loss of $40.8 million for the third quarter of 2014, which missed analyst projections by 143 percent. In the days after this announcement, Vivint's stock price dropped by approximately 20 percent and fell below the offering price of $16 per share. The plaintiff argued that Vivint had a duty under Section 11 of the Securities Act to disclose in the IPO offering materials the company's interim financial results for the third quarter, which ended the day before the IPO. Applying the standard adopted by the federal appeals court based in Boston, Massachusetts to address when a duty to disclose interim financial information arises, the district court granted the defendants' motion to dismiss because the third quarter results did not amount to an "extreme departure" from previous performance.

On appeal, the court here affirmed the district court's dismissal of the plaintiff's claim, but expressly declined to adopt the "extreme departure" standard. The court explained that its prior case law established a different standard for assessing whether issuers have a duty to disclose interim financial results under the Securities Act. Under that standard, a duty to disclose arises when there is "a substantial likelihood that the disclosure of the omitted [information] would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." The court approved that standard because (i) it "rests upon the classic materiality standard in the omission context," (ii) the "'extreme departure' test leaves too many open questions," such as the degree of change necessary to trigger the standard and which metrics should be considered, and (iii) the "extreme departure" test can be "analytically counterproductive" because it can fail to consider appropriately or sufficiently the context of the omitted information. Applying the "total mix of information" standard, the court determined that the alleged omissions were not actionable because the omitted information, when viewed in the proper context, was consistent with Vivint's disclosed results and investor expectations, and because the company, in its offering materials, adequately warned that financial results could fluctuate.

The standard that the court applied here places significant limits on the ability of plaintiffs to bring claims under Section 11 of the Securities Act based on the alleged omission of interim financial information. In particular, this decision requires that omitted information be considered in the context of all of the disclosures that a company makes. Although the federal appeals court in New York is influential, the decision nevertheless remains in tension with the decision of the federal appeals court in Boston, so the Supreme Court may eventually need to clarify the law.

City of Dearborn Heights Act 345 Policy & Fire Retirement Sys. v. Align Technology, Inc.: Federal Appeals Court Applies Omnicare's Standard for False Statements of Opinion to Claims Brought under the Securities Exchange Act of 1934

On May 5, 2017, in *City of Dearborn Heights Act 345 Policy & Fire Retirement Sys. v. Align Technology, Inc.*, the federal appeals court based in California affirmed a lower court's dismissal of securities fraud claims because the plaintiff's allegations failed to meet the falsity standard for statements of opinion established by the US Supreme Court in 2015 in *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund*, 135 S. Ct. 1318 (2015). In affirming the lower court's decision that the defendants' comments about the "goodwill" on the company's financial statements were inactionable statements of opinion, the court joined the federal appeals court based in New York in applying the *Omnicare* standard to claims brought under Section 10(b) of the Exchange Act.

The plaintiff here alleged that Align Technology, Inc. ("**Align**"), an orthodontics and dental products maker, violated Section 10(b) by misleading investors about the goodwill valuation of a business unit of a company that Align had recently purchased. Align attributed a large portion of the purchase price of that company to goodwill, which is "the amount of the purchase price exceeding the fair value of the net assets of the acquired company." The plaintiff alleged that Align deliberately overvalued the goodwill when it conducted its annual goodwill impairment test in 2011 and that it ignored the need to perform interim impairment tests until October 2012. In affirming the district court's dismissal of the complaint, the court here determined that the standard for liability that the Supreme Court established in *Omnicare* for opinion statements under Section 11 of the Securities Act also applies to claims brought under Section 10(b) of the

Exchange Act. In order for a plaintiff to plead that a statement of opinion is a material misrepresentation under *Omnicare*, the plaintiff must allege both that "the speaker did not hold the belief she professed" (i.e., subjective falsity) and that the belief is objectively untrue. The court here ruled that to the extent that its pre-*Omnicare* standard permitted plaintiffs to plead that opinion statements are material misrepresentations by alleging that "there is no reasonable basis for the belief," that standard is "clearly irreconcilable with *Omnicare*, and is therefore overruled."

The court here explained that statements related to goodwill valuations are statements of opinion because they "are inherently subjective and involve management's opinion regarding fair value." The plaintiff failed to allege the subjective falsity of the defendants' statements because the complaint did not allege any basis to infer that the defendants believed that goodwill was impaired in 2011 or that they were required to perform additional impairment testing.

In determining that *Omnicare*'s standard of liability for statements of opinion applies to Section 10(b) of the Exchange Act, the court followed the reasoning of the federal appeals court based in New York, which the court here noted is the only other federal appeals court to have considered the issue. This decision thus further clarifies the scope of liability for statements of opinion under the Exchange Act after *Omnicare*.

Recent Regulatory Enforcement Matters

Kokesh v. SEC: US Supreme Court Holds That SEC Disgorgement Orders Are "Penalties" Subject to Five-Year Statute of Limitations

On June 5, 2017, in *Kokesh v. SEC*, the US Supreme Court held unanimously that the ability of the SEC to seek disgorgement for violations of the federal securities laws is subject to a five-year statute of limitations. Disgorgement actions by the SEC generally seek to recover a violator's ill-gotten gains. The Court's conclusion that the five-year statute of limitations applies to those actions was based on its assessment that disgorgement orders qualify as "penalties" under the statute of limitations.

The petitioner here was the owner of several investment advisory firms. In late 2009, the SEC began an enforcement action against him, alleging that he had, through his firms, misappropriated $34.9 million between 1995 and 2009. Following the jury's verdict that he was liable for those wrongs, at the SEC's request, the United States District Court for the District of New Mexico ordered that he disgorge $34.9 million, plus an additional $18.1 million in prejudgment interest. Most of the disgorgement amount ($29.9 million) related to conduct that occurred more than five years prior to commencement of the SEC's action.

Under 28 U.S.C. § 2462, a five-year statute of limitations applies to any "action, suit or proceeding [brought by the SEC] for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise." Until the Supreme Court decided this case, the federal appeals courts around the country were split as to whether Section 2462's statute of limitations applies to disgorgement actions brought by the SEC. The Supreme Court determined that disgorgement orders achieved by the SEC contain several characteristics that qualify them as "penalties" under the statute. First, SEC disgorgement actions seek to redress violations of "public laws" that are "committed against the United States rather than an aggrieved individual." Second, SEC disgorgement actions are intended to deter future violations based on similar conduct. Third, SEC disgorgement actions do not play a compensatory function because "disgorged profits are paid to the district court," which then exercises its discretion over how the disgorged funds will be distributed. Although in some instances disgorged funds compensate private parties for their losses, that is not always so. The Court rejected the SEC's argument that disgorgement actions are not punitive, but "remedial," because they seek to restore the status quo prior to the violation. Rather, the Court explained, in order to achieve a deterrent effect, "disgorgement does not [always] restore the status quo; it [sometimes] leaves the defendant worse off" than he or she was before the violation.

This case provides greater certainty in an important area of SEC enforcement law. It also puts a temporal limit on the SEC's ability to bring disgorgement actions. On the other hand, the SEC already often seeks tolling agreements with potential subjects of investigations to suspend the applicable statute of limitations while it investigates potential violations. It seems likely in light of the *Kokesh* decision that the SEC will now seek such agreements earlier and more reflexively in the future.

For more information on the *Kokesh* case, our related client note is available at:

- http://www.shearman.com/en/newsinsights/publications/2017/06/us-sc-sec-subject-to-five-yr-statute-limitations

EU Developments

General

European Commission Publishes Guidelines for Reporting of Non-Financial Information

On June 26, 2017, the European Commission (the "**Commission**"), published guidelines on the methodology to be adopted by certain large companies and groups when reporting non-financial information under Directive 2014/95/EU amending the Accounting Directive. The Commission's intention is to improve the quality, relevance, usefulness, consistency and comparability of companies' non-financial information in a way that creates greater market transparency for stakeholders and so fosters growth.

The guidelines are based around key principles, which include the guidance that disclosure must:

- contain all contextualized material information;
- be fair, balanced and understandable;
- be comprehensive and concise;
- be strategic and forward looking;
- be stakeholder orientated; and
- be consistent and coherent.

The full text of the guidelines is available at:

- http://ec.europa.eu/transparency/regdoc/rep/3/2017/EN/C-2017-4234-F1-EN-MAIN-PART-1.PDF

European Commission Mid-Term Review of the Capital Markets Union Action Plan

On June 8, 2017, the Commission published its mid-term review of the 2015 Capital Markets Union ("**CMU**") action plan.

The review states that approximately two-thirds of the actions anticipated by the plan have been delivered since its inception. The Commission is now reframing the action plan in response to the results of the recent consultation (which it launched in January 2017 and which was covered in the April 2017 edition of this newsletter) and to other challenges in the market, including the UK's anticipated departure from the single market.

The Commission has identified a number of new priority actions, which are:

- to strengthen the powers of ESMA;

- to deliver a more proportionate regulatory system for small- and medium-sized enterprises listing on public markets;
- to strengthen the EU's leading role in pioneering sustainable investment;
- to support cross-border investment; and
- to support the development of local capital market ecosystems.

These actions are additional to those already identified still outstanding in the action plan.

- The responses to the Commission's consultation, which fed into the mid-term review, identified a number of specific challenges faced by the CMU, including:
- the requirement for more risk finance to support the innovation and growth of start-up and scale-up firms;
- the small size of public equity and debt markets in some member states relative to other developed economies;
- the relative cost and complexity of accessing public markets, especially for small- and medium-sized companies;
- a general contraction on the amount of new lending to EU business by EU banks since the financial crisis;
- inadequate investment by insurance companies and pension funds in risk capital, equity and infrastructure;
- low engagement on the part of retail investors with capital markets; and
- long-standing obstacles preventing EU cross-border investment.

In the Commission's view, it will have made sufficient progress on achieving these measures so as to lay the foundations for a true CMU by 2019.

The full text of the Commission's review is available at:

- https://ec.europa.eu/info/sites/info/files/communication-cmu-mid-term-review-june2017_en.pdf

ESMA: Updated Q&A on the Market Abuse Regulation ('MAR')

On May 30, 2017, the European Securities and Markets Authority ("**ESMA**") published an updated version of its Q&A on MAR. Changes since the last version include:

- A new question on whether credit institutions are required under MAR to systematically publish the results of their Pillar II assessment in relation to the disclosure of inside information.
- Confirmation that circumstances surrounding delay of disclosure under Article 17(4) or notification of delay under Article 17(5) will need to be assessed on a case-by-case basis by the relevant issuer.
- In the context of the Supervisory Review and Evaluation Process to be conducted in accordance with Article 97 of Directive 2013/36/EU, whenever a credit institution subject to the market abuse regime becomes aware of information, notably as a result of a Pillar II assessment, it must evaluate whether such information constitutes inside information; if it does, then MAR provisions apply to the consequential disclosure requirements, and the credit institution must publicly disclose the inside information as early as possible, subject to the MAR provisions on delaying disclosure.
- A reminder that if any publication, which does not come from the issuer complying with its disclosure obligations, or a rumor in the market, relates explicitly to inside information, the issuer must react and respond to the publication or rumor if it is accurate enough to indicate that the confidentiality of the inside information can no

longer be assured. This response should be made publicly available in the same way as communication of inside information and without delay.

- A new question on whether blanket order cancellation policies issued upon the discovery of a person being in possession of inside information are compliant with the ban on insider dealing under MAR. ESMA's response notes that there is a rebuttable presumption under Article 8(1) of MAR that "the use of inside information by cancelling or amending an order placed before the person concerned possessed inside information" constitutes insider dealing. However, if the cancellation was done without the use of inside information then this will not constitute insider dealing. Whether or not this is the case must be assessed on a case by case basis.

The full text of the Q&A is available at:

- https://www.esma.europa.eu/sites/default/files/library/esma70-145-111_qa_on_mar.pdf

Shareholder Rights Directive: Directive Published in the Official Journal

On May 20, 2017, the final text of the directive to amend the Shareholder Rights Directive was published in the Official Journal of the European Union and came into force on June 9, 2017.

The text of the directive follows that which was adopted by the Council of the EU and which was covered in the April 2017 edition of this newsletter. Member states have until June 10, 2019 to implement the directive.

The full text of the directive is available at:

- http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017L0828&from=EN

New Prospectus Regulation: Publication in the Official Journal

On May 16, 2017, the Council of the EU adopted the proposed regulation to repeal and replace the existing Prospectus Directive and Prospectus Regulation, which was adopted by the European Parliament on April 5, 2017. The text adopted by the Council was substantively the same as that adopted by the Parliament, which we covered in the April 2017 edition of this newsletter.

Following the Council decision, the regulation was published in the Official Journal on June 30, 2017. The majority of its provisions will apply from July 21, 2019. However, certain provisions—such as the prospectus exemption for admissions to trading for additional listed securities of (currently) less than 10%, which is to be increased to additional listed securities of less than 20%, in any 12 month period—will become effective on July 20, 2017. Other provisions—for example the increased thresholds for exemptions for prospectuses for public offers (which move from €100,000 to €1,000,000 with an optional €8,000,000 threshold without the benefit of passporting)—will become effective on July 21, 2018.

The full text of the new Prospectus Regulation is available at:

- http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R1129&from=EN

European Commission Publishes Consultation on Scope and Content of Company Law Initiative on Digital Technologies and Cross-Border Mobility

On May 10, 2017, the EU Commission published its consultation on the scope and content of the forthcoming company law initiative to facilitate the use of digital technologies by companies, provide efficient rules for cross-border mobility of companies and provide uniform conflict-of-interest rules for companies.

The consultation seeks views on the problems, their seriousness and the need for the EU to take action in each area. Each section of the consultation contains a number of specific questions exploring the following issues:

- the extent to which differences between Member States' legal frameworks or overall lack of legal framework hinder the proper functioning of the Single Market;
- the limited EU legal framework for the use of digital processes and tools in company law and the disparity between the relevant rules of Member States;
- the absence of any harmonized EU law for cross-border divisions and conversions and the problems this creates in relation to protection of creditors, minority shareholders and other stakeholders; and
- the problems created for companies by the divergence in the rules of different Member States on conflict of law rules as this is regulated at a national level.

Responses are requested by August 6, 2017. The Commission may respond with further legislative measures or other initiatives.

The full text of the consultation is available at:

- https://ec.europa.eu/eusurvey/runner/CompanyLawPackageSurvey2017

European Commission Publishes Consultation on Conflict of Laws Rules for Third Party Effects of Transactions in Securities and Claims

On April 7, 2017, the European Commission published a consultation document on the conflict of laws rules for third party effects of transactions in securities and claims, in order to assess the practical problems arising from legal uncertainty in this area and to gather opinions on possibilities for improving such rules in furtherance of its Capital Markets Union Action Plan.

The Commission intends to address the legal uncertainty surrounding securities ownership in cases where the securities issuer and the investor are located in different Member States and/or securities are held by financial institutions in different Member States.

The Commission notes that another obstacle to cross-border investment results from differences in the national treatment of third party effects of assignment of debt claims that complicates their use as cross-border collateral, in particular as underlying receivables in securitizations, and makes it difficult for investors to price the risk of debt investments. The Commission is therefore proposing a possible legislative initiative that would give legal certainty as to which national law shall apply to securities ownership and to third party effects of the assignment of claims.

The deadline for responses to the consultation was June 30, 2017.

The full text of the consultation is available at:

- http://ec.europa.eu/info/sites/info/files/2017-securities-and-claims-consultation-document_en.pdf

EU Financial Markets Regulation Developments

European Commission Proposals for a 'Location Policy' and Enhanced Supervision of Third Country CCPs

On June 13, 2017, the European Commission published legislative proposals to amend the European Market Infrastructure Regulation ("**EMIR**") and the Regulation establishing **ESMA**. The proposals are on the supervision of central counter parties ("**CCPs**"), both EU CCPs and third-country CCPs, and include the controversial new proposals for a formal EU "location policy" for CCPs. The main proposals are:

- to establish a new CCP Executive Session within ESMA, in which central banks of issue, such as the European Central Bank, have a veto over recognition decisions;
- for EU CCPs, national regulators will supervise CCPs in their jurisdiction in agreement with the CCP Executive Session of ESMA;
- to introduce a two-tier system for third-country CCPs whereby ESMA will categorize each CCP as either a non-systemically important CCP (Tier 1 CCP) or a systemically important CCP (Tier 2 CCP). Tier 1 CCPs will continue to operate under the existing equivalence framework under EMIR. Tier 2 CCPs will be subject to additional requirements, most notably, a line-by-line application of all the prudential, conduct of business, governance and margin requirements that are applicable to EU CCPs;
- to provide that ESMA may determine that a third-country CCP is too systemically important even to operate as a Tier 2 CCP, in which case the Commission could adopt legislation to the effect that the CCP is too systemically important and that it may only provide services in the EU if it establishes itself in an EU member state; and
- to introduce a system whereby ESMA should assess at least every two years the recognition of a third-country CCP, including assessing its systemic importance. Transitional provisions are also proposed whereby CCPs already recognized under EMIR will be reviewed by ESMA on this basis as well.

The proposals have been submitted to the European Parliament and the Council of the European Union for consideration. The European Commission is accepting feedback on the proposals until August 9, 2017.

The proposals and feedback page is available at:

- https://ec.europa.eu/info/law/better-regulation/initiatives/com-2017-331_en

EU Extends Transitional Measures for Exposures to CCPs

On June 7, 2017, a Commission Implementing Regulation on the extension of the transitional periods related to own funds requirements for exposures to central counterparties set out in the Capital Requirements Regulation ("**CRR**") and EMIR was published in the Official Journal of the European Union. As the recognition process for some third-country CCPs is still incomplete, without an extension of the transitional periods, banks and investment firms in the EU would need to increase their own funds requirements for their exposures to those CCPs that are not yet recognized. The implementing Regulation extends the transitional period by an additional six months to December 15, 2017.

The proposals to amend the CRR published by the European Commission in November 2016 include an amendment to these transitional provisions. The proposed amendment would remove the need for the European Commission to continuously extend the transitional period by basing the transitional deadline instead on the timing of an application for recognition by a third-country CCP.

The Commission Implementing Regulation is available at:

- http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R0954&from=EN

The proposed amendments to CRR are available at:

- http://finreg.shearman.com/european-commission-proposes-draft-quotcrd5quot-a

European Commission Proposes Technical Changes to the European Market Infrastructure Regulation

On May 4, 2017, the European Commission published a legislative proposal to amend EMIR. This proposal is the result of an extensive assessment of EMIR between 2015 and 2016. The proposal covers a wide-range of areas within EMIR, including reporting requirements, non-financial counterparties ("**NFCs**"), exemptions and trade repositories.

The main proposals are:

- to introduce single-sided reporting of all exchange-traded derivatives. The CCP would be responsible for reporting the trade on behalf of both counterparties;
- to extend the pension fund clearing exemption for three more years;
- to exempt small NFCs from the clearing obligation;
- to provide that once an NFC has reached the clearing threshold for one particular asset class, the NFC would only be subject to the clearing obligation for that particular class of derivatives;
- removing the back loading requirement (i.e. the requirement to report historic transactions);
- to treat all funds and fund managers globally as financial counterparties;
- to require CCPs to hold both contracts and positions on a bankruptcy remote basis; and
- to remove the requirements for small NFCs to report intra-group transactions.

The legislative proposal is available at:

- http://ec.europa.eu/transparency/regdoc/rep/1/2017/EN/COM-2017-208-F1-EN-MAIN-PART-1.PDF

The annex to the legislative proposal is available at:

- http://ec.europa.eu/transparency/regdoc/rep/1/2017/EN/COM-2017-208-F1-EN-ANNEX-1-PART-1.PDF

Our client note is available at:

- http://www.shearman.com/en/newsinsights/publications/2017/05/emir-review-expansion-third-country-funds

Update: European Market Infrastructure Regulation Exemptions for Central Banks in Six Countries

On June 10, 2017, a Commission Delegated Regulation exempting central banks in six countries—Australia, Canada, Hong Kong, Mexico, Singapore and Switzerland—from complying with EMIR was published in the Official Journal of the European Union. EMIR imposes clearing, reporting and risk mitigation obligations for derivatives. EU central banks and EU public bodies managing public debt are exempt from EMIR. The European Commission may exempt central banks and public bodies managing public debt from other countries following analysis of the international treatment of the relevant entities in a particular country. Central banks and public bodies responsible for the management of debt in the United States and Japan were the first to be added to the list of exempted bodies through a Commission Delegated Regulation. These new exemptions came into effect on June 30, 2017.

The Delegated Regulation is available at:

- http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R0979&from=EN

Delay to EU Clearing Obligation for 'Category 3' and 'Category 4' Counterparties

On April 29, 2017, an amending Commission Delegated Regulation extending the deadline for compliance with clearing obligations for certain counterparties dealing with over the counter ("**OTC**") derivatives was published in the Official Journal of the European Union. The EMIR imposes a clearing obligation on certain classes of derivatives. The ESMA has so far assessed that the clearing obligation should apply to interest rate swaps denominated in seven currencies (EUR, GBP, JPY, USD, NOK, PLN and SEK) and to two classes of credit default swaps indices (iTraxx Europe Main and iTraxx Europe Crossover). The clearing obligation is being phased in with those with the largest derivatives trading activity becoming subject to the obligation first. The obligation to clear OTC IRS denominated in the G4 currencies (EUR, GBP, JPY and USD) applied to clearing members of EU CCPs from June 21, 2016.

The Delegated Regulation amends the Regulatory Technical Standards ("**RTS**") imposing the clearing obligation so that the timing of the clearing obligation for financial institutions with a low volume of derivatives trading activity (namely those with so-called "Category 3 and 4" counterparties, which are small financial counterparties and alternative investment funds or non-financial counterparties) is extended to June 21, 2019 for the clearing of OTC IRS and CDS. ESMA recommended the extension in a report published on November 14, 2016. The Delegated Regulation entered into force on May 19, 2017.

The amending Delegated Regulation is available at:

- http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R0751&from=EN

The ESMA's report is available at:

- https://www.esma.europa.eu/press-news/esma-news/esma-asks-commission-delay-central-clearing-small-financial-counterparties

EU Clarification on CCP Portfolio Margining Requirements

On April 10, 2017, ESMA published an Opinion addressed to EU national regulators on the portfolio margining requirements for CCPs under EMIR. The RTS on portfolio margining that supplement EMIR provide that a CCP can offset or reduce the required margin across instruments that it clears if the price risk of one instrument is significantly and reliably correlated to the price risk of other financial instruments. In those cases, a CCP may apply portfolio margining. European legislation provides certainty over the requirements only to a limited degree because there is no indication as to which instrument or product can be considered the same or which elements are needed for an instrument or product to be considered the same. ESMA's Opinion aims to provide clarification as to when two contracts can or cannot be considered the same instrument for the purpose of portfolio-margining, referencing all asset classes. In addition, ESMA confirms that CCPs have to limit the reduction in margin requirement when conducting portfolio-margining across different instruments.

ESMA's Opinion is available at:

- https://www.esma.europa.eu/press-news/esma-news/esma-clarifies-ccps%E2%80%99-portfolio-margining-under-emir

UK Developments

UK Corporate Law Developments

ICAEW Publishes Report on Corporate Reporting

On June 29, 2017, the Institute of Chartered Accountants England and Wales ("**ICAEW**") published a report on the future of corporate reporting.

The report highlights five key policy questions which the ICAEW considers should be addressed to ensure progress in corporate reporting. These are:

- clearly defining the objectives and beneficiaries of corporate reporting;
- considering how and to what extent companies should seek to meet the demands of different stakeholders in its reporting;
- developing ways to achieve consistency and credibility in corporate reporting;

- prioritizing ways that various intangible elements can best be reflected on companies' balance sheets and results; and
- considering how and to what extent data and technology can be used to improve the quality of corporate communications.

The full text of the report is available at:

- https://www.icaew.com/en/technical/financial-reporting/information-for-better-markets/what-next-for-corporate-reporting

FRC Publishes Details of Its Functions and Powers

On June 28, 2017, the Financial Reporting Council ("**FRC**") published a schedule of its functions and powers, which replaces the schedule in its 2014 publication.

These new powers set out the FRC's statutory powers in relation to audits as well as its role in supervising the accounting elements of corporate reporting and corporate governance.

FCA Policy Statement on the Prohibition of Restrictive Contractual Clauses

On June 27, 2017, the FCA published a policy statement (PS17/13) outlining new rules to be added to the FCA Handbook to prohibit contractual clauses that restrict competition without providing clear benefits to clients in the context of the provision of primary market services (debt capital markets, equity capital markets and merger and acquisition services).

The policy statement is the result of the FCA's market study into the UK investment and corporate banking market, published in October 2016, which had concluded that certain practices of providers of primary market services could restrict competition and that such clauses appeared in contracts used by between half and three-quarters of the service providers surveyed, depending on the service in question.

The FCA's new rules apply only to written agreements which contain restrictions with regards to unspecified and uncertain categories of future services (for example, giving the provider of a service the *right* to provide unspecified future services to the client). The FCA has stressed that these rules will not apply to specified pieces of future work, so as not to prohibit a service provider agreeing upfront the terms of a specific piece of future business. In particular, the rules do not apply to future services with respect to bridging loans.

The FCA notes that the most restrictive types of clauses are:

- "right to act" clauses—giving a service provider the right to provide future services to the client; and
- "right of first refusal" clauses—giving a service provider the right to provide future services to the client before the client is able to accept any third party offer.

The FCA also notes that "right to match" clauses are acceptable in this context, provided that the client retains a genuine choice over which service provider to contract with for the future services.

These new rules will apply along the same geographical scope as the Conduct of Business sourcebook rule 1.1. That is, the prohibition:

- applies where the designated investment activities or activities connected with them are undertaken from a firm's UK establishment—this includes agreements entered into by the firm's UK establishment or its overseas branches; however, it does not capture agreements entered into by the firm's subsidiaries or affiliates; and
- applies irrespective of the geographical location of the client.

The rules will come into effect on January 3, 2018. The full text of the new rules is published as an appendix to the policy statement, which is available at:

- https://www.fca.org.uk/publication/policy/ps17-13.pdf

PSC Amendment Regulations Published

On June 23, 2017, the Information about People with Significant Control (Amendment) Regulations 2017 ("**PSC Amendment Regulations**") were published, transposing certain requirements of the EU's Fourth Anti-Money Laundering Directive. The regulations came into force on June 26, 2017.

The PSC Amendment Regulations made various amendments to the PSC regime including the following key changes:

- Adding a new requirement on companies to update their own registers and to inform Companies House of the changes to their PSC register. The time limits under this new requirement are as follows:
  - the internal PSC Register must be updated within 14 days of becoming aware that a person meets the conditions for entry onto the PSC Register; and
  - the central public register (for example, Companies House for English companies) must be updated within a further 14 days;
- The PSC Register regime extends to companies admitted to trading on prescribed markets (such as AIM and NEX Exchange) but does not apply to companies listed on the UK main market.
- The PSC Register regime applies also to unregistered companies, Scottish limited partnerships and Scottish qualifying general partnerships;
- The registration requirements for the new companies that have been brought within the scope of the PSC Register regime will apply from July 24, 2017.

The new notification requirements do not apply to changes to a company's PSC register which took place prior to June 26, 2017 which were notified to the central register in the company's annual confirmation statement. However, for changes made prior to June 26, 2017 which have not been notified to the central register must be notified to Companies House within 14 days of June 26, 2017 under the new regime.

The Department for Business, Energy and Industrial Strategy has also published its revised draft statutory guidance on these changes.

The full text of the guidance is available at:

- https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/621687/psc-statutory-guidance-companies.pdf

and at:

- https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/621571/170623_NONSTAT_GU.pdf

UK Published MiFID II Implementing Regulations

On June 22, 2017, the Financial Services and Markets Act 2000 (Markets in Financial Instruments) Regulations 2017 were published, which, amongst other things, implemented parts of the MiFID II Directive.

In particular, these regulations introduced an amendment to the definition of a "qualified investor" Part 6 of FSMA 2000. Section 86 (Exempt offers to the public) of FSMA 2000 was amended so that a "qualified investor" may now also

include a person whom the firm continues to treat as a professional client under the guidance published in Annex II of MiFID II.

This amendment will come into force on January 3, 2018.

The full text of the regulation is available at:

- http://www.legislation.gov.uk/uksi/2017/701/made

Pre-Emption Group Publishes Monitoring Report and Appendix of Best Practice

On May 12, 2017, the Pre-Emption Group published a monitoring report on the implementation of its 2015 Statement of Principles and the use of the template resolutions for disapplying pre-emption rights. The Principles were updated in 2015 to allow companies issuing shares for cash to seek authority by way of an additional resolution to disapply pre-emption rights up to an amount equal to a further 5% of the company's issued share capital. The additional 5% authority may be sought for the purposes of an acquisition or specified capital investment, and should not be applied for automatically but only when it is appropriate for the company's circumstances.

Key determinations and recommendations of the report are set out below:

- The Principles and template resolutions have generally been adhered to, although there have been instances of possibly poor consultation and disclosure.
- Companies and investors should address both the spirit and letter of the 2015 Statement of Principles in discussions.
- A request for a general disapplication is likely to be supported subject to certain conditions (size, duration and resolution format). However, this does not reduce the importance of effective dialogue and timely notification.
- Representatives of listed companies, investors and intermediaries support the 2015 Statement of Principles.

The monitoring report is available at:

- http://www.pre-emptiongroup.org.uk/getmedia/5bd81023-fffd-45ea-8969-6b967953903b/170512-PEG-monitoring-report.pdf.aspx

To assist companies, the Pre-Emption Group also published an Appendix of Best Practice, which is available at:

- http://www.pre-emptiongroup.org.uk/getmedia/9438a4c1-2aff-494c-aff4-6eca603e6a47/170511-Appendix.pdf.aspx

The Investment Association Publishes Guidance on Long-Term Reporting

On May 9, 2017, the Investment Association ("**IA**") published guidance on long-term reporting, after calling for companies to cease quarterly publication in November 2016 in favor of meaningful long-term reporting.

The guidance sets out the expectations of members of the IA with regards to long-term reporting. The aim of the guidance is to help identify companies that deliver long-term returns to shareholders, contribute to economic growth and help to build a more productive economy in order that such companies are put in the best possible position to attract investment.

The recommendations cover the following areas:

- Business models and long-term reporting—Companies are encouraged to give more attention to longer term performance and strategic issues.

- Productivity—Companies should report on drivers of productivity and ideally develop a set of key performance indicators against which to measure improvements in productivity over time.
- Capital management—Outlines expectations on capital management disclosures and how reporting on connection between capital management and long-term strategy can be improved by companies.
- Disclosure of material environmental and social risks—Covers disclosures relating to the board responsibilities and policies, procedures and verification systems to manage environmental, social and governance risks.
- Human capital and culture—sets out expectations on how companies should report on human resources issues and culture.

This guidance applies to companies with a premium listing of shares. Companies with other forms of listing are encouraged to adopt the guidance as best practice. Implementation of the guidance will be monitored by the Institutional Voting Information Service, which will notify IA members of companies who choose to retain a short-term reporting model and who do not adopt the required disclosures.

The guidance is available at:

- https://www.ivis.co.uk/media/12519/Long-Term-Reporting-Guidance.pdf

Companies House Publish Business and Strategic Plans for 2017–2018 and 2017–2020

On April 19, 2017, Companies House published its business plan for 2017–2018 and its strategic plan for 2017–2020. One of the goals of Companies House is to support the UK government's commitment to make the UK the most transparent place in the world to do business. In particular, this applies in the context of beneficial ownership of interests in companies and other entities.

In particular, Companies House will focus on:

- implementing the Fourth Money Laundering Directive by the end of June 2017 (which was in fact implemented on June 26, 2017);
- working to improve the accuracy and completeness of information regarding people with significant control; and
- working with the Department for Business, Energy & Industrial Strategy:
  - to prepare for future legislative changes, including the creation of a new register showing the beneficial owners of overseas entities that own or propose to buy property in the UK; and
  - to consider whether the register strikes the right balance between corporate transparency and protection of the individual's privacy.

The business plan for 2017–2018 is available at:

- https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/609263/Companies_House_Business_Plan_2017-18.pdf

The strategic plan for 2017–2020 is available at:

- https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/609467/Companies_House_Strategy_2017-2020.pdf

Pensions & Investments Research Consultants ('PIRC') Publish Shareowner Voting Guidelines 2017

PIRC has published its 2017 UK shareowner voting guidelines (24th edition). The key changes in each chapter from the version published in March 2016 are as follows.

The board of directors

- clear rationale must be given when the roles of chairman and chief executive at a listed company are proposed to be combined and should only ever be done so on a temporary basis and under exceptional circumstances;
- the re-election of an executive chairman except in exceptional circumstances will be opposed;
- finance directors should not be appointed as chairman of the same company;
- formally advertising vacancies for executive directors should be the normal practice;
- PIRC will not support the re-election of a nomination committee of a FTSE 350 company where the composition of the committee falls below, or has no credible proposal for achieving, the recommended level of female representation of 33%;
- statements in the previous guidelines regarding the additional flexibility that may be required (in terms of annual meetings and special meeting) by a UK listed company incorporated in an overseas jurisdiction which has a reduced level of legal protection compared to the UK have been removed;
- statements in the previous guidelines that the company secretary should not also be a director have been removed; and
- statements in the previous guidelines opposing the appointment of alternate directors have been removed.

Report and accounts, audit and financial controls

- PIRC clarifies that tax compliance fees charged by auditors should be recorded as non-audit fees for the purpose of calculating what percentage of audit fees are made up of fees for non-audit work.

Shareowner rights, capital stewardship and corporate actions

- Where a company has received a significant proportion of votes cast against a management proposed resolution, it should provide a statement within its RNS announcement and disclose in subsequent annual reports the steps taken to engage with shareholders on the substantive concerns represented by any "significant" votes.

Directors' remuneration

- Companies must disclose the consultants used and remuneration consultant fees on an annual basis; and
- PIRC notes that it has become "more common" for audit firms to provide remuneration consultancy, which PIRC considers wholly unacceptable.

Sustainability and corporate responsibility reporting

- The BEIS Green Paper on corporate governance reform is consistent with PIRC's interpretation of the law regarding directors' duties and the requirements to explain how the directors have fulfilled their duties under the CA 2006 in the Strategic Report.

The full text of the guidelines is available at:

- http://pirc.co.uk/news-and-resources2/guidelines

FRC Issues Discussion Paper on Preliminary Announcements

On April 27, 2017, the FRC issued a discussion paper on the role of auditors and preliminary announcements, intending to provoke discussion about how the value of preliminary announcements may be improved. It proposes changes from the current auditor guidance, including:

- expanding the parameters of current FRC auditor guidance to include voluntary engagements where companies outside the main UK listed market ask their auditors to agree the release of a preliminary announcement—the FRC proposes that the guidance should be extended to AIM companies as well as its current application to Main Market companies;
- requiring audits to be complete and the auditor's report on the statutory financial statements to be signed before preliminary results may be released in order to mitigate the risk of mismatching information and to provide more clarity;
- requiring a bespoke auditor's report to be contained alongside the preliminary announcement instead of the full statutory auditor's report; and
- requiring auditors to have completed their review of 'other information' in the annual report before agreeing to the publication of a preliminary announcement to ensure that auditors may complete their review of the preliminary announcement in an informed and meaningful way.

Comments that the FRC receives on this paper will be used to inform changes to the auditor guidance, and the FRC will consult formally on these proposed alterations.

The full text of the discussion paper is available at:

- https://www.frc.org.uk/Our-Work/Publications/Audit-and-Assurance-Team/Discussion-Paper-Invitation-to-comment-Auditors-File.pdf

The Takeover Panel Executive Amends Practice Statement No. 20.

On April 13, 2017, the Takeover Panel Executive announced that it had made the following changes to Practice Statement No. 20: Rule 2 – Secrecy, possible offer announcements and pre-announcement responsibilities:

- The addition of a sentence to paragraph 8.2 clarifying that the necessity to consult the Executive before more than a total of six parties are approached about an offer or possible offer remains applicable during an offer period relating to a possible offer by any potential offeror which has not been publicly identified.
- The addition of a new paragraph 8.6 clarifying that in the case of a meeting (including telephone/electronic meetings) with a shareholder or other relevant person before an offer period begins which either relates to the possible offer or would not be taking place save for the possible offer:
  - an appropriate financial adviser or corporate broker must attend the meeting; and
  - whichever of the above attends the meeting must, by not later than 12 noon the following business day, provide a written confirmation to the Takeover Panel *unless* (a) no representative of, or adviser to, the offeror or offeree company was present apart from the above person; and (b) no material new information or significant new opinions relating to the possible offer were provided during the meeting.

The full text of the amended Practice Statement showing the changes is available to view at:

- http://www.thetakeoverpanel.org.uk/wp-content/uploads/2017/04/PS20.track_.pdf

The Takeover Panel and the Code of the Committee Publish Instrument 2017/1 and the Code Committee Publish Instrument 2017/2

On April 13, 2017, the Takeover panel and the Committee published Instrument 2017/1 which makes minor and technical changes to the Introduction of the Takeover Code, and the Code Committee published Instrument 2017/2 which makes various minor amendments to the Takeover Code.

Amongst other things, Instrument 2017/2 introduces the following change:

- Sections 3(a)(i) and (ii) of the Introduction have been amended to clarify that, where a company's securities are or have been admitted to trading on a multilateral trading facility in the UK, the Takeover Code will only apply if the company has approved trading, or requested admission to trading, of its securities on the relevant multilateral trading facility.

The full text of Instrument 2017/1 is available at:

- http://www.thetakeoverpanel.org.uk/wp-content/uploads/2017/04/2017.1.SECTION8inst.pdf

The full text of Instrument 2017/2 is available at:

- http://www.thetakeoverpanel.org.uk/wp-content/uploads/2017/04/2017.2b.pdf

ICAEW and ICAS Publish Updated Guidance on Realized and Distributable Profits Under the Companies Act 2006 (CA 2006)

The Institute of Chartered Accountants in England and Wales ("**ICAEW**") and the Institute of Chartered Accountants of Scotland ("**ICAS**") have published a technical note (TECH02/17) which provides updated guidance on realized and distributable profits under the CA 2006 and statutory instruments made under the CA 2006. It aims to identify, interpret and apply the principles relating to the determination of realized profits and losses for the purposes of making distributions under the CA 2006.

Changes made to the existing rules by the technical note include:

- Additional guidance on the meaning of distributions in kind, making it clear that:
  - the transfer of an asset can be a distribution as a matter of law, and consequently within the scope of sections 845 and 846 CA 2006 even if there is no impact on accounting; and
  - a transfer to a parent of an amount receivable from a third party is within the scope of section 846 of the CA 2006.
- A new paragraph 2.9FA introducing additional guidance on the determination of the amount of a distribution in kind which clarifies that a distribution in kind may still be unlawful for example where an increase in book value of an asset is not reflected in the accounts and the consideration paid.

The full text of the technical note is available at:

- https://www.icaew.com/-/media/corporate/files/technical/legal-and-regulatory/company-law/tech-02-17bl-guidance-on-distributable-profits.ashx?la=en

Revised LSE Admission and Disclosure Standards

The London Stock Exchange has published revised Admission and Disclosure Standards, which came into effect on May 8, 2017. The revisions include minor amendments to the definitions of MTF and securities (removing references to specific provisions of MiFID), and to the definition of Professional Securities Market. International Securities Market

(ISM) is now defined, with an amendment to Section 1.3 providing that most of the Standards do not apply to Securities admitted to trading on ISM.

The full text of the revised Standards is available at:

- http://www.londonstockexchange.com/traders-and-brokers/rules-regulations/change-and-updates/stock-exchange-notices/2017/n0417_attach3.pdf

Upcoming Review of the Best Practice Principles for Shareholder Voting Research

On April 21, 2017, the Best Practice Principles Group for Shareholder Voting Research announced a review of its best practice principles for shareholder voting research and analysis, which is to take place by the end of 2017. A key aim of the review is to address the transparency requirements for proxy advisors outlined in the amendments to the revised EU Shareholder Rights Directive 2007/36/EC, adopted on April 3, 2017. It is also intended that the updated principles should be applicable to all markets for which voting research and analysis is provided, and by all providers of such services.

In order to gather the views of stakeholders, a public consultation will be held in the summer, and an advisory stakeholder panel will be established to provide input into the preparation of a consultation document and any subsequent revisions to the principles.

The press release is available at:

- http://bppgrp.info/wp-content/uploads/2017/04/170418-BPP-Press-Release.pdf

FCA Mission Document

On April 18, 2017, the FCA published the following corporate documents; its mission statement, its sector views, its Business Plan for 2017/18, and a feedback statement (FS17/1) to its consultation on the FCA's mission for 2017. Together, these documents give firms and consumers greater clarity as to how the FCA reaches regulatory judgments and operates.

The mission document provides a detailed explanation of how the FCA prioritizes its interventions in financial markets and how it interprets its competition duties. The sector views set out the issues and developments the FCA sees in the sectors that it regulates. The feedback statement summarizes the key responses to its consultation on its mission for 2017 and outlines how the FCA plans to address them, including in relation to difficulties in navigating and interpreting the FCA Handbook, which can create uncertainty as to the Handbook's requirements.

The full text of the documents is available at:

- https://www.fca.org.uk/publication/corporate/our-mission-2017.pdf
- https://www.fca.org.uk/publication/corporate/sector-views-2017.pdf
- https://www.fca.org.uk/publication/business-plans/business-plan-2017-18.pdf
- https://www.fca.org.uk/publication/feedback/fs17-01.pdf

Updated CLLS/Law Society MAR Q&A

On June 30, 2017, the City of London Law Society and the Law Society published their updated Q&A on MAR. This updated version of the Q&A includes a new Part C relating to various transactions (for example, placings or open offers, etc.) involving a subscription for shares. It addresses three specific questions in relation to disclosure of inside information in connection with such transactions:

- can the issuer selectively disclose inside information to counterparties to such transactions;
- if so, can the issuer delay the disclosure of that inside information to the market; and
- does that inside information have to be announced before contracts in respect of the relevant transaction are entered into.

The full text of the updated Q&A is available at:

- http://www.citysolicitors.org.uk/attachments/category/114/MAR%20QA%20Updated%2030%20June%202017.pdf

Money Laundering Regulations 2017 in Force

On June 26 2017, the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 came into force. These regulations implement the EU's 4th Directive on Money Laundering, and replace the Money Laundering Regulations 2007 and the Transfer of Funds (Information on the Payer) Regulations 2007 which were previously in force.

Italian Developments

CONSOB Regulatory Provisions Implementing MAR

On March 22, 2017, the Italian securities and exchange commission (*Commissione Nazionale per le Società e la Borsa*, "**CONSOB**") issued the resolution No. 19925 (the "**Resolution No. 19925**") approving the amendments to certain CONSOB regulations, and particularly to CONSOB Regulation No. 11971 of May 14, 1999, as subsequently amended and supplemented (the "**Regulation on Issuers**"), and to CONSOB Regulation No. 16191 of October 29, 2007, as subsequently amended and supplemented (the "**Market Regulation**"), to implement MAR, with a view to aligning domestic secondary legislation with relevant EU legislation.

In particular, pursuant to the newly introduced Article 144-*bis*.1 of the Regulation on Issuers, buy-back programs and purchase transactions for the stabilization of securities do not represent market abuse, as long as they are carried out in accordance with Article 5 of MAR. Except for these cases, issuers shall inform the public and CONSOB in the form and manner provided in Annex 3F to the Regulation on Issuers when trading in treasury shares.

In addition, with respect to transactions carried out by managers or persons closely associated with them, pursuant to Article 19 of MAR, reporting obligations will be triggered upon exceeding the threshold of €20,000. The same threshold is set for transactions carried out by relevant shareholders of the issuer (i.e., shareholders holding more than 10% of the voting rights).

The Resolution No. 19925 also introduced Article 78-*bis* of the Regulation on Issuers on the transparency of certain issuers' resolutions (such as those approving the financial statements and dividend distributions), which shall be disclosed to the public, and amended Article 109 of the Regulation on Issuers, specifying the manner in which information on relevant events and circumstances shall be disclosed.

In connection thereto, with notice No. 11445 of June 1, 2017, Borsa Italiana reviewed the regulatory framework for model price-sensitive press releases setting out the minimum content and the manner of presenting such information.

Also, with the introduction of Article 109-*ter* of the Regulation on Issuers, the Resolution No. 19925 introduced the possibility for issuers to delay disclosure to the public of information on relevant events and circumstances in order not to prejudice their legitimate interests, subject to specific conditions. In particular, issuers shall give notice to CONSOB of the delay and of related circumstances immediately after the disclosure of the information to the public (and not, as alternatively provided in MAR, upon request of the competent authority).

Finally, with respect to the Market Regulation, the Resolution No. 19925 replaced Articles 40 and 43 of such Regulation on market practice and market manipulation, respectively, with direct references to the relevant provisions of MAR.

Amendments to CONSOB Regulation on Issuers and to Bank of Italy and CONSOB Joint Regulation Implementing UCITS V

On April 27, 2017, CONSOB issued the resolution No. 19974 (the "**Resolution No. 19974**"), approving the amendments to the Regulation on Issuers, and the Bank of Italy and CONSOB amended their joint regulation pursuant to Article 6, paragraph 2-*bis*, of Legislative Decree No. 58 of February 24, 1998, dated October 29, 2007, as subsequently amended and supplemented (the "**Joint Regulation**") to implement the provisions of Directive 2014/91/EU ("**UCITS V**").

In particular, with respect to the rules applicable to depositaries of open-end collective investment funds, Resolution No. 19974 widened the scope of the information to be provided in prospectuses relating to the offering of units of such funds regarding (i) conflicts of interest, (ii) delegation of safekeeping duties, and (iii) depositaries' liability for loss of financial instruments that are held in custody. In addition, Resolution No. 19974 also identified the information to be included in prospectuses with respect to remuneration and employee incentive policies and practices.

The amendments to the Joint Regulation, by entirely replacing Title III of the Joint Regulation, *inter alia*, (i) extended the scope of application of the provisions on remunerations to undertakings for collective investment in transferable securities ("UCITS"), (ii) set out provisions relating to the structure of the remuneration (fixed and/or variable) and (iii) clarified how the provisions should apply to managers belonging to banking groups or brokerage firms.

Requirements for Admission for Issuers Incorporated under Foreign Law

On June 1, 2017, Borsa Italiana S.p.A., the managing company of the Italian stock exchange, issued notice No. 11445 (the "**Notice No. 11445**"), with a view to clarifying the application of the rules concerning issuers incorporated under foreign law.

In particular, in the case of issuers incorporated under foreign law, Borsa Italiana S.p.A., in the process of assessing the sufficient distribution requirements for the purposes of admission to listing, will apply the relevant thresholds provided by local legislation applicable to such issuers in compliance with Directive 2013/50/EU on the harmonization of transparency requirements.

With Notice No. 11445, Borsa Italiana S.p.A. clarified that, for purposes of calculating the sufficient distribution necessary to satisfy the free float requirement for admission to trading (which shall be presumed to exist where shares representing at least 25% of the capital represented by shares of the same class are distributed among professional as well as non-professional investors), the shareholding held by institutional investors, such as collective investment undertakings, pension funds and social security institutions, is generally taken into account, except for shareholding greater than 10% of the total relevant shareholding.

Asia Developments

A Holistic Review to Reform the Listing Regime in Hong Kong

On June 16, 2017, Hong Kong Exchanges and Clearing Limited and its subsidiary The Stock Exchange of Hong Kong Limited (the "**Exchange**") launched a consultation on a package of proposals (the "**Proposals**") through two separate papers:

- the New Board Concept Paper (the "**Concept Paper**"); and
- the Consultation Paper on the Review of the Growth Enterprise Market (GEM) and Changes to the GEM and Main Board Listing Rules (the "**Consultation Paper**").

The Proposals are the result of a holistic review of the Hong Kong listing framework aimed at widening capital markets access by opening up to a more diverse range of issuers and improving the quality of the Exchange's markets. In the Concept Paper, the Exchange proposes the establishment of a New Board, which is separate from the Main Board and the GEM. The New Board will comprise two distinct segments, namely New Board PREMIUM and New Board PRO.

In the Consultation Paper, the Exchange proposes changes to the Main Board and GEM to ensure they reflect currently acceptable standards in the market and address the recent regulatory and market concerns on GEM applicants and listed issuers (largely by tightening up the requirements for GEM listings). The proposed changes to the Main Board eligibility requirements are to preserve the Main Board's position as a market for larger companies.

Synopsis of the Four Boards

Some of the key features of the Main Board, GEM, New Board PREMIUM and New Board PRO are summarized in the table below, should the Proposals be adopted:

	Main Board	GEM	New Board PREMIUM	New Board PRO
Target issuers	Larger established economy companies	Small to mid-sized established economy companies	New economy companies (see below) meeting Main Board financial and key requirements, but unable to meet certain criteria: ▪ non-standard equity governance structures ▪ US-listed companies with standards differing from Hong Kong	Early-stage / pre-profit new economy companies
Weighted voting rights	Not allowed	Not allowed	Allowed	Allowed
Financial requirements, minimum market capitalization at the time of listing	▪ No change to Rule 8.05 of the Main Board Listing Rules ▪ Minimum market capitalization of HK$500 million (currently HK$200 million)	▪ No change to Rule 11.12A of the GEM Listing Rules except for minimum amount of operating cash flow of HK$30 million (currently HK$20 million) ▪ Minimum market capitalization of HK$150 million (currently HK$100 million)	Follow Main Board financial track record requirements in force from time to time	▪ No financial or track record requirements ▪ Minimum market capitalization of HK$200 million
Minimum public float value at the time of listing	▪ HK$125 million (currently HK$50 million) ▪ Minimum 300 investors	▪ HK$45 million (currently HK$30 million) ▪ Minimum 100 investors	Follow Main Board open market requirements in force from time to time	▪ Minimum public float of 25% ▪ Minimum of 100 investors

	Main Board	GEM	New Board PREMIUM	New Board PRO
Offer mechanism	▪ Retail + professional investors ▪ May not list by way of placing only if there is likely to be significant public demand for the securities	▪ Retail + professional investors ▪ Mandatory public offering of at least 10% of the total offer size	Retail + professional investors	Placement to professional investors only
Secondary listing of Mainland companies	Not allowed	Not allowed	Allowed	Allowed
Overseas issuers	Follow guidance in "Joint Policy Statement Regarding the Listing of Overseas Companies" ("**JPS**")	Follow guidance in JPS	▪ Must have IOSCO MMOU / SFC bilateral agreement ▪ Waivers for issuers already listed on a Recognised US Exchange (being the New York Stock Exchange and NASDAQ Stock Market) from Hong Kong "equivalent" shareholder protection standards	▪ Must have IOSCO MMOU / SFC bilateral agreement ▪ No requirement for Hong Kong equivalent shareholder protection as required by JPS
Post-IPO lock-up *("**First Lock-up Period**" refers to the period starting from the listing date, where controlling shareholder(s) cannot dispose any of their equity interests)* *("**Second Lock-up Period**" refers to the period subsequent to the first lock-up period, where controlling shareholder(s) cannot dispose their equity interests to the extent of losing the control status)*				
1. First Lock-up Period	12 months (currently 6 months)	12 months (currently 6 months)	Not discussed	Not discussed
2. Second Lock-up Period	12 months (currently 6 months)	12 months (currently 6 months)	Not discussed	Not discussed

Since New Board PRO would be open to professional investors only, it is proposed that a "lighter touch" approach will apply to initial listing requirements. Specifically, the existing sponsor regime will not apply to New Board PRO and a financial adviser is proposed to be appointed, who would be expected to exercise its own professional judgement as to what investigations are appropriate for the applicant and to ensure that the listing document provides accurate and sufficient information to enable professional investors to make an informed investment decision.

Under the Proposals, there would be no fast-track migration mechanism between the New Board and the Main Board or GEM, or from New Board PRO to New Board PREMIUM. The Exchange proposes removing the "stepping stone" concept (GEM as a stepping stone to the Main Board) and the streamlined process for transfers from GEM to the Main Board. This means that GEM transfer applicants will be required to appoint a sponsor and issue a "prospectus-standard" listing document. Further, the Exchange proposes all GEM transfer applicants to have published at least two full financial years of financial statements after their GEM listings before they can be considered for a transfer to the Main Board.

New Concepts from the Proposals

There are a few new concepts / terminologies introduced in the Proposals which Hong Kong capital markets practitioners and stakeholders should be familiarised with in order to understand the Proposals.

- **New Economy Companies –** New economy companies may encompass a range of different sectors including biotechnology, health care technology, internet and direct marketing retail, internet software and services, IT services, software, technology hardware and storage and peripherals. In light of the evolving nature of technology,

no fixed definition is actually proposed for this terminology and the Listing Committee will retain the ultimate discretion to determine the listing eligibility for the New Board on a principle-based approach.

- **Weighted Voting Rights ("WVR") –** Picking up from where it left off after the roadblock to the "Concept Paper on Weighted Voting Rights" back in 2014, the Exchange is proposing to allow companies with WVR to list in Hong Kong through New Board PRO and New Board PREMIUM. The Exchange admitted that one major attraction of the US market for many companies is that WVR structures are permitted there, whereas the Hong Kong market does not allow them. Two approaches are proposed to regulate companies seeking a listing on the New Board with a WVR structure. One option would be to take a disclosure-based approach. This would require such companies to prominently disclose that they have a WVR structure and the risks associated with the structure. An alternative approach would be to impose mandatory safeguards in addition to disclosure requirements. Examples of such safeguards include restrictions on the types of persons that can hold WVR, the minimum equity that they must hold in the company on an ongoing basis and restrictions on the transfer of WVR to other persons, and requirement that the WVR structure fall away after a predetermined period of time.
- **Private Market –** The Exchange is also exploring the creation of a Private Market, a platform on which unlisted, or pre-listing companies with a market value below HK$150 million could be registered. Registration on the Private Market would enable private companies to manage their shareholder registers, investor communications and corporate actions, and would help prepare companies for an eventual transition to listed status.

Consultation Period

The consultation period for the Proposals is two months and the deadline for responses is August 18, 2017. The Exchange emphasized that these interlinked Proposals should be viewed and considered holistically when deciding the way forward. That said, the Exchange expects the amendments to the GEM Listing Rules and the Main Board Listing Rules to take effect approximately six months after the date of the Consultation Paper, i.e., around December 2017.

The Concept Paper and the Consultation Paper are available at:

- http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp2017061.pdf
- http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp2017062.pdf

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

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