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In this newsletter, we provide a snapshot of the principal Asian, US, European and selected global governance and securities law developments of interest to corporates and financial institutions, both with and without a US listing.

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

ASIAN DEVELOPMENTS

HKEx Launches Consultation on Reform of Connected Transaction Rules

On 26 April 2013, The Stock Exchange of Hong Kong Limited (the "Stock Exchange") launched a two month public consultation on proposals to amend the connected transaction requirements under the Main Board Listing Rules and the Growth Enterprise Market Listing Rules (collectively the "Listing Rules"). Two consultation papers were published, with one dealing specifically with proposals to align the meanings of "connected person" and "associate" in different chapters of the Listing Rules.

Some of the Stock Exchange's proposals are highlighted below:

Use of plain language

The Stock Exchange proposes to simplify the language of the connected transaction rules by replacing the current Chapter 14A of the Main Board Listing Rules and Chapter 20 of the Growth Enterprise Market Listing Rules with the plain language "Guide on Connected Transaction Rules" issued in April 2012.

Relaxation of the rules

While the Stock Exchange considers that the current connected transaction regime, last amended in June 2010, is appropriate and does not merit a fundamental redesign, it is prepared to relax a number of the requirements. We welcome the Stock Exchange's initiatives to simplify the rules and introduce further exemptions where the risk of abuse by connected persons is limited. In particular, we believe that the proposed exemptions for connected persons at the subsidiary level, as discussed below, would help to reduce compliance burden on listed issuers.

Exemptions for transactions entered into with connected persons at the subsidiary level. Under the Listing Rules, "connected persons" include both connected persons at the issuer level and connected persons at the subsidiary level. Unless an exemption applies, a transaction between the listed group and a connected person is subject to reporting, announcement and independent shareholders' approval requirements. Taking into account that connected persons at the subsidiary level are less likely to be able to influence the decisions of the issuer, the Stock Exchange proposes the following exemptions, which may be adopted together or separately:

- exempt transactions with persons connected only at the subsidiary level from the independent shareholders' approval requirement; and/or
- full exemption for all transactions with persons connected only at the subsidiary level, other than transactions between a subsidiary (or any subsidiary below it) and the person connected with that subsidiary.

Excluding certain transactions involving buying or selling interests in target companies from or to third parties where the risk of abuse by "controller" is limited. At present, connected transactions include acquisition or disposal of interests in a target company where each of the issuer and its "controller" is, or will be, a shareholder of the target company. "Controller" is defined to mean a director, chief executive or controlling shareholder (30% or more) of the issuer or any of its subsidiaries. The Stock Exchange considers that the current scope of the rules is too wide and proposes the following changes:

- limit the application of the rules to acquisition of interests by the listed group in a target company in which a controller is, or will be, a substantial shareholder (10% or above); and
- exclude transactions involving target companies partly owned by controllers at the subsidiary level.

Expanding the "insignificant subsidiary" exemption. The Stock Exchange proposes to expand the exemption for transactions entered into between the listed group and persons connected only because of their relationship with the issuer's insignificant subsidiaries and remove these persons from the definition of "connected person".

Removing the 1% cap for the exemption on provision of consumer goods and services. Currently, an issuer providing or receiving consumer goods or services to or from a connected person may rely on a full exemption provided that a number of conditions are satisfied. One of the qualifying conditions to the exemption is that the transaction value must be less than 1% of the listed group's total revenue or total purchases. If the 1% cap is removed as proposed by the Stock Exchange, the exemption will apply irrespective of the transaction size so long as the other qualifying conditions are satisfied, e.g. the transaction must be on normal commercial terms, the goods or services have to be for private use or consumption and must be consumed in the same state as when they were acquired.

Exemptions for indemnity or insurance against directors' liabilities. It is also proposed that exemptions be introduced allowing issuers to grant indemnities to directors and to purchase insurance for directors against liabilities that may be incurred in the course of performing their duties, provided that such indemnity or insurance does not contravene any law of the issuer's place of incorporation.

Relaxation of requirements applicable to continuing connected transactions. Connected transactions may be one-off transactions or continuing transactions. Under the current rules, an issuer is required to enter into a written agreement, and to disclose the annual caps on a continuing connected transaction in terms of monetary value. The Stock Exchange proposes that the requirement for a written framework agreement may be waived if it is impracticable or unduly burdensome and the issuer has obtained a mandate for the transaction from its shareholders. In relation to a continuing connected transaction of a revenue nature, the issuer will be allowed to disclose the annual caps in monetary terms or as a percentage of the issuer's annual revenue or other financial items in its published audited accounts.

Proposals to align and enhance the meaning of "connected person" in the Listing Rules

Currently, Chapter 14A of the Main Board Listing Rules and Chapter 20 of the Growth Enterprise Market Listing Rules extend the general definitions of "connected person" and "associate" to a wide scope of persons for the purposes of the connected transaction rules. The Stock Exchange proposes that such extended meanings of "connected person" and "associate" should apply not only to the connected transactions but also transactions and corporate actions under other parts of the Listing Rules where there is a need to protect public shareholders from possible conflicts of interests, e.g. notifiable transactions, voting at general meetings and board meetings, share option schemes and repurchase of securities.

In addition, the Stock Exchange proposes to clarify in the rules that it may deem as an issuer's connected person:

- a shadow director or a de facto controlling shareholder of the issuer; and
- any person who is accustomed to acting according to a connected person's directions.

Other consultation issues

The Stock Exchange proposes to retain the following connected transaction rules subject to market comments:

Thresholds for de minimis exemptions. The de minimis exemptions provide both percentage and monetary limits to exempt small transactions. The Stock Exchange proposes to retain the current monetary limits of HK$1 million for fully exempt connected transactions and HK$10 million for connected transactions exempt from the independent shareholders' approval requirement, and invites comments on whether such limits should be retained or increased.

Connected persons at the issuer level. Currently, connected persons at the issuer level include an issuer's directors, substantial shareholders and their respective associates. The Stock Exchange notes that in some other jurisdictions, directors of an issuer's controlling shareholder or holding company would also be taken as connected parties, and market comments are sought on whether similar extension of the meaning of "connected person" should be made in Hong Kong.

Financial assistance to or from "commonly held entity". At present, the provision or receipt of financial assistance to or from a connected person or a "commonly held entity" are both classified as a connected transaction. A "commonly held entity" is a company whose shareholders include (i) a member of the listed group, and (ii) any connected person at the issuer level who can control the exercise of 10% or more of the voting power of the company. Given financial assistance is generally a high risk area, the Stock Exchange proposes to retain the rules on financial assistance involving commonly held entities subject to market comments.

The consultation closed on 26 June 2013.

The consultation papers are available at:

http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp201304.pdf

http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp2013042.pdf

US DEVELOPMENTS

SEC Developments

SEC Staff Issues Guidance on Conflict Minerals

On 30 May 2013, the US Securities and Exchange Commission ("SEC") Division of Corporation Finance issued responses to frequently asked questions ("FAQs") on various aspects of the reporting requirements regarding conflict minerals originating in the Democratic Republic of the Congo and adjoining countries ("Conflict Minerals Rules").

The SEC Staff provided responses to 12 FAQs ranging from substantive interpretations, such as whether packaging is covered – it is not – to procedural applications of the Conflict Minerals Rules. A myriad of other issues will continue to be debated. For the upcoming first reporting deadline of 31 May 2014 for the 2013 calendar year, and in the likely absence of further SEC Staff guidance, each issuer will ultimately need to make judgments on how best to comply with the Conflict Minerals Rules based on its specific facts and circumstances and in consultation with its advisors and relevant industry association. Accordingly, we would urge all SEC reporting issuers to proceed apace with its conflict minerals compliance program and due diligence inquiries to satisfy this new reporting obligation.

Our related client publication is available at:

http://www.shearman.com/files/Publication/e9d70c77-d47e-4dee-9ed6-012fdeda7a11/Presentation/PublicationAttachment/b7607027-46aa-4a41-bc8d-58903c87ec10/SEC-Staff-Issues-Guidance-on-Conflict-Minerals_CM_053113.pdf

Court Vacates SEC Resource Extraction Rule

The SEC, in August 2012, adopted a rule that requires resource extraction issuers to include in their annual report information relating to any payment made by the issuer to a foreign government or the US federal government for the purpose of the commercial development of oil, natural gas or minerals. This rule was adopted pursuant to Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which added Section 13(q) of the Securities Exchange Act of 1934.

The American Petroleum Institute and others brought an action against the SEC challenging this rule for a number of reasons. On a motion for summary judgment, the District Court for the District of Columbia determined on 2 July 2013 that the SEC "misread the statute to mandate public disclosure of the reports, and its decision to deny any exemption was, given the limited explanation provided, arbitrary and capricious." Consequently, the Court ordered for the rule to be vacated.

Because of the Court's decision to vacate the rule, the rule as it now stands is void. Consequently the SEC would be required to go through a new rulemaking process if it intended to reinstate the rule. As of now, companies will not be obliged to comply with the new rule for fiscal years ending after 30 September 2013.

Our related client publication is available at:

http://www.shearman.com/Court-Vacates-SEC-Rule-on-Disclosure-of-Government-Payments-by-Resource-Extraction-Issuers-while-Similar-EU-Requirement-is-Finalized-07-03-2013/

Noteworthy US Securities Law Litigation

Police & Fire Retirement System of the City of Detroit v. IndyMac MBS, Inc.: Court Rules that Statute of Repose under Securities Act of 1933 is not Subject to Tolling

In June 2013, a federal appeals court ruled that the three-year statute of repose that governs claims under the Securities Act of 1933 could not be extended under a doctrine known as American Pipe tolling. The doctrine is named after a 1974 Supreme Court case – American Pipe & Construction Co. v. Utah – which held that the filing of a class action tolls (or suspends) the running of the statute of limitations for all members of the proposed class during the pendency of the case.

In IndyMac, the plaintiffs asserted Securities Act claims against IndyMac and other defendants for alleged misrepresentations in the registration statements that governed over 100 different offerings of mortgage-backed securities. In 2010, the district court dismissed for lack of standing all claims arising from securities not purchased by the named plaintiffs. Six other unnamed members of the putative class then moved to intervene to assert claims arising from those securities. The district court denied the motion to intervene because the Securities Act statute of repose had expired and the intervening plaintiffs' claims were accordingly time-barred. The district court also held that the Securities Act statute of repose was not subject to class action tolling under American Pipe.

The Second Circuit, affirming the lower court, concluded that the time limitation contained in the Securities Act statute of repose is "absolute" and not subject to tolling. In reaching this conclusion, the Second Circuit declined to resolve the still open question of whether American Pipe is a form of equitable or legal tolling. As the Court wrote, if American Pipe tolling is equitable in nature, then it is inapplicable to the Securities Act statute of repose under prior Supreme Court precedent. If, instead, American Pipe tolling is legal in nature (because it derives from Rule 23 of the Federal Rules of Civil Procedure), then its application to the Securities Act statute of repose is barred by the Rules Enabling Act, which forbids interpreting any Federal Rule as abridging, enlarging or modifying any federal right.

This decision could have a significant impact on some securities class actions because it will force unnamed members of a proposed class to decide, before the statute of repose expires, whether they need to assert their own individual claims (either by filing their own separate lawsuit or, where appropriate, by seeking to intervene in the pending class action).

Indiana State District Council of Laborers & HOD Carriers Pension & Welfare Fund v. Omnicare, Inc.: Sixth Circuit Establishes a Lenient Standard for Pleading a Section 11 Claim Based on an Allegedly Misleading Opinion in a Registration Statement

In May 2013, a federal appeals court ruled that, when a plaintiff asserts a claim under Section 11 of the Securities Act of 1933 based on an allegedly false statement of opinion or belief, the plaintiff must plead (and eventually prove) that the statement was objectively false, but does not have to plead or prove that the defendant knew the statement was untrue at the time it was made.

In Omnicare, the plaintiffs alleged that Omnicare, which is one of the largest providers of pharmaceutical care services for the elderly in the United States and Canada, made a materially misleading statement in its registration statement for a secondary public offering when it stated that its contracts with drug companies were "legally and economically valid arrangements that bring value to the healthcare system and patients that [it] serve[s]." The plaintiffs claimed that the statement about "legal compliance" was materially misleading because, a month after the secondary public offering, several government agencies raided Omnicare facilities, and, less than a year later, Omnicare and one of its subsidiaries settled allegations that it had received kickbacks from pharmaceutical manufacturers and submitted false claims to Medicare and Medicaid. The defendants moved to dismiss the plaintiffs' complaint, and the district court granted the motion because, among other things, the plaintiffs failed to allege facts suggesting that the defendants knew their statement about legal compliance was false when made.

On appeal, a federal appeals court reversed the district court's decision and ruled that, for a Section 11 claim, it was inappropriate for the district court to require the plaintiffs to plead knowledge of the statement's falsity, even for a statement of opinion or belief. The court explained that, because Section 11 provides for strict liability when a registration statement contains an untrue statement of material fact, a defendant's knowledge is not relevant to the claim.

This decision conflicts with those of other federal appeals courts, which have held that an opinion can give rise to a claim under Section 11 only if the complaint alleges that the statement was both objectively false and not believed by the defendant at the time it was made. The conflict makes it somewhat more likely that the Supreme Court will agree to hear a case raising this issue in the future.

More information on the Omnicare case is available at:

http://www.shearman.com/The-Sixth-Circuit-Establishes-a-Lenient-Standard-for-Pleading-a-Section-11-Claim-Based-on-an-Allegedly-Misleading-Opinion-in-a-Registration-Statement-06-25-2013/

SEC v. Wyly: Court Limits Tolling of Five Year Statute of Limitations Governing Civil Penalty Claims to Narrow Circumstances

In June 2013, a federal district court in New York ruled that the five-year statute of limitations that governs civil penalty claims brought by the SEC should be tolled only in very narrow circumstances – for example, where the defendant destroys evidence or takes active steps to prevent the SEC from filing its suit within the limitations period. In reaching this conclusion, the district court relied on the Supreme Court's recent decision in SEC v. Gabelli, which, as we noted in our April 2013 update, held that, in civil actions where the SEC seeks civil penalties, the five-year statute of limitations begins to run when the fraud occurs and not when the fraud is discovered by the SEC.

In Wyly, the SEC argued that the five-year statute of limitations was tolled because the defendants had engaged in acts of concealment, such as lying to the SEC and using offshore accounts to avoid SEC disclosure requirements. The district court ruled that this evidence was insufficient because it failed to distinguish between the defendants' acts of perpetration and their acts of concealment. The Court explained that, in order to obtain the benefit of tolling based on the doctrine of fraudulent concealment, the SEC had to identify specific acts beyond those that form the basis for the claim, such as preventing the SEC from filing suit within the limitations period or destroying evidence. Because the SEC failed to cite any acts by the defendants that were sufficiently separate from the substantive fraud at issue, the court ruled that the five-year statute of limitations was not tolled.

The Wyly case is noteworthy because it is one of the first cases to invoke the Supreme Court's recent decision in Gabelli, and limits the applicability of the doctrine of fraudulent concealment for purposes of tolling the five-year limitations period.

SEC v. Bankosky: Court Considers Director/Officer Ban for Securities Violators

In May 2013, a federal appeals court identified factors a court can consider in deciding whether an individual who committed securities fraud should be barred from serving as an officer or director of a public company.

As background, prior to 2002, Section 21(d)(2) of the Securities Exchange Act of 1934 stated that a court could prohibit any person who committed securities fraud from serving as an officer or director if the person's conduct demonstrated "substantial unfitness." In interpreting this statute, courts typically relied on six non-exclusive factors to determine whether to impose the officer and director bar: (1) the egregiousness of the underlying securities law violation; (2) the defendant's repeat offender status; (3) the defendant's role or position when he engaged in the fraud; (4) the defendant's degree of scienter; (5) the defendant's economic stake in the violation; and (6) the likelihood that the misconduct will recur. In 2002, as part of the Sarbanes-Oxley Act, Congress amended Section 21(d)(2) and eliminated the word

"substantial" from the statute because, according to the legislative history, the "substantial unfitness" standard caused courts to refrain from imposing bars even in cases where the defendant engaged in egregious misconduct.

In Bankosky, the SEC asked a district court to impose a permanent bar on a senior executive of a pharmaceutical company who had engaged in insider trading. In analyzing the SEC's request, the district court applied the six factors and noted that, on the one hand, the defendant was not a repeat offender and his behavior was not egregious, but that, on the other hand, he knowingly engaged in insider trading, provided false testimony to the SEC, and placed his own interests ahead of his company's. Based on this balancing, the court imposed a ten-year bar.

On appeal, the SEC argued that the six factors were no longer applicable because Section 21(d)(2) had been amended. The federal appeals court disagreed and held that the six factors were as relevant in determining "unfitness" as they were in determining "substantial unfitness." Importantly, the court stated that the six factors were neither mandatory nor exclusive, and that a court could take other relevant factors into consideration in deciding whether to impose the bar as long as there was factual support for each factor on which the court relied. Based on this standard, the court affirmed the district court's imposition of a ten-year bar.

This case is the first federal appeals court decision to analyse the amended statute governing officer and director bars and provides guidance to practitioners, officers, and directors about the factors courts will consider in deciding whether to impose one.

Recent SEC/DOJ Enforcement Matters

Ralph Lauren Corporation

In April 2013, Ralph Lauren Corporation became the first company to enter into a non-prosecution agreement ("NPA") with the SEC in order to resolve allegations that it violated the Foreign Corrupt Practices Act ("FCPA"). The case developed after Ralph Lauren discovered that one of its subsidiaries in Argentina had paid bribes to government officials in order to secure the importation of its products into Argentina without having to obtain certain paperwork and inspections. Upon learning of the problem, Ralph Lauren conducted an internal investigation and promptly reported its findings to the SEC.

The SEC indicated that it entered into the NPA – rather than charging Ralph Lauren with violations of the FCPA – because Ralph Lauren reported the violations on its own initiative and provided extensive cooperation to the SEC in its investigation. Under the terms of the NPA, Ralph Lauren agreed to pay $593,000 in disgorgement and $141,845.79 in prejudgment interest. In parallel criminal proceedings, Ralph Lauren entered into an NPA with the Department of Justice and agreed to pay an $882,000 penalty.

This case marks the first time that the SEC has used an NPA to resolve an FCPA investigation. The SEC announced that it would begin using deferred prosecution and NPAs in 2010 as part of its "Cooperation Initiative." Since announcing the initiative, the SEC has entered into NPAs in other contexts, but not in an FCPA case.

Employment Benefits Updates

Ongoing Fee Disclosure Obligations Under ERISA

Both US and non-US firms that manage separate accounts or funds that hold assets of plans regulated by the Employee Retirement Income Security Act of 1974 ("ERISA") are subject to ongoing disclosure obligations to ERISA plan clients under the fee disclosure regulations of the US Department of Labor (the "DOL"). It has been nearly a year since the

DOL's regulations on service provider fee disclosures first became effective. These regulations require asset managers and certain other service providers to ERISA plans to provide their plan clients with detailed disclosures related to the direct and indirect fees charged to the plans, thereby allowing plan administrators (including companies that sponsor employee benefit plans subject to ERISA) to comply with their own disclosure obligations to participants. The regulations resulted in a round of fee disclosures to existing plan clients last summer ahead of the 1 July 2013 effective date of the new regulations.

The DOL regulations also require asset managers to keep their fee disclosures current. New disclosure obligations are triggered when there are changes, whether or not material, to the information that managers previously provided to plan fiduciaries. Some of the changes to the fee disclosure may be covered in an amended investment management agreement, which, by definition, would have been given to the plan fiduciary as part of the amendment process. Alternatively, an emerging best practice appears to be a single disclosure document, similar to the template provided in the DOL regulations, capturing all changes to covered disclosure items since the last update.

Some of the most common changes that require supplemental disclosure are described below:

- First, at least annually, managers of plan asset funds need to disclose changes to each of the following:
  - the compensation that is charged directly against the plan asset fund (such as commissions, sales loads, sales charges, redemption fees, surrender charges, exchange fees, account fees and purchase fees) and that is not included in annual operating expenses;
  - the annual operating expenses charged against the plan asset fund, if the return is not fixed, and other ongoing expenses in addition to annual operating expenses; and
  - if the fund being managed is an investment option in a client's self-directed individual account plan (such as a 401(k) plan), other information about the fund that is within the manager's control or reasonably available to the manager and which the plan client is required by the DOL to disclose to plan participants.
- For purposes of the DOL regulations, the phrase "at least annually" appears to mean at least once in any 12-month period. The first anniversary of the effective date of the fee disclosure regulations was 1 July 2013. Therefore, due to the ambiguity in the regulations, some managers have been taking the precautionary step of making any required updated disclosure by 1 July 2013.
- Second, managers of plan asset funds and separate accounts must disclose changes to any of the following no later than 60 days after becoming aware of the change:
  - fiduciary services provided by the manager;
  - direct or indirect compensation that the manager, its affiliates or subcontractors expect to receive in connection with the fiduciary services provided to the plan asset fund or separate account;
  - compensation paid among the manager, its affiliates or subcontractors (referred to as "related parties") for the fiduciary services provided to a plan asset fund or separate account, if the compensation is set on a transaction basis or charged against a plan's investment and reflected in the net asset value of the fund or separate account;
  - compensation to be paid to the manager, its affiliates or subcontractors for terminating the arrangement; and
  - changes in the manner in which any compensation will be received by the manager, its affiliates or subcontractors. For example, a change from billing a plan for the compensation to deducting the compensation from the separate account managed for the plan must be disclosed.

There may be overlap between these disclosure requirements. For example, changes in compensation among related parties may overlap with the disclosure of changes in direct or indirect compensation. Additionally, changes that require disclosure within 60 days may overlap with the changes that require disclosure at least annually, such as the requirement to disclose changes in direct compensation and the requirement to disclose changes in compensation that will be charged against a plan asset fund. Typically, compliance with the 60-day deadline should suffice to satisfy the annual disclosure requirement.

The DOL regulations do not include a materiality threshold for reporting changes and failure to comply could require termination of the arrangement with the ERISA plan. As a result, companies should be aware of the disclosure requirement and work with managers to ensure timely compliance with the requirement.

Our related client publication is available at:

http://www.shearman.com/once-is-not-enough-ongoing-fee-disclosure-obligations-under-erisa-06-05-2013/

EU DEVELOPMENTS

Third Country Equivalence Advice Under EMIR

On 14 June 2013, the European Commission extended the deadline for the European Securities and Markets Authority ("ESMA") to provide its technical advice on third country equivalence under the European Market Infrastructure Regulation ("EMIR"). The ESMA advice on the US and Japanese regimes is now due on 1 September 2013 and its advice on the regimes in Australia, Canada, Hong Kong and Switzerland is due on 1 October 2013. The European Commission and ESMA have announced that they will apply to the Commodity Futures Trading Commission ("CFTC") for a substituted compliance assessment to be undertaken on EU rules for the CFTC's entity level and transaction level requirements for swaps.

The European Commission letter extending the deadline is available at:

http://www.esma.europa.eu/content/Updated-mandate-EMIR-equivalence

Reporting Start Date Under EMIR

ESMA has indicated on its website that the start date for reporting interest rate and credit derivatives under EMIR is unlikely to be 23 September 2013 as previously indicated. The ESMA website has shown the September start date as the earliest possible date for reporting to begin. However, the date is dependent on a trade repository being registered by 25 June 2013. Applications for registration as a trade repository are decided by ESMA and on the basis of its involvement in that process, ESMA does not consider that such registration will occur before August. The actual reporting start date for these asset classes will be 90 days after registration of a trade repository.

More information from the ESMA website is available at:

http://www.esma.europa.eu/page/European-Market-Infrastructure-Regulation-EMIR

Updated Q&As on EMIR

ESMA has published updated Q&As on the practical implementation of EMIR. The aim of the Q&As is to promote common supervisory approaches and practices in the application of EMIR by national regulators. It is also a useful source of clarity for investors and market participants on the requirements under EMIR.

The updated Q&As are available at:

http://www.esma.europa.eu/system/files/2013-685_qa_ii_on_emir_implementation_final_for_publication_20130604.pdf

European Commission Request for ESMA Technical Advice on Trade Repositories

The European Commission has requested ESMA to provide technical advice on the procedure for the exercise of ESMA's powers of direct registration and supervision over trade repositories. ESMA has until 31 December 2013 to deliver its advice to the Commission.

The European Commission's request is available at:
http://www.esma.europa.eu/system/files/request_for_technical_advice.pdf

Commission Memorandum on Recognition Under EMIR for Non-EU CCPs

On 13 May 2013, the European Commission published a memorandum explaining the recognition procedure under EMIR for central counterparties ("CCPs") that are established outside the EU, but wish to provide services to market participants established in the EU. The Commission stated that CCPs offering clearing services for any type of financial product must apply for recognition - it is not limited to CCPs clearing OTC derivatives. The memorandum discusses the benefits of CCPs being recognised under EMIR and the process for recognition.

The Commission's memorandum is available at:

http://ec.europa.eu/internal_market/financial-markets/docs/derivatives/130513_equivalence-procedure_en.pdf

ESMA Compliance Table on Guidelines on the Market Making Exemption from the Short Selling Regulations

On 19 June 2013, ESMA published a compliance table relating to its Guidelines on exemptions for market making activities and primary market making operations under the European Regulation on short selling and certain aspects of credit default swaps ("Short Selling Regulation"). ESMA noted that the Financial Conduct Authority ("FCA") intends to comply with all the Guidelines with the exception of the provisions concerning the requirement to be a member of a trading venue (which the FCA considers goes beyond the requirements of the Short Selling Regulation) and the scope of products eligible for the exemption (which the FCA considers is too narrow).

ESMA noted that Germany, Denmark and Sweden have also stated that they will not fully comply with the Guidelines and France that it will only do so once they are fully applied by all national regulators across the European Union.

The compliance table is available at:

http://www.esma.europa.eu/content/Guidelines-compliance-table-Exemption-market-making-activities-and-primary-market-operations

ESMA Technical Advice on the Impact of the Short Selling Regulation

On 3 June 2013, ESMA published its technical advice on the impact of the Short Selling Regulation. The report includes the following key recommendations:

- making technical improvements for the calculation of net short positions in shares;

- revisiting the method of calculation of net short positions in sovereign debt, particularly the duration-adjusted approach;
- reviewing the threshold for notifications relating to sovereign debt;
- considering adjustments to allow internal locate arrangements within the same legal entity for uncovered short sales in shares and sovereign debt;
- revisiting the definition of "liquid shares" for the purpose of locate arrangements;
- refining the language on bans on uncovered sovereign CDS transactions;
- developing an alternative approach to the list of shares exempted from the Regulation on the basis of turnover calculations;
- amending the scope of the market maker exemption;
- considering changing the instrument per instrument approach for notifications of the market maker exemption; and
- simplifying the regime for introducing temporary bans in the case of a significant fall in price.

ESMA's technical advice is available at:

http://www.esma.europa.eu/system/files/2013-614_final_report_on_ssr_evaluation.pdf

European Parliament Resolution on Proposal to Amend Accounting Directive

On 21 June 2013, the Council of the European Union announced that it had adopted a European Commission proposal creating a single directive to standardise the form and content requirements of annual and consolidated financial statements, in order to minimise reporting obligations, especially for single-member entities. This new directive consolidates, repeals and replaces the Fourth and Seventh Company Law Directives (78/660/EEC and 83/349/EEC, respectively). The Commission has indicated that the new directive may pave the way for more stringent tax disclosure obligations by large companies in future (reflecting the extended disclosure regime credit institutions have been required to comply with in recent years).

The new directive focuses primarily on:

- including "micro-undertakings" (undertakings with a balance sheet not exceeding EUR 350,000 per year, or an annual net turnover of less than EUR 700,000) as a category of undertaking and allowing such entities to produce simple accounts with minimal notes;
- redefining "small undertakings" as those with any two of the following characteristics:
  - a balance sheet of no more than EUR 4,000,000;
  - a net turnover of no more than EUR 8,000,000; and
  - an average number of employees during the financial year of no more than 50,

although Member States have been granted leeway to shift the above thresholds upwards to EUR 6,000,000 and EUR 12,000,000 respectively;

- generally limiting disclosure for small undertakings, in terms of what the notes to the accounts are required to provide, and removing the requirement for such accounts to be audited;
- requiring:

   - "medium-sized undertakings" (those with any two of the following characteristics: a balance sheet between EUR 4,000,000 and 20,000,000, a net turnover of between EUR 8,000,000 and 40,000,000 and an average number of employees per financial year of no more than 250);
   - "large undertakings" (those with any two of the following characteristics: a balance sheet over EUR 20,000,000, a net turnover over EUR 40,000,000 and an average number of employees per financial year of more than 250); and
   - "public-interest entities" (those with transferable securities admitted to trading on a regulated market, credit institutions, insurance undertakings or undertakings designated as "public interest entities" by Member States because of their business, size or number of employees),

to disclose the nature and purpose of arrangements that are not included in the balance sheet and the financial impact on the undertaking of the risks or benefits of such of those arrangements as is necessary for the purposes of assessing the financial position of the undertaking. Such entities must also disclose the nature and effect of material events arising after the balance sheet date but which would otherwise have been included on it and certain information about related party transactions; and

- requiring that all payments over EUR 100,000 to governments by certain extractive or logging companies, such as mining or oil companies, be disclosed annually in a separate report to the entity's Annual Report, to improve transparency.

Our related client publication is available at:

http://www.shearman.com/Court-Vacates-SEC-Rule-on-Disclosure-of-Government-Payments-by-Resource-Extraction-Issuers-while-Similar-EU-Requirement-is-Finalized-07-03-2013/

European Parliament Resolution Adopting Amendments to Transparency Directive

- On 12 June 2013, the European Parliament passed a resolution to adopt, with amendments, the European Commission's proposal for a directive to amend the Transparency Directive (2004/109/EC), for the purpose of further harmonising the transparency requirements of issuers trading on regulated markets. The amended proposal has now been submitted to the European Council for approval. The European Parliament focused on:
   - despite the abolition of interim accounting requirements, delegating authority to Member States to require (if desired) more frequent publication of periodic financial information than annual and half-yearly financial reports, where doing so would not constitute a significant financial burden on issuers and where doing so would be proportionate to investment decisions;
   - extending the deadline for publication of half-yearly financial reports from two to three months after the end of the reporting period;
   - delegating authority to Member States to set stricter obligations than are currently required under the Transparency Directive for content and timing of notifications, including the disclosure of shareholders' intentions and the process for notifications by major shareholders;
   - preventing Member States from requiring more stringent rules than are provided in the current Transparency Directive concerning the basis of calculation of notification thresholds and aggregation of voting rights attaching to shares with those attaching to financial instruments. In relation to the level of the thresholds themselves, Member States should, however, have the right to set both lower and additional thresholds for

notification of voting rights or requirements for disclosure of capital holdings, despite the proposed changes to what is included in the calculation;

- requiring issuers in the extractive or logging industries to make the annual disclosures noted above, in the discussion of the Accounting Directive, concerning payments to governments;
- introducing default determination of a "home Member State" for issuers who do not disclose their "home Member State" within three months of being required to do so by the competent authorities. The default will be the Member State in which the issuer is admitted to trading and, where this is true in respect of more than one Member State, each of those Member States will be a "home Member State" until the issuer specifies a single one. To ensure consistency in the definitions of "home Member State" in the Transparency Directive and the Prospectus Directive (2003/71/EC), the European Parliament has indicated that Article 2(1)(m) of the Prospectus Directive should be amended to provide additional flexibility where securities of an issuer incorporated in a third country cease to be admitted to trading on a regulated market in its home Member State, but instead are admitted to trading in at least one other Member State;
- Member States must ensure that, under national law, the available sanctions for breaches of the disclosure and notification requirements in the Transparency Directive include the power to suspend the voting rights attached to the shares. However, in relation to breaches of the notification requirements, Member States may provide for such suspension to apply in relation to the most serious breaches only. Member States are permitted to provide for additional sanctions or measure or higher levels of fines than those provided in the Transparency Directive; and
- providing a longstop date of January 2018 for ESMA to produce a single online access portal for all regulated information of all issuers with securities admitted to trading on a regulated market in the EU.

The revised framework is available at:

http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+TA+20130612+SIT+DOC+WORD+V0//EN&language=EN

Prospectus Directive: ESMA Report Comparing National Liability Regimes

- On 10 June 2013, in response to a request from the European Commission, ESMA published a report comparing sanctions and liability regimes across the European Economic Area ("EEA") under the Prospectus Directive, with the aim of harmonising liability regimes across the EU and providing a clearer compliance framework for issuers. The Prospectus Directive (Article 6) currently requires the issuer or its board, the offeror, the person requesting admission to trading or the guarantor to take responsibility for the prospectus, by way of a statement included in the prospectus. Currently, the standard of liability is left for individual Member States to decide upon.
- The report details the responses of competent authorities across the EEA to questions on civil, administrative, criminal and governmental liability for breaches of national prospectus legislation, which implements the Prospectus Directive and Prospectus Regulation across the EEA. Most significantly, the report finds that persons in breach may be held liable in multiple jurisdictions, which may cause compliance difficulties where jurisdictions diverge on their approach. There are common areas under national law under all four areas of liability, including the degree of fault, and negligence in particular, which triggers liability thresholds, the fact that liability for including false or misleading information in a prospectus may be both criminal and civil and that punishments for criminal breach may include both fines and imprisonment. ESMA concludes that no one approach is better than the next,

where there are differences. ESMA has not yet proposed concrete plans to progress harmonisation of liability regimes beyond this consultation.

The report is available at:

http://www.esma.europa.eu/system/files/2013-619_report_liability_regimes_under_the_prospectus_directive_published_on_website.pdf

European Parliament Non-Legislative Resolution on the Takeover Bids Directive

- On 21 May 2013, the European Parliament adopted a non-legislative resolution on the application of the Takeover Bids Directive (2004/25/EC) to clarify certain aspects of the directive in response to a report on its impact by the European Commission, published in June 2012. The Commission reported that the directive is working well and the European Parliament's non-legislative resolution simply addresses areas it noted as requiring clarification. It does not make any concrete proposals for reform but suggests that areas requiring clarification might be:
  - the strengthening of a level playing field between bidder and target companies;
  - encouraging cooperation between national authorities on their approach to takeovers whilst not requiring EU-wide supervision;
  - whether the concept of "acting in concert" could be more helpfully defined and standardised across the EU;
  - whether national derogations from the mandatory bid rule in fact jeopardise the protection of minority shareholders;
  - ensuring board neutrality both pre- and post-hostile bid to protect shareholder interests;
  - employee rights on a takeover; and
  - the fact that takeover law has been reformed during an economic downturn, so data should continue to be monitored as the market picks up.

The resolution is available at:

http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2013-0198+0+DOC+XML+V0//EN&language=EN

European Commission Proposal for Amending Directive on Disclosure of Non-Financial and Diversity Information

- On 16 April 2013, the European Commission announced its intention to adopt (by means of a directive) a proposal for the disclosure of non-financial information by large companies, being those with more than 500 employees and either a balance sheet totalling more than EUR 20 million or a net turnover of more than EUR 40 million. The 500 employee threshold is higher than the one currently applied within the Accounting Directives (more than 250 employees) in order to limit any undue administrative burden and ensure an appropriate scope of non-financial reporting obligations. It is estimated by the Commission that, on this basis, the new requirement would cover around 18,000 companies in the EU.
- Such companies would therefore have to include, as a minimum, environmental, social, employment, human rights, anti-corruption and bribery matters in their annual report or in a separate, non-financial report. The disclosure is proposed to operate on a "comply or explain" basis and the report should either contain a statement of the company's policies, results and risk factors in relation to each of the above categories, or a justification of why any

such information is missing. To ease the process of compliance, companies may specify that they have acted in line with a given EU-based or international framework in connection with disclosures. The aim of the proposal is to clarify, standardise and improve compliance with existing legislation in this field.

- The proposal also covers the publication of a diversity policy by large listed companies (or an explanation of why the company has no such policy), to include information on age, gender, geographical diversity and educational and professional background. Companies must also provide information on the objectives, implementation and results of the policy.
- It is unlikely that the compliance requirement will be triggered until 2017, which is when it is estimated that the directive should have been implemented by Member States.

The proposal is available at:

http://ec.europa.eu/internal_market/accounting/docs/non-financial-reporting/com_2013_207_en.pdf

UK DEVELOPMENTS

FCA Short Selling Regime

The FCA has introduced, from 10 June 2013, a new regime for notifying and disclosing net short positions in certain instruments. The changes include:

- a new registration form and requirements (only for those who have not previously registered);
- one form to make all notifications and disclosures for shares (including correcting or deleting previous incorrect notifications); and
- one form to make all notifications and disclosures for sovereign debt or sovereign credit default swaps (including correcting or deleting previous incorrect notifications).

On 7 June 2013, the FCA published a new factsheet on the European Regulation on short selling and certain aspects of credit default swaps (Short Selling Regulation) which provides information about the short selling notification process.

FCA information on the new regime is available at:

http://www.fca.org.uk/firms/markets/international-markets/eu/short-selling-regulations/notifications-disclosures

The new factsheet is available at:

http://www.fca.org.uk/static/documents/factsheets/short-selling-factsheet.pdf

The FCA has published a revised note on the UK notification process under the Short Selling Regulation for market-makers and authorised primary dealers. The note takes into account the Guidelines issued by ESMA which applied from 2 June 2013 (the FCA has notified ESMA that it will comply with some but not all of the Guidelines). The note sets out relevant definitions, how to determine the relevant competent authority to notify, the exemptions available under the Regulation and how they apply, as well as details (content, timing and contact) of the notification process.

The revised note is available at:

http://www.fca.org.uk/your-fca/documents/uk-notification-procedures

ESMA's Guidelines are available at:

http://www.esma.europa.eu/node/64784

The Department for Business, Innovation and Skills ("BIS") Calls for Evidence on Corporate Responsibility

On 27 June 2013, BIS requested views on corporate responsibility, meaning the responsibility that organisations should take for the impacts of their decisions and activities on society and the environment through transparent and ethical behaviour, above and beyond statutory requirements. BIS intends to publish an actionable framework by the end of 2013. The key themes around which the BIS consultation is centred are as follows:

- alignment of corporate responsibility policies with international guidelines and principles, such as the UN Global Compact and the OECD Guidelines for Multinational Enterprises. BIS notes specifically that it and the Foreign and Commonwealth Office intend to publish their strategy on the implementation of the UN Guiding Principles on Business and Human Rights and welcome any comments on UK aspects of this guidance (with which corporate responsibility obligations should also be aligned);
- encouraging voluntary reporting and disclosure of non-financial information and greater transparency and standardisation of corporate disclosures by the potential introduction of a set of voluntary metrics and external verification avenues relating to social and environmental factors;
- querying whether companies should be obliged to take responsibility for actions within their supply chain, with a view to encouraging ethical business, and, if so, how this could be achieved without legislation;
- developing corporate responsibility standards for small and medium-sized companies and improving the public profile of such compliance; and
- generally how to improve contributions by businesses to social outcomes and initiatives and how to strengthen ties between businesses and society.

The consultation is available at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/209219/bis-13-964-corporate-responsibility-call.pdf

Financial Reporting Council ("FRC") Feedback Statement on October 2012 Discussion Paper, "Thinking about Disclosure in a Broader Context: a Road Map for a Disclosure Framework"

On 26 June 2013, the FRC published feedback on its October 2012 discussion paper (see our January 2013 newsletter for details) on implementing a disclosure framework and improving the quality and accessibility of corporate disclosure. In the feedback statement, the FRC notes that the International Accounting Standards Board ("IASB") has not yet commenced its project on disclosures, a discussion paper, which is expected to materialise in September 2013. The FRC also announced its intention to provide input on this future project. The FRC's particular recommendations to the IASB are that it should aim to:

- define the boundaries of financial reporting (for example by including non-financial disclosure in a separate report to the annual report);
- develop placement criteria (i.e. criteria as to where particular disclosures should appear in the report);
- provide guidance on "materiality" in disclosures, as well as terms such as "significant", "key" and "critical";

- delineate presentation and disclosure requirements more clearly in International Accounting Standard 1; and
- set principles based on standards rather than a detailed list of disclosure requirements.

The feedback is available at:

http://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Thinking-about-disclosures-in-a-broader-contex/Feedback-Statement/Feedback-Statement-Thinking-about-disclosures-in-a.aspx

Update on Directors' Remuneration

On 24 June 2013, BIS produced the final Large and Medium-sized and Groups (Accounts and Reports) (Amendment) Regulations 2013 (the "Remuneration Regulations") for affirmative Parliamentary approval. The Remuneration Regulations are expected to come into force on 1 October 2013 and set out the form and content of the directors' remuneration report required under the amendments made to the Companies Act 2006 by the Enterprise and Regulatory Reform Act 2013 (the "ERRA"), which was published on 2 May 2013. Further background on this can be found in the April 2013 edition of this newsletter.

The Remuneration Regulations require quoted companies to obtain shareholder approval for a remuneration policy every three years (or earlier, if and when the policy is varied), with which, once approved, the company must comply. Quoted companies must also publish an annual remuneration report for an advisory vote. The most significant updates to the previous draft of the Remuneration Regulations are that:

- more extensive information must be disclosed in the directors' remuneration report on pensions benefits;
- directors must state in the remuneration report how they plan to implement the shareholder-approved remuneration policy over the following financial year (i.e. the year in which the report will be presented to shareholders);
- the extent of any discretion retained by the directors under the approved policy to vary the policy;
- there is no longer a requirement to disclose in the remuneration report the maximum percentage of the face value of long-term incentive scheme awards, which directors could potentially receive; and
- there is no longer a requirement to set out in the policy the maximum total salary for a new director that could be agreed as a percentage of the salary of the highest paid director. Rather, the policy must set out the maximum level of variable remuneration which may be granted to new directors.

BIS has confirmed that the following amendments to the Companies Act 2006, pursuant to ERRA, will come into force on 1 October 2013:

- a requirement for the directors' remuneration report to include a separate forward-looking policy section;
- a requirement for shareholder approval by ordinary resolution at least every three years of the directors' remuneration policy (including the policy on termination payments). The policy must be re-approved before the expiry of the three-year period if the company wishes to change the policy or the shareholders did not approve the advisory vote on the non-policy part of the directors' remuneration report at the company's previous annual general meeting;
- a prohibition on payments to current, former or future directors and remuneration payments for loss of office, unless the payment in question is consistent with the most recently approved remuneration policy. Payments which are inconsistent with an approved policy will be unlawful. The recipient will hold the payment on trust which can then be recovered by way of a derivative action. Directors who approve payments not in line with the remuneration

policy face potential joint and several liability for indemnifying the company against loss resulting from the payment; and

- confirming that the "implementation report" section of the remuneration report, on how the remuneration policy was implemented in the financial year being reported on, is subject to an annual advisory vote.

The Remuneration Regulations is available at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/208289/bis-13-963-draft-large-and-medium-sized-companies-amendment-regulations-2013.pdf

The ERRA is available at:
http://www.legislation.gov.uk/ukpga/2013/24/contents/enacted

BIS Published Revised Draft of the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013

The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 (the "Report Regulations") provide details of the new requirement for a company to produce a standalone annual strategic report, as part of its annual report and accounts. In the January 2013 and April 2013 editions of this newsletter, we discussed the background to this legislation. Broadly, BIS suggested that the Report Regulations would replace the directors' business review by directors in the annual directors' report and perform a similar function to this review but with lighter disclosure requirements. The strategic report is intended to constitute an easier point of access for shareholders, who elect to receive it in place of the full annual report.

On 12 June 2013, BIS produced a revised draft of the Report Regulations, which is intended to come into force on 1 October 2013 and will apply to accounting periods beginning on or after that date. Since the Report Regulations were initially published for consultation in October 2012 ahead of their proposed entry into force on 1 October 2013, BIS has added the following amendments:

- in their annual strategic report, quoted companies must state the gender split, in number, for senior managers (i.e. employees of the company with responsibility for a strategically significant part of the company);
- quoted companies must make certain disclosures in their directors' reports regarding their greenhouse gas emissions (a copy of the client briefing that we proposed on this topic is available at: http://www.shearman.com/uk-proposes-mandatory-carbon-reporting-for-quoted-companies-07-06-2012/); and
- companies must provide supplemental materials (as specified under the Regulations) when providing a copy of their strategic report to those who have agreed to receive it in place of a full version of the annual report and accounts.

The revised draft is available at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/206241/bis-13-889-companies-act-2006-draft-strategic-and-directors-report-regulations-2013.pdf

Implementation of Revised Financial Action Task Force to Prevent Misuse of Companies and Legal Arrangements

On 18 June 2013, the UK government published a policy paper on improving transparency of ownership, control of companies and legal arrangements to tackle illicit activity (such as money laundering, terrorist finance and misuse of companies). It intends to implement the Financial Action Task Force fully and to share findings of a national assessment of money laundering and terrorist financing risks by 2014.

Significantly from a legal perspective, the government plans on using the UK Money Laundering Regulations and the Companies Act 2006 to ensure companies hold accurate, current and adequate information on their beneficial owners. The paper suggests that such information would be held at Companies House and be readily available to the authorities and possibly also to the public. There will be a consultation on whether such information should also be publicly accessible.

The paper proposes a review of company and trust service providers, to improve supervision and enforcement of company facilitators. This could lead to additional identification and verification compliance for company formation agents. The paper suggests that BIS will conduct a review into corporate transparency, including analysis of bearer shares and nominee directors, and will issue a pre-consultation paper by September 2013.

Implementation would occur through the transposition of the 4th EU Money Laundering Directive, UK Money Laundering Regulations, amendments to the Companies Act 2006 and through other relevant bilateral and multilateral agreements. The possibility of improving internal communications on this topic will also be examined.

The policy paper is available at:

https://www.gov.uk/government/publications/uk-action-plan-to-prevent-misuse-of-companies-and-legal-arrangements

Institute of Chartered Secretaries and Administrators ("ICSA") Publishes Guidance on Cyber Risk

ICSA's June 2013 guidance is aimed at boards and is focused on management of cyber risk, as a critical risk analysis matter for board (and audit committee) oversight on a par with other corporate risks, rather than simply an IT problem. Recommendations in the guidance include:

- carrying out a comprehensive risk assessment in relation to current and emerging cyber risks and possible attacks, on a company-specific basis and taking external advice where necessary. The analysis should include consideration of the supply chain, including performing thorough due diligence when outsourcing. The company secretary should take steps to ensure that an adequate quality and quantity of information on cyber risks reaches the board;
- thorough consideration of the consequences of a cyber-attack on the business;
- ensuring that the Chief Risk Officer (or equivalent) appreciates the potential risk of cyber-crime on the business as a whole;
- monitoring and reviewing board control procedures to assess effectiveness and appointment of persons to bring about a quick response to any attack; and
- ongoing assessment of recognised cyber-attacks, to maximise internal controls and their efficiency.

The guidance is available at:

https://www.icsaglobal.com/assets/files/Guidance%20notes/gn06-2013cyberrisk.pdf

ICSA and Airmic Report on Risk Management and Disclosure

On 12 June 2013, ICSA and Airmic, a UK association for risk and insurance management professionals, published a joint report on risk management and disclosure, which focuses on the annual reports and accounting requirements of certain FTSE 350 companies and how achieving a dynamic and comprehensive risk management framework can increase

shareholder confidence. The report notes that the following five components make up effective risk management and should be evidenced in corporate risk reports:

- risk agenda (information on the reasons for undertaking risk management and anticipated benefits);
- risk assessment (information on the extent and methodology for undertaking risk assessments and details of risk factors);
- risk communication; and
- risk governance (providing assurance to shareholders about risks and managing existing and emerging risks).

Based on these criteria, the report found that risk management differs greatly between different FTSE 350 companies and sectors. The most successful sectors at managing risk and developing effective coping strategies are the leisure and retail sectors. Risk management should be a pervasive attribute of wider corporate strategy, rather than a standalone compliance focal point.

The report is available at:

https://www.icsaglobal.com/assets/files/pdfs/guidance/Guidance-notes-2013/icsa-armic-risk-reporting.pdf

FRC Announces Plans in Connection with the Sharman Panel's Recommendations On Going Concern

Having first voiced its support for the Sharman Panel's recommendations in January 2013 (as discussed in our April 2013 newsletter), on 6 June 2013, the FRC announced modifications to its proposed implementation of the Sharman Panel's recommendations on going concern and now intends to:

- issue separate guidance for small and medium enterprises ("SMEs");
- clarify the definition of "going concern", to avoid further confusion over the use of "going concern" to describe both the specific assessment required when preparing the financial statements and the broader assessment of the risks affecting a company's viability. The FRC also plans to consult on whether any clarification in this regard needs to be made to the UK Corporate Governance Code (the "Code"). If so, such changes will be expected to come into force in October 2014;
- make a clearer link between business viability risks and broader corporate risk assessment, which should form part of a company's normal risk management and reporting processes. This clarification will also be considered by the FRC in the further development of the Code and related guidance; and
- issue further consultation documents in 2013 on proposed changes to the Code and on SMEs.

The press release can be found at:

http://www.frc.org.uk/News-and-Events/FRC-Press/Press/2013/June/FRC-to-adopt-lessons-from-consultation-on-going-co.aspx

ESMA Published Updated Q&A on Prospectus Requirements

On 23 May 2013, ESMA updated its "Prospectus Q&As" (last updated in December 2012), which cover frequently asked questions on the requirements of the Prospectus Directive (*2003/71/EC*, as amended by *2010/73/EU*) and Prospectus Regulation 2005 (*SI 2005/1433*).

New answers include a revised definition of the scope of "Profit Estimate" in Article 2 of the Prospectus Regulation. For the purposes of this definition, publication of results for an expired annual financial period equates to publication of the final figures approved by the issuer's persons responsible and in respect of which the auditor's report has been published. Fourth quarter reports which contain unaudited results for an annual financial period should be considered as interim financial information rather than profit estimates.

ESMA has also clarified that an issuer, offeror or person seeking admission to trading need not disclose expenses charged to the investor by financial intermediaries offering securities in a retail cascade. Those expenses will be disclosed in the intermediaries' terms and conditions.

In connection with the proportionate disclosure requirements for SMEs and companies with reduced market capitalisation, ESMA says that the last year of audited financial information may not be older than 15 months from the date of the registration document in cases where the issuer does not include interim financial statements in the registration document. If the issuer submits a prospectus to the competent authority and the audited financial information is older than 15 months (but not older than 18 months), ESMA considers that the competent authority could nevertheless approve the prospectus if the issuer includes audited interim financial statements in the registration document.

The ESMA Q&A can be accessed at:

http://www.esma.europa.eu/system/files/2013-594_19th_version_qa_document_prospectus_related_issues_may_2013.pdf

Companies Subject to the Takeover Code

On 15 May 2013, the Takeover Panel published its response to the consultation it had launched in July 2012 over which UK incorporated targets should be subject to the Takeover Code. Background to this announcement can be found in our October 2012 newsletter. The Panel has announced amendments to the Takeover Code, which will take effect from 30 September 2013 and which will apply even to ongoing transactions which start before and continue after that date. These include:

- that the existing requirement in the Takeover Code that targets whose securities are not admitted to trading on a Regulated Market (such as the Main Market of the London Stock Exchange) in the UK or a stock exchange in the Channel Islands or Isle of Man must have their place of central management and control in the UK, Channel Islands or Isle of Man will no longer apply where such targets have securities admitted to trading on a multilateral trading facility (such as AIM or the ISDX Growth Market) in the UK;
- that this "residency" requirement will, however, be retained for certain categories of companies, in particular companies whose registered office is in the UK, the Channel Islands or the Isle of Man but whose securities are admitted to trading solely on an overseas market; and
- certain more technical amendments to the so-called "ten year rule", under which certain private companies may be subject to the Takeover Code if, during the previous ten years, there have been certain elements of "public trading" in their securities.

The response statement can be found at:

http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/RS201203.pdf

Code Committee of the Takeover Panel Response Statement on Code Amendments for Pension Scheme Trustees

The Takeover Panel's response statement, published on 22 April 2013, confirmed that amendments to the Code would be made to give certain rights to the trustees of an offeree pension scheme as employee representatives currently enjoy. Discussion of the background to this can be found in our October 2013 newsletter. Notable deviations from the consultation paper, which are outlined in the Panel's response statement, include:

- defining "pension scheme" so as to limit the number of schemes under which an offeror must state its intentions under offer documentation;
- not including a requirement for an offeror to state the likely repercussions of its strategic plans for the offeree on the offeree's pension scheme;
- specifying that the offeror's statement of intentions must only relate to employer contributions, the accrual of benefits for existing members and admission of new members;
- not including a requirement for an offeree board circular to set out its views on the effects of the offer on the offeree's pension scheme; and
- not imposing a requirement for a summary of any agreement on future funding between the offeror and the trustees of the offeree's pension scheme to be included in the offer document and on a website. Only material funding contracts relating to the offeror need appear on a website.

The changes took effect on 20 May 2013.

The response statement is available at:

http://www.thetakeoverpanel.org.uk/wp-content/uploads/2013/01/2013-5.pdf

Amendments to the Listing Rules

The Listing Rules were amended as follows, as of 1 May 2013:

- a premium listed company is now required to appoint a sponsor when it is required to submit a supplementary prospectus or supplementary listing particulars;
- there is no longer a requirement for a depositary that issues global depositary receipts to be a suitably authorised and regulated financial institution acceptable to the Financial Conduct Authority; and
- there is no longer a requirement that depositaries issuing global depositary receipts must hold rights and monies relating to the shares on trust (or under equivalent arrangements) for the benefit of global depositary receipt holders.

Earlier discussion on these amendments can be found in our January 2013 newsletter.

The statutory instrument is available at:

http://media.fshandbook.info/Legislation/2013/FCA_2013_44.pdf

The Listing Rules' definition of "sponsor service" has also been amended and broadened to include all the sponsor's communications with the FCA in connection with a service relating when a sponsor must be appointed or its assistance obtained under the Listing Rules.

The statutory instrument is available at:

http://media.fshandbook.info/Legislation/2013/FCA_2013_41.pdf

Quoted Companies Alliance ("QCA") Publishes Updated Corporate Governance Code for Small and Mid-Size Quoted Companies 2013

On 1 May 2013, the QCA published a revised Corporate Governance Code for Small and Mid-Size Quoted Companies 2013 (the "QCA Code"), which updates the 2010 version. As with the UK Corporate Governance Code, the QCA Code sets a minimum standard of compliance for smaller quoted companies, which must report under the QCA Code on a "comply or explain" basis. The QCA Code contains 12 principles of corporate governance, now reordered to reflect a growing emphasis on delivering growth to shareholders on a long-term basis. It also sets out a minimum level of disclosure (for the annual reports or websites of smaller quoted companies) which would evidence compliance with the principles of the QCA Code. The QCA Code places specific emphasis on creating and maintaining an effective and independent board. QCA focuses particularly on the role of the chairman but also considers other important players, including the role of executive directors.

QCA notes that it is desirable for reporting to be company-specific rather than to follow a "one size fits all" approach, in order to engage shareholders properly and earn shareholder trust.

The updated QCA Code is available to purchase at:

http://www.theqca.com/

Share Buybacks: Companies Act 2006 (Amendment of Part 18) Regulations 2013 (*SI 2013/999*) (the "Buyback Regulations")

The Buyback Regulations came into force on 30 April 2013. The Buyback Regulations were adopted in the form published in draft on 19 March 2013. Earlier discussion on the Buyback Regulations can be found in our April 2013 newsletter. Key features of the Buyback Regulations are that:

- private companies may, where authorised by their articles, buy back shares using small amounts of cash (up to a cap of £15,000) which does not form part of their distributable reserves;
- private companies may finance buybacks (in connection with an employees' share scheme) out of capital, subject to signing a solvency statement and obtaining a special resolution and provided that the payment out of capital is made no earlier than five weeks and no later than seven weeks after the relevant shares are surrendered;
- companies may authorise multiple off-market buybacks in advance in connection with an employees' share scheme (rather than having to authorise, separately, each off-market buyback contract);
- private companies and unlisted public companies may hold treasury shares; and
- only an ordinary, rather than a special, resolution is required for approval of an off-market buyback contract.

The Buyback Regulations is available at:

http://www.legislation.gov.uk/uksi/2013/999/pdfs/uksi_20130999_en.pdf

Second Annual Progress Report on Women on Boards

On 10 April 2013, Lord Davies' second annual progress report on women on boards was published. The report highlighted the positive progress by FTSE 350 companies since the first report (published in February 2011), with women accounting for 17.3% of FTSE 100 board positions, as opposed to 12.5% in February 2011. Lord Davies nevertheless recommended that FTSE 350 companies review (or set) targets for 2015, FTSE 250 companies should

follow FTSE 100 companies in aiming for 25% female representation on boards by 2015 (as opposed to the 13.2% current level) and that FTSE 350 chief executives should disclose, by the end of 2013, the percentage of women they aim to have on their executive committees, including senior management levels, in 2015. In furtherance of this, companies should release executive committee members to serve on the boards of other companies. A group of companies should also develop and report on a pilot for advertising directorship opportunities and the risks of such an approach.

The report is available at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/182602/bis-13-p135-women-on-boards-2013.pdf

ICAP Securities & Derivatives Exchange ("ISDX") Consultation on Amendments to Growth Market Framework

An ISDX consultation of 8 April 2013 proposed amendments to the ISDX Growth Market framework, including changes to the ISDX Rules for Issuers and the ISDX Corporate Advisers Handbook. The ISDX Growth Market is a prescribed market (not an EU regulated market) for unlisted securities of small and mid-cap companies. The proposed amendments include:

- a change in eligibility criteria and assessment based on an applicant's free float (with the introduction of a minimum free float of 10% for all issuers (other than investment vehicles)), EBITDA and revenue in the preceding 12 months, three year historic revenue record and gross assets (including cash) (with an 18 month transition period, after which existing issuers will also be assessed on the new criteria);
- tailored rules for specialist issuers, for example mineral exploration companies and investment vehicles;
- increased continuing obligations for issuers, including shareholder approval requirements for certain deep-discounted (25% or more) placings or cancellation of admission to the market, website disclosure of prescribed information and disclosure of related party transactions;
- mandatory corporate governance requirements and limits on the number of directorships held by board members of issuers; and
- increased obligations and codified responsibilities for ISDX corporate advisers.

The outcome of the consultation is awaited.

The consultation is available at:

http://www.isdx.com/files/pdf/consultations/Consultation-Paper.pdf

Local Authority Pension Fund Forum ("LAPFF") Guidelines on Executive Pay

The LAPFF Guidelines on Executive Pay, published in March 2013, aim to promote alternative remuneration strategies amongst FTSE 350 companies that are better aligned with long-term, sustainable returns and shareholder value.

The recommendations cover structure and incentives, such as using base salaries as the primary vehicle for remuneration, rather than variable elements, which should be minimised for large-cap companies and linked only to exceptional performance. Other incentives include phasing out LTIPs in favour of company-wide long-term profit pools that use a formula for calculating bonuses based on salary and seniority, setting pay for new executives below that of departing executives, director participation in pension schemes on the same terms as employees and bonuses being

clawed back where ethical standards are breached or where poor environmental or social performance causes harm to the company.

Pay equity is also recommended. LAPFF discourages using market benchmarks as points of reference, and advocates publishing the ratios between average employee pay and average executive director pay. It advises that the discrepancy of pay between the top and bottom 10% of employees be published.

LAPFF identifies executive recruitment as a key area, advising public advertisement of new executive positions, transparent recruitment processes, consideration of internal candidates for executive roles and the discontinuance of sign-on bonuses.

LAPFF also recommends consultation with shareholders, middle-management and employees on remuneration, in order to minimise the discretion of remuneration committees. Such discretion should only be exercised in order to reduce remuneration levels.

The LAPFF Guidelines is available at:

http://www.lapfforum.org/TTx2/news/files/2013MarchExpectationsonPayFINAL.pdf

DEVELOPMENTS SPECIFIC TO FINANCIAL INSTITUTIONS

EU Developments

Council of European Union Adopts New Capital Requirements Legislation

On 27 June 2013, the Capital Requirements Directive and Capital Requirements Regulation, together known as CRD IV, which amend the EU's rules on capital for banks, were published in the European Official Journal. The new rules will apply from 1 January 2014.

The Capital Requirements Regulation and Capital Requirements Directive are available at:

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:176:0001:0337:EN:PDF

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:176:0338:0436:EN:PDF

EBA Launches Consultations on Draft Technical Standards under New Capital Requirements Regime

The EBA has launched numerous consultations on draft technical standards it is required to prepare under CRD IV. The Authority is also holding public hearings on many of the topics under discussion. Due to the tight deadlines for compliance with the new requirements, the EBA has begun its work early in order to give firms an early insight into its views under the new regulatory framework. The draft technical standards, made up of regulatory technical standards and implementing technical standards, cover the following areas:

- own funds;
- supervisory reporting;
- collateral methodologies;
- FX lending;
- securitisation retention;
- disclosure and notifications under the passport regime;

- remuneration;
- consolidated supervision; and
- connected exposures.

The EBA consultation papers are available at:

http://eba.europa.eu/news-press/calendar?p_p_id=8&tabs1=events&_8_eventTypes=consultation,discussion

ESRB Recommendation on Intermediate Objectives and Instruments of Macro-Prudential Policy

The European Systemic Risk Board's ("ESRB") recommendations on intermediate objectives and instruments of macro-prudential policy were published in the Official Journal on 15 June 2013. The ESRB made five recommendations: (i) macro-prudential authorities should define and pursue intermediate objectives of macro-prudential policy for their national financial system; (ii) Member States should assess the effectiveness of their macro-prudential instruments and add new instruments if necessary; (iii) Member States should define a policy strategy on macro-prudential matters, analyse the application of macro-prudential instruments to strengthen policy and ensure there is no adverse effect on other Member States; (iv) macro-prudential authorities should periodically evaluate their intermediate objectives and instruments; and (v) the European Commission should consider the need for establishing macro-prudential instruments.

Responses to the recommendations should be submitted to the ESRB, European Banking Authority ("EBA") and Council of the European Union by either 31 December 2014 or 31 December 2015, depending on the recommendation to which a response is directed.

The recommendations are available at:

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2013:170:0001:0019:EN:PDF

EBA Recommendations to Supervisors

On 16 May 2013, the EBA agreed on recommendations to supervisors to conduct asset quality reviews on major EU banks. This was agreed so as to help alleviate concerns over the deterioration of asset quality due to negative economic conditions in Europe. Accordingly, the EBA has adjusted the timeline for the next EU-wide stress test to 2014, so that it will take place once these asset quality reviews have been completed.

A press release relating to the recommendations is available at:

http://www.eba.europa.eu/News--Communications/Year/2013/EBA-recommends-supervisors-to-conduct-asset-qualit.aspx

EBA Consults on Regulatory Technical Standards under RRD

On 20 May 2013, the EBA launched consultations on draft regulatory technical standards ("RTS") on the following elements of the proposed recovery and resolution directive ("RRD"):

- The assessment process of recovery plans by competent supervisors.
- The range of scenarios to be used in recovery plans. Financial institutions will be responsible for selecting relevant scenarios, the adequacy of which will be subject to assessment by the national supervisor. In addition, three scenarios are prescribed in the draft RTS: a system-wide event, an idiosyncratic event and a combination of both events.

As the RRD has not yet been finalised, the draft RTS are subject to change.

The consultations on draft RTS are available at:

http://eba.europa.eu/documents/10180/204980/EBA-CP-2013-08---CP-on-Draft-RTS-on-Assessment-of-Recovery-Plans.pdf

http://eba.europa.eu/documents/10180/205759/EBA-CP-2013-09---CP-on-Draft-RTS-on-Scenarios-For-Recovery-Plans.pdf

Credit Ratings Agencies Regulation

On 31 May 2013, a regulation amending the European Regulation on Credit Rating Agencies ("CRA III") and a related directive were published in the European Official Journal. The regulation applied from 20 June 2013 except for certain articles. The directive must be transposed into national laws by EU member states by 21 December 2014. CRA III introduces measures to strengthen the regulation of credit rating agencies ("CRAs") through: (i) reducing the overreliance of issuers on their ratings; (ii) increasing the independence and integrity of CRAs, including limiting the potential for conflicts of interest; (iii) mitigating the potential for market volatility from CRAs' sovereign debt ratings; and (iv) arming investors and issuers with the power of redress when ratings negatively impact upon them as a consequence of intentional or gross negligent breach of the regulations by a CRA.

The regulation is available at:

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:146:0001:0033:EN:PDF

The directive is available at:

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:145:0001:0003:EN:PDF

On 18 June 2013, the European Commission published FAQs on CRA III. The FAQs state the reasons for introducing the new regulation, its scope and the impact it will have.

The FAQs are available at:

http://europa.eu/rapid/press-release_MEMO-13-571_en.htm?locale=en

On 17 June 2013, ESMA published Guidelines and Recommendations as a means of clarifying the interpretation of the scope of the CRA Regulation with respect to the following items: the obligation for CRAs to register with ESMA; credit rating activities and exemptions from registration; the establishment of branches outside the European Union by registered CRAs; the specific disclosure requirement for best practice and enforcement of the scope of the CRA Regulation.

The Guidelines and Recommendations will be translated into the official languages of the European Union. The deadline for reporting requirement dates will be two months after the publication of the translations.

The Guidelines and Recommendations are available at:

http://www.esma.europa.eu/page/CRA-documents

European Commission Consults on the European System of Financial Supervision

The European Commission launched a consultation on the European System of Financial Supervision ("ESFS") on 26 April 2013. The Commission is due to review the ESFS by the end of 2013. The consultation is intended to assist that review. The ESFS was established on 1 January 2011 in response to the failures in financial supervision that the financial crisis exposed.

The Commission is seeking opinions on:

- the effectiveness and efficiency of the European Supervisory Authorities ("ESAs"), which are the EBA, ESMA and the European Insurance and Occupational Pensions Authority ("EIOPA");
- governance of the ESAs and the ESRB;
- the ESRB mandate and experience with systemic risks;
- cooperation and interaction between the ESAs and the ESRB; and
- the structure of the ESFS, including the impact of the creation of the single SSM, which is at the final stages of the EU legislative stages. The SSM will transfer prudential supervision of banks established in euro area Member States to the EBA.

Responses to the consultation are due by 19 July 2013.

The consultation is available at:

http://ec.europa.eu/internal_market/consultations/2013/esfs/index_en.htm

ESMA Peer Review Report on the Application of MMF Guidelines

On 15 April 2013, ESMA published a peer review report examining whether EU securities supervisors correctly apply ESMA's guidelines on money market funds ("MMFs").

The report found that more than two thirds of the 20 jurisdictions reviewed have implemented the MMF guidelines on MMFs nationally as mandatory provisions, while a minority have used measures that do not have the force of law. However, the general supervisory and enforcement approaches relating to MMFs vary across Member States to a significant extent.

The peer review report only covers the situation up to 30 June 2012 and since that date a number of jurisdictions have taken steps to ensure that they are in compliance with the guidelines.

The ESMA peer review report is available at:

http://www.esma.europa.eu/system/files/2013-476_-_peer_review_-_money_market_fund_guidelines.pdf

Venture Capital and Social Investment Funds Regulations

On 25 April 2013, the Regulations on European Venture Capital Funds ("VCF") and European Social Entrepreneurship Funds ("ESEF") were published in the European Official Journal. The VCF Regulation provides for a new internal market for venture capital funds in the EU. The ESEF Regulation introduces measures to improve the effectiveness of fundraising by investment funds who invest in social businesses.

The Regulations are available at:

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:115:0001:0017:EN:PDF

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:115:0018:0038:EN:PDF

ESMA Co-operation Arrangements under the AIFMD

ESMA published a press release on 30 May 2013 announcing that it had approved arrangements between EU securities regulators, with responsibility for the supervision of alternative investment funds ("AIFs"), including hedge funds, private equity and real estate funds, and 34 other regulators. The existence of co-operation arrangements between the

EU and non-EU authorities is a precondition for allowing managers based outside the EU to access EU markets or perform fund management by delegation from EU managers. The co-operation arrangements apply from 22 July 2013.

ESMA's press release is available at:

http://www.esma.europa.eu/system/files/2013-629_esma_promotes_global_supervisory_co-operation_on_alternative_funds_30_may_2013_0.pdf

Consultation Paper on ESMA's Guidelines on AIFMD Reporting Obligations

On 24 May 2013, ESMA published a consultation paper on its guidelines on reporting obligations under the AIFMD. The draft guidelines, set out in Annex II of the consultation paper, provide clarification on the information that AIFs should report to their home state regulators, the timing of such reporting and the procedures an AIFM should follow when moving from one reporting obligation to another. The consultation closed on 1 July 2013.

The ESMA consultation paper is available at:

http://www.esma.europa.eu/content/Guidelines-key-concepts-AIFMD-0

ESMA Final Report on Guidelines on Key Concepts of the AIFMD

On 24 May 2013, ESMA published a report, including final guidelines, on key concepts used in the definition of AIFs in the AIFMD. The aim of the guidelines is to ensure common and uniform application of AIFMD. The Guidelines will apply to AIFMs and national regulators.

The ESMA report is available at:

http://www.esma.europa.eu/content/Guidelines-key-concepts-AIFMD-0

Implementing Regulations for AIFMD

On 16 May 2013, two implementing Regulations required under the AIFMD were published in the European Official Journal: (i) Commission Implementing Regulation No 448/2013 establishing the procedure for determining the Member State of reference of non-EU AIFMs; and (ii) Commission Implementing Regulation No 447/2013 establishing the procedures for AIFMs which choose to opt-in under the AIFMD. Both implementing Regulations entered into force on 6 June 2013 and will apply from 22 July 2013.

European Commission Consultation Paper on Bank Structure Reform

On 16 May 2013, the European Commission published a consultation paper outlining its strategy following the recommendations of the Liikanen High Level Expert Group (*Liikanen*). The paper focusses on the structural separation recommendation only. It is divided into three parts: (i) the problems that bank structural reform is intended to address; (ii) the importance of EU action being coordinated across Member States; and (iii) the policy options being considered on which banks would be subject to separation, the scope of activities to be separated and the strength of separation. The consultation paper is accompanied by an impact assessment which invites respondents from banks to provide data to substantiate their assessments of the impact of bank structural reform. The consultation is open until 11 July 2013.

The European Commission consultation paper is available at:

http://ec.europa.eu/internal_market/consultations/2013/banking-structural-reform/docs/consultation-document_en.pdf

On 7 June 2013, the European Commission published FAQs regarding the template included in its consultation on bank structural reform which was launched in May 2013. The FAQs relate to the confidentiality of the information to be provided by respondents and provide additional scenario analysis.

The FAQs are available at:

http://ec.europa.eu/internal_market/consultations/2013/banking-structural-reform/docs/faq_en.pdf

Online and Alternative Dispute Resolution for Consumer Disputes

On 18 June 2013, Regulations relating to online dispute resolution ("ODR") and alternative dispute resolution ("ADR") for consumer disputes were published in the European Official Journal. The ODR Regulation introduces a mechanism for consumers and traders in the European Union to resolve out-of-court disputes arising out of online transactions by electronic means. The ADR Regulation makes ADR available for all types of disputes stemming from sales or service contracts made between consumers and traders in the European Union. The ODR platform is also applicable to ADR procedures. These Regulations aim to ensure a harmonised, efficient and low-cost means of resolving cross-border disputes in the European Union. Both Regulations will enter into force on 8 July 2013.

The ODR is available at:

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:165:0001:0012:EN:PDF

The ADR is available at:

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:165:0063:0079:EN:PDF

UK Developments

Bank of England Publishes Financial Stability Report

On 26 June 2013, the Bank of England ("BoE") published issue no. 33 of its Financial Stability Report ("FSR"), which included the following recommendations by the Financial Policy Committee ("FPC"):

- The FCA and Prudential Regulation Authority ("PRA") should provide an assessment to the FPC of the vulnerability of borrowers and financial institutions to sharp upward rises in long-term interest rates and credit spreads, by September 2013.
- The PRA should employ, among other measures, the Liquidity Coverage Ratio ("LCR"), as defined in the European Union's implementation of the Basel standard. The FPC recommends that the minimum requirement until 1 January 2015 should be an LCR of 80%, rising thereafter to reach an LCR of 100% on 1 January 2018.
- The PRA, in conjunction with the banking industry, should work to ensure that disclosures by UK banks and building societies are made in line with Pillar 3 disclosures.

The FSR is available at:

http://www.bankofengland.co.uk/publications/Documents/fsr/2013/fsrfull1306.pdf

PRA Statement on Bank Capital

On 22 May 2013, the PRA announced that it is taking forward, with the major UK banks, the adjustments to capital positions relating to expected future losses, conduct costs and prudential risk-weighting, as recommended by the FPC. On 20 June 2013, the PRA announced that it had completed this capital shortfall exercise and noted that following its

discussions with the banks, five out of the eight banks it assessed (Barclays, Co-operative Bank, LBG, Nationwide and RBS) fell short of meeting the target of a risk-weighted capital ratio, based on the Basel III definition, of at least 7% at the end of 2012. The PRA have put the onus on these banks to put together a plan as to how they will remedy these shortfalls.

In March 2013, the FPC recommended, among other things, that the PRA: (i) assess capital adequacy in line with Basel having made some appropriate deductions; (ii) consider applying higher capital requirements to any major bank or building society with concentrated exposures to vulnerable assets; and (iii) should ensure major UK banks and building societies have credible transition plans to meet higher capital targets required by Basel III.

The PRA's statement is available at:

http://www.bankofengland.co.uk/publications/Pages/news/2013/081.aspx

FCA and PRA Statements on CRD IV

The FCA and PRA issued individual, although they are very similar, statements on 16 April 2013 in response to the European Parliament adopting CRD IV. The statements note that the regulators are anticipating that CRD IV is to be implemented from 1 January 2014 and are making their plans accordingly. Both regulators are planning to launch consultations this summer:

1. A main consultation will set out the changes to the FCA's/PRA's rules to remove current FCA/PRA provisions covered in Capital Requirements Regulation ("CRR"), and to implement the Capital Requirements Directive ("CRD") and the relevant discretions provided for in CRR.
2. A consultation on specific issues related to the procedure for transitioning, as appropriate, existing waivers, which will be conducted either before or as part of the main consultation.

HM Treasury Statement on Secondary Legislation for Extending the Special Resolution Regime

On 25 April 2013, HM Treasury issued a statement announcing that it plans to consult on the secondary legislation required to support the extension of the special resolution regime to group companies, investment firms and UK clearing houses before the end of the UK Summer. Secondary legislation will set the conditions for the exercise of resolution powers over group companies, and provide safeguards in the event of a partial property transfer from a failing entity. The statement notes the government's concerns over the potential application of the extended special resolution regime to some capital market arrangements and it will consult on how best to preserve relevant arrangements.

Review of UK SAR for Investment Banks

The UK special administration regime ("SAR") for investment banks covers investment banks that are incorporated in the UK. A review of the SAR is being undertaken. An interim report of the SAR for investment banks, dated 23 April 2013 by Peter Bloxham, makes several recommendations:

- The SAR should be retained.
- A mechanism should be introduced to facilitate the rapid transfer of customer relationships and positions, where feasible.
- The statutory objective in relation to client assets should be clarified by extending from "return" of client assets to "return or transfer".
- The bar date mechanism should be extended to include client monies.

- The administrator should be permitted to make distributions of client assets during the period after the bar date process has commenced.
- The SAR regime should clarify rights of clients to:
- Income/interest/distribution for client assets; and
- Interest on client monies.

For the period of the administration:

- Further consideration should be given to granting limited immunity for administrators.
- Certain good practice recommendations for firms and the FCA, among others.

The final report is expected in July 2013, which will include the FCA's review of its client asset and client money rules.

On 23 April 2013, Greg Clark, the Financial Secretary to the Treasury, published a written statement in which the Treasury welcomed the report by Peter Bloxham and accepted the conclusion that the SAR for investment firms should be retained and that there will need to be some adjustments to the regime for it to better fulfill its objectives.

Parliamentary Commission on Banking Standards Publishes Report

On 19 June, the UK's Parliamentary Commission on Banking Standards ("PCBS") published its final report "Changing Banking for Good". The Commission's proposals include: (i) a new criminal offence, punishable by imprisonment, for senior persons of reckless misconduct in the management of a bank; (ii) a new remuneration code to better align risks taken and rewards received in remuneration, with more remuneration to be deferred for much longer; (iii) a new power for the regulator to cancel all outstanding deferred remuneration, along with pension rights and loss of office payments, for senior bank employees in the event of their banks needing taxpayer support; (iv) amending the Companies Act 2006 to prioritise financial safety over shareholder value in the case of banks; and (v) several measures to improve competition and improve the quality of regulation.

The UK government has indicated that it will publish its response to the report before 18 July.

The report is available at:

http://www.parliament.uk/documents/banking-commission/Banking-final-report-volume-i.pdf

http://www.parliament.uk/documents/banking-commission/Banking-final-report-vol-ii.pdf

FCA Prepares for Authorisations under AIFMD

The FCA has published, for full scope alternative investment fund managers ("AIFMs"), a draft Variation of Permission ("VoP") application pack for feedback by 5 July. A final version of the application pack will be available from 22 July 2013 the date from which the AIFMD applies. Firms that consider that they require early authorisation to avoid disruption to their business may contact the FCA regarding the early authorisation process.

The FCA has also published, for firms wishing to act as trustee or depository of an AIF, a draft VoP form for feedback. Firms that are already authorised by the FCA will be able to make use of the transitional arrangements which enable firms to act as the trustee or depositary to an AIF(s) from 22 July 2013 without needing to obtain the new permission. Such firms will need to apply for a variation of permission by 22 July 2014. Firms that are not already authorised by the FCA should use the draft VoP and the current application pack for wholesale investment firms to apply before 22 July 2013 for permission to act as a depository to an AIF(s).

FCA Signs MoUs with Non-EEA Authorities

The FCA has signed supervisory cooperation agreements with 34 non-EEA authorities as part of its implementation of the Alternative Investment Fund Managers Directive ("AIFMD") following the approval of such agreements by ESMA. The agreements will be effective as of 22 July 2013, when the AIFMD comes into force.

FCA Consultation on New Powers under the AIFMUKR

On 6 June 2013, the FCA published its quarterly consultation which includes a consultation on the changes to the FCA's Handbook as a result of the Alternative Investment Fund Managers Regulations 2013 ("AIFMUKR"). The proposed amendments implement provisions in AIFMUKR relating to the issuance of various statutory notices relating to authorisations, registrations and discipline by the regulator and new and updated powers of enforcement. Comments on the proposals are due by 6 July 2013.

The quarterly consultation is available at:

http://www.fca.org.uk/static/documents/consultation-papers/cp13-03.pdf

FCA Clarifies its Position on UK AIFMs Providing Cross-border MiFID Services

The FCA has published information in response to a number of requests to clarify the position of a full scope UK AIFM wanting to provide services under the Markets in Financial Instruments Directive ("MiFID") on a cross-border basis. The FCA's position, agreed with HM Treasury, is that an AIFM authorised to provide MiFID services should be able to passport those services to other EEA States.

This is contrary to the opinion of the European Commission which, in its Question and Answers ("Q&A") published in March 2013, stated that MiFID services could not be passported. The European Commission also states that an AIFM cannot obtain separate authorisation under MiFID, which means that an AIFM can passport its collective portfolio management services to other EEA States, but cannot provide MiFID services anywhere other than its Home State.

The FCA intends to proceed with requests from authorised full scope UK AIFMs in this regard and to notify other EEA state regulators that a firm intends to provide MiFID services under the AIFM Directive in that host state. The FCA warns that firms should, however, be aware that a host state regulator may refuse the notification, having regard to the Commission's opinion as set out in the Q&A.

Deferred Prosecution Agreements

On 25 April 2013, the Crime and Courts Act 2013 ("CCA") received Royal Assent. Schedule 17 of the CCA permits the use of Deferred Prosecution Agreements ("DPAs") in the UK. Whilst DPAs have been used in the US for decades, they have not previously been available under English law. However, unlike its US counterpart, the UK regime ensures that the judiciary will play a more active role in the regime itself.

A DPA is essentially an agreement entered into between a prosecutor and a company where the prosecutor has agreed to bring but not immediately proceed with a criminal charge against the company, subject to successful compliance by the company with agreed terms and conditions as set out in the DPA. The DPA may also impose a financial penalty on the company. DPAs are therefore an alternative to criminal prosecution or civil enforcement (such as civil recovery orders under the Proceeds of Crime Act 2002).

DPAs will be available for a range of statutory and common law offences (as specified in the CCA), and may be extended to cover further "financial or economic crime". However, before a DPA is finalised, the prosecutor must apply to the court for a declaration that the DPA is in the public interest and the proposed terms are fair, reasonable and proportionate. Currently, only the Director of the Serious Fraud Office ("SFO") and the Director of Public Prosecutions

can enter into DPAs, although the CCA also allows the Home Secretary to designate additional prosecutors who can enter into DPAs (and therefore it could potentially be extended to include the newly created Financial Conduct Authority).

The DPA regime has many advantages for both prosecutors and companies under investigation for the relevant offences. Most notably, prosecutors will save the substantial costs often incurred in investigating and prosecuting companies for such offences. Companies, on the other hand, will avoid the negative publicity surrounding a formal prosecution and the subsequent impact of a guilty verdict. Additionally, companies considering entering into a DPA will benefit from confidentiality until the final judicial approval of the DPA.

Before schedule 17 of the CCA comes into force, the Director of Public Prosecutions and the Director of the SFO are required to publish a joint code on DPAs, giving guidance on matters such as the principles to be applied in determining whether a DPA is likely to be appropriate in a given case. A consultation paper on this code was published on 27 June 2013 (the consultation period closes on 20 September 2013), and the Code will likely be published later this year or early next year. The Sentencing Council of England and Wales is also due to publish guidelines to assist judges in exercising their role under the DPA regime.

The DPA must include an expiry date. Once the DPA expires, the criminal proceedings must be discontinued by the prosecutor. Further criminal proceedings can only be initiated if the company provided inaccurate, misleading or incomplete information to the prosecutor during the course of the negotiations relating to the DPA (which the company knew or ought to have known).

If the prosecutor considers that a company has not complied with the DPA, the prosecutor must apply to the court. If the court finds that the DPA has been breached, the DPA could be terminated, which may lead to a prosecution of the company for the offence.

Schedule 17 of the CCA is available at:

http://www.legislation.gov.uk/ukpga/2013/22/schedule/17/enacted

The SFO consultation paper on the code of practice is available at:

https://www.sfo.gov.uk/press-room/latest-press-releases/press-releases-2013/deferred-prosecution-agreements-consultation-on-draft-code-of-practice.aspx

FCA Guidance Consultation on Oversight of Member Controls by RIEs and MTFs

On 24 April 2013, the FCA published a guidance consultation on what measures they expect recognised investment exchanges ("RIEs") and firms operating multilateral trading facilities ("MTFs") to take to ensure the on-going oversight of the systems and controls, which their member firms operate to comply with the RIE's or MTF operator's rulebook. The FCA guidance consultation was prompted by the fact that RIEs and MTF operators defined and implemented their oversight responsibilities very differently. The guidance consultation notes that RIEs and firms operating MTFs should have in place effective and proportionate frameworks, with documented processes and procedures, sufficient to enable them to determine that their members' systems and controls can reasonably be expected to ensure compliance with the respective platform's rules and trading procedures. The monitoring systems of an RIE or firm operating an MTF should be proportionate, risk-based and proactive.

The FCA guidance consultation is available at:

http://www.fca.org.uk/static/documents/guidance-consultations/gc13-01.pdf

Global Developments

FOA and FIA Announce Agreement to Combine Organisations

On 21 June 2013, the Futures and Options Association ("FOA") and the Futures Industry Association ("FIA") announced an agreement in principle to combine their two organisations under one global structure called FIA Global. The press release states that the proposed affiliation will enable the associations to speak as one global voice to reflect the cross-border nature of derivatives, extend the global reach of the industry, enable a pooling of resources, and enable the associations to align their policies and strategies. The formation of the new body is contingent on FOA member approval on 24 July.

ISDA 2013 Reporting Protocol

ISDA announced the launch of the ISDA 2013 Reporting Protocol on 13 May 2013. The Protocol is intended to facilitate compliance with mandatory trade reporting requirements. The Protocol is more generic than the separate protocols that ISDA has published to facilitate compliance with the requirements of the Dodd-Frank Act and intends to publish for the EMIR requirements.

ISDA / FOA Client Cleared OTC Derivatives Addendum

On 11 June 2013, ISDA and the FOA published their joint Client Cleared OTC Derivatives Addendum. The Addendum is a template agreement between a clearing member and its client for clearing OTC derivatives through central counterparties.

The Addendum is available at:

http://www.isda.org/publications/isda-clearedswap.aspx

IMF Working Paper

On 14 May 2013, the International Monetary Fund ("IMF") published a working paper entitled "Creating a Safer Financial System: Will the Volcker, Vickers and Liikanen Structural Measures Help?" The paper discusses the measures proposed by the EU, UK, France, Germany and the US for the structural reform of banks as well as the potential implications of implementing different policy measures in respective jurisdictions. The paper suggests that subjecting global institutions to different structural measures in different jurisdictions may impact cross-border resolution and consolidated supervision. It is necessary to conduct a global cost-benefit exercise, including extra-territorial implications, to assess whether the measures are justified. The paper recommends that a tailored approach where measures are suited to the specific risk profile of an individual bank at global level might promote financial stability more effectively.

The IMF working paper is available at:

http://www.imf.org/external/pubs/ft/sdn/2013/sdn1304.pdf

CPSS and IOSCO Consult on Authorities' Access to Trade Repository Data

On 11 April 2013, the Committee on Payment and Settlement Systems ("CPSS") and International Organisation of Securities Commissions ("IOSCO") published a report to provide guidance to trade repositories ("TRs") and authorities on the principles that should guide authorities' access to data held in TRs for typical and non-typical data requests. The report also sets out possible approaches to addressing confidentiality concerns and access constraints.

The consultative report is available at:

http://www.bis.org/publ/cpss108.pdf

IOSCO Addendum to Report on Investigating and Prosecuting Market Manipulation

On 22 April 2013, IOSCO published an addendum to its May 2000 report on investigating and prosecuting market manipulation. The aim of this addendum is to reflect present day financial market conditions and the new issues which have developed since its initial report in May 2000. The addendum covers the following areas: (i) types of manipulative conduct; (ii) tools for preventing market manipulation; (iii) tools for detecting market manipulation; (iv) investigating market manipulation; (v) the challenges in taking enforcement action against manipulation; and (vi) cross border cooperation.

The addendum is available at:

http://www.iosco.org/library/pubdocs/pdf/IOSCOPD411.pdf

IOSCO Final Report on Technological Challenges to Effective Market Surveillance

On 22 April 2013, IOSCO published its final report on technological challenges to effective market surveillance. The introduction to the final report provides a broad overview of market surveillance, the goals that it aims to achieve and the concerns raised by certain market surveillance tools. Chapter Two details current regulatory capabilities, focussing on general market surveillance and data collection practices, and cross-market and cross-asset surveillance and audit trail data. Chapter Three highlights the challenges to the effective monitoring of markets, including problems relating to data collection and reporting, issues with staffing skills and technological systems and the associated difficulties of monitoring cross-border activities. Finally, Chapter Four details a number of high level recommendations and questions for consultation, including on the following areas: regulatory capabilities, review of surveillance capabilities, access to data, customer identification, the format in which data should be provided, data protection, synchronisation of business clocks, and cross-border surveillance capabilities.

The final report is available at:

http://www.iosco.org/library/pubdocs/pdf/IOSCOPD412.pdf

FSB Data Gaps Initiative on a Common Data Template for Global Systemically Important Banks

The FSB has been tasked by the G20 to develop a common data template for systemically important global financial institutions. Together with the IMF the FSB published a report addressed to the G20 in which the FSB agreed to:

- develop proposals for implementing a new common data template for globally systemic institutions for the purpose of better understanding the exposures of these institutions and provide the authorities with a framework to assess such risks; and
- develop proposals for implementing a strong international framework that supports improved collection and sharing of information on global financial institutions as a means of providing the authorities with a clearer view of financial networks.

On 18 April 2013, the FSB announced the successful implementation of the first phase of the initiative with the start in March 2013 of the harmonised collection and pooling of improved consolidated data on bilateral credit exposures of major systemic banks as well as their consolidated aggregate credit exposures. These consolidated data will be held centrally by an international data hub that will be hosted by the Bank for International Settlements ("BIS") and reports based on the data will be shared with the national supervisory authorities that are participating in the network.

The FSB announcement is available at:

http://www.financialstabilityboard.org/publications/r_130418.pdf

BCBS Monitoring Tools for Intraday Liquidity Management

On 11 April 2013, the Basel Committee on Banking Supervision ("BCBS") published its final version of the monitoring tools for intraday liquidity. It was developed in consultation with the Committee on Payment and Settlement Systems to enable bank supervisors to better monitor a bank's management of intraday liquidity risk and its ability to meet payment and settlement obligations on a timely basis. These tools will also provide supervisors with a better understanding of bank's payment and settlement behaviour.

The framework includes:

- the detailed design of the monitoring tools for a bank's intraday liquidity risk;
- stress scenarios;
- key application issues; and
- the reporting regime.

Contact Information

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

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

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