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In this newsletter, we provide a snapshot of the principal 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.

US DEVELOPMENTS

Securities and Exchange Commission ("SEC") Developments

In this section, we are covering developments relating to the implementation of provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Reform Act") and the Jumpstart Our Business Startups Act ("JOBS Act") through SEC rulemaking as well as other SEC developments.

SEC Reporting Companies Begin to Comply with New Iran-Related Disclosure Requirements

Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012 ("Section 219"), which was codified as Section 13(r) of the US Securities Exchange Act of 1934, as amended, imposes on SEC-registered companies specific additional disclosure requirements concerning certain business activities relating to Iran and other targets of US economic sanctions programs. For a summary of these new disclosure requirements, please refer to our update on 9 October 2012.

A large number of SEC-registered companies have now filed their annual reports on Form 10-K or Form 20-F including the disclosures required under Section 219. Collectively, these disclosures highlight several issues relating to this new reporting requirement. More importantly, these disclosures make it clear that further regarding compliance with the disclosure requirements under Section 219 would be most beneficial.

Based on the filings to date, several noteworthy trends have emerged:

- activities of foreign subsidiaries of US companies have dominated the disclosures;
- reporting issuers have taken a broad view of affiliates in their disclosures;
- most of the activities disclosed under Section 219 to date were not sanctionable at the time the activity was conducted; and
- issuers recognise that there is no de minimis value threshold for reporting under Section 219.

Our related client publications are available at:

http://www.shearman.com/flash-report-section-219-disclosures-under-the-iran-threat-reduction-and-syria-human-rights-act-of-2012-02-14-2013/and

http://www.shearman.com/whats-going-on--over-a-month-of-section-219-disclosures-under-the-iran-threat-reduction-and-syria-human-rights-act-of-2012-03-20-2013/.

SEC Says Social Media is Acceptable for Company Announcements if Investors Are Alerted

On 2 April 2013, the SEC issued a report that makes clear that companies can use social media outlets like Facebook and Twitter to announce key information in compliance with Regulation Fair Disclosure ("Regulation FD"), so long as investors have been alerted about which social media will be used to disseminate such information.

Regulation FD requires companies to distribute material information in a manner reasonably designed to get that information out to the general public broadly and non-exclusively. It is intended to ensure that all investors have the ability to gain access to material information at the same time. Regulation FD does not technically apply to foreign private issuers, although many foreign private issuers choose to comply with its principles.

The SEC's report of investigation confirms that Regulation FD applies to social media and other emerging means of communication used by public companies the same way it applies to company websites. The SEC issued guidance in 2008 clarifying that websites can serve as an effective means for disseminating information to investors if they have been made aware of them as a source of information. The report clarifies that company communications made through social media channels could constitute selective disclosures and, therefore, require careful Regulation FD analysis.

The SEC's report stems from an enquiry launched in to a post by Netflix CEO Reed Hastings on his personal Facebook page stating that Netflix's monthly online viewing had exceeded one billion hours for the first time. We reported on the Netflix matter in our January 2013 update. Netflix did not report this information to investors through a press release or Form 8-K filing, and a subsequent company press release later that day did not include this information. Neither Hastings nor Netflix had previously used his Facebook page to announce company metrics, and they had never before taken steps to alert investors that Hastings' personal Facebook page might be used as a medium for communicating information about Netflix. Netflix's stock price had begun rising before the posting and increased from $70.45 at the time of the Facebook post to $81.72 at the close of the following trading day.

The SEC did not initiate an enforcement action or allege wrongdoing by Hastings or Netflix. Recognising that there has been market uncertainty about the application of Regulation FD to social media, the SEC issued the report of investigation.

The report explains that although every case must be evaluated on its own facts, disclosure of material, nonpublic information on the personal social media site of an individual corporate officer — without advance notice to investors that the site may be used for this purpose — is unlikely to qualify as an acceptable method of disclosure under the securities laws. Personal social media sites of individuals employed by a public company would not ordinarily be assumed to be channels through which the company would disclose material corporate information.

This serves as a reminder that a company's disclosure controls and procedures should not be limited to the documents that the company files with the SEC, such as its reports on Form 20-F and 6-K, but should encompass other disclosures attributable to the company and its senior management, including press releases, websites, blogs and postings on social media networks such as Facebook or Twitter.

The SEC's report is available at:

http://www.sec.gov/litigation/investreport/34-69279.pdf.

SEC Publishes "A Brief Overview for Foreign Private Issuers"

The SEC recently published "A Brief Overview for Foreign Private Issuers" on its website. This is a short and simple summary of various US federal securities law issues relating to foreign private issuers, as well as additional matters these issuers may wish to take into account when considering having their securities trade in the US capital markets.

"Accessing the U.S. Capital Markets — A Brief Overview for Foreign Private Issuers" is available at:

http://www.sec.gov/divisions/corpfin/internatl/foreign-private-issuers-overview.shtml.

New Developments, Practices and Trends for the 2012 Form 20-F

In January 2013, we published our annual client publication "It's Annual Report Time! — New Developments, Practices and Trends for the 2012 Form 20-F". In order to assist with the preparation of the 2012 Form 20-F, this publication summarises new developments and best practices, highlights topics and trends that will likely be the focus of review by the SEC and discusses various other developments of interest to non-US companies.

Our "It's Annual Report Time! — New Developments, Practices and Trends for the 2012 Form 20-F" client publication is available at:

http://www.shearman.com/its-annual-report-time-new-developments-practices-and-trends-for-the-2012-form-20-f-01-22-2013/.

SEC Approves NYSE and Nasdaq Listing Standards for Compensation Committees and Their Advisors

On 11 January 2013, amendments to the listing standards of each of the New York Stock Exchange ("NYSE") and the NASDAQ Stock Market ("Nasdaq") were approved. The amendments implement the SEC's final rules ("Final Rules") on the independence of compensation committees and their selection of advisors pursuant to Rule 952 of the Reform Act. The final listing standards were adopted substantially as proposed by the exchanges in September 2012. Notable provisions in the NYSE and Nasdaq listing standards include the following:

- Nasdaq significantly enhanced its listing requirements regarding the composition of compensation committees and now will, like the NYSE, require listed companies to (i) have a standing compensation committee consisting of at least two independent directors and (ii) adopt a formal, written compensation committee charter specifying certain responsibilities and authority;
- Nasdaq partially harmonises the compensation committee director independence criteria with those of the audit committee and therefore prohibits independent compensation committee members from accepting, directly or indirectly, any consulting, advisory or other compensatory fee from the listed company or its subsidiaries;

- The NYSE added an additional test for director independence that requires the board to consider all factors relevant to determining whether the director has a relationship that is material to the director's ability to be independent from management; and
- Both the NYSE and Nasdaq adopted the six advisor independence factors as set forth in the Final Rules. Although the SEC invited the exchanges to add to the list of factors, neither Nasdaq nor the NYSE elected to do so. Nasdaq clarified that compensation committees are required to consider only the six specified factors when evaluating advisor independence. The NYSE rules provide, however, that compensation committees must consider all factors relevant to an advisor's independence, including the six factors. Neither the Final Rules nor the listing standards require that a compensation advisor actually be independent but only that the committee consider the six factors when selecting or seeking advice from a given advisor.

Effective Dates

Nasdaq. Nasdaq rules relating to the compensation committee's (i) retention, compensation, oversight and funding of advisors and (ii) requirement to analyse advisor independence will be effective on 1 July 2013. Compliance with the remaining provisions will be required by the earlier of: (1) the listed company's first annual meeting after 15 January 2014 or (2) 31 October 2014. Companies must certify compliance with the applicable requirements no later than 30 days after the applicable implementation deadline. The form of certification will be available through Nasdaq's Listing Center website prior to the effective date of the Nasdaq rules.

NYSE. The NYSE rules will generally be effective 1 July 2013. However, with respect to the compensation committee independence requirements, listed companies will have until the earlier of: (i) their first annual meeting after 15 January 2014 or (ii) 31 October 2014, to comply.

Exemption for Foreign Private Issuers

The Final Rules exempt a foreign private issuer from the independent compensation committee requirements if it discloses in its annual report the reasons it does not have an independent compensation committee. Foreign private issuers would be subject to the compensation advisor rules unless the exchanges elect to exempt them.

Nasdaq. Nasdaq expands the Final Rules to exempt foreign private issuers that follow their home country corporate governance practices from both the compensation committee independence and advisor rules, provided that the foreign private issuer discloses each Nasdaq listing requirement that it does not follow and describes its applicable home country practice. If a foreign private issuer follows its home country practice and does not have an independent compensation committee, it must also disclose the reasons why it does not.

NYSE. The NYSE also exempts foreign private issuers that follow their home country corporate governance practices from both the compensation committee independence and advisor rules, provided that the foreign private issuer discloses the significant ways in which its corporate governance practices differ from those followed by domestic listed companies. Accordingly, any foreign private issuer seeking to avail itself of the exemption afforded by the amended listing standards rules would need to disclose the differences in its corporate governance practices from the domestic company requirements. Disclosure of the reasons for these differences is not required, however, as the NYSE noted that most frequently foreign private issuers would merely be stating that home country law has no similar requirement.

Next Steps

Listed companies that are subject to the amended listing standards or foreign private issuers that voluntarily choose to comply with them should begin to take action to comply with these rules. In particular:

- Compensation committee charters should be reviewed and revised as necessary to ensure that the compensation committee is provided the powers and authorities articulated in the Final Rules and the amended listing standards. Although not a required element of the charter under the Nasdaq or NYSE standards, companies should consider adding to the charter a requirement that the compensation committee carry out the required advisor independence assessments. NYSE listed companies must have a compliant charter in place by 1 July 2013. Nasdaq listed companies generally must adopt a compliant charter by the earlier of: (i) the first annual meeting after 15 January 2014 or (ii) 31 October 2014 to comply; however, any Nasdaq company that does not have a compliant charter in place by 1 July 2013 should adopt a board resolution providing the compensation committee with the authority and responsibilities with respect to advisors.
- Implement new procedures or revise existing procedures to reflect the new compensation committee independence standards. This will likely include amendments to the company's D&O questionnaire.
- Implement new procedures or revise existing procedures related to the evaluation of compensation committee advisor independence. The evaluation should be done prior to selecting or receiving advice from a new advisor and at least annually thereafter. In order to ensure a consistent basis for analysing advisor independence, companies should consider developing a questionnaire that all advisors (other than in-house counsel) will be required to complete and that will elicit the information relevant to the independence assessment. Information and representations obtained from an advisor can be used as the basis of the committee's analysis but should not replace the committee's independent assessment and independence determination.
- Nasdaq-listed companies that do not already have a compensation committee must establish one by the earlier of: (i) the first annual meeting after 15 January 2014 or (ii) 31 October 2014 to comply.
- As a reminder, any proxy statement for an annual meeting occurring on or after 1 January 2013 must include a disclosure of any conflicts of interest arising as the result of the engagement of compensation consultants (but not other advisors). The instruction to item 407(e)(3)(iv) states that the six factors relevant to consultant independence should be considered in determining whether a conflict of interest exists. If not yet completed, all listed companies should conduct a conflicts analysis to prepare for this disclosure. It should be noted that the disclosure requirement is an obligation of the company, whereas the assessment of compensation consultant independence is required to be conducted by the compensation committee. Companies should consider procedures that will enable the company to benefit from the compensation committee's analysis for purposes of determining whether any conflict disclosure is required.

Our related client publication is available at:

http://www.shearman.com/sec-approves-nyse-and-nasdaq-listing-standards-for-compensation-committees-and-their-advisors-01-29-2013/.

SEC Staff Issues No Action Letter to Allow Participation in an Equity-Based Compensation Program Involving Loans to Officers and Directors

On 4 March 2013, the SEC's Division of Corporate Finance issued new guidance on how companies may provide equity-based compensation to their employees without violating Section 402 of the SOX, which prohibits companies from making personal loans to officers and directors. The SEC approved a specific type of EBIC program that involves loans to officers and directors made through a trust. The no-action letter is noteworthy as it represents the first interpretive guidance from the SEC staff under Section 402 of the SOX.

The SEC issued the no-action letter in response to a formal request sent to the SEC staff seeking guidance on Section 402 of the SOX with regard to the EBIC program that had been developed by RingsEnd Partners, LLC in collaboration with

BNP Paribas. The EBIC program contemplated awards of company stock to participating employees and, thereafter, a transfer of that stock to an independently managed Delaware statutory trust. The trust would then use the stock as collateral to obtain term loans from a third-party banking institution.

In the no-action letter, the SEC stated that an issuer that permits its directors and officers to participate in the EBIC program would not be deemed to violate Section 402 of SOX. Further, the SEC stated that the issuer's undertaking of certain limited ministerial and administrative activities relating to the participation of its directors and officers in the EBIC program would not violate Section 402.

The SEC's no-action letter is available at:

http://www.sec.gov/divisions/corpfin/cf-noaction/2013/ringsend030413.htm.

The incoming letter seeking guidance from the SEC is available at:

http://www.sec.gov/divisions/corpfin/cf-noaction/2013/ringsend030413-13-incoming.pdf.

Noteworthy US Securities Law Litigation

Amgen v. Connecticut Retirement Plans and Trust Funds: US Supreme Court Allows Plaintiff Class to be Certified Without Separate Materiality Inquiry

In February 2013, the US Supreme Court issued an important decision regarding the requirements for class certification in securities fraud cases under Section 10(b) of the Securities Exchange Act of 1934. In *Amgen*, the Court held that a plaintiff did not need to prove that an alleged misstatement or omission was material in order to satisfy one of the prerequisites to class certification – namely, that questions of law or fact common to the class predominate over any questions affecting only individual class members.

As background, in order to establish a claim under Section 10(b), a plaintiff must prove, among other things, the element of reliance by showing that the plaintiff was aware of the defendant's misrepresentation and engaged in the securities transaction based on that specific misrepresentation. More than 20 years ago, the Supreme Court recognised in *Basic v. Levinson* the difficulty of proving direct reliance and endorsed the "fraud-on-the-market" theory, which permits a plaintiff to invoke a rebuttable presumption of reliance on material misrepresentations communicated to the general public. The fraud-on-the-market theory rests on the premise that well-developed markets are efficient processors of public information and that the market price of securities that trade on those markets will reflect all publicly available information. Under this theory, if a plaintiff establishes that the market for a security is efficient, then the court may presume that an investor who traded the security relied on public, material misrepresentations. Absent the fraud-on-the-market theory, the requirement that a plaintiff establish reliance would ordinarily preclude certification of a class action seeking money damages because individual reliance issues would overwhelm questions common to the class.

In *Amgen*, the issue was whether a plaintiff asserting securities fraud had to prove materiality in order to satisfy the class certification requirement (set forth in Rule 23(b)(3) of the Federal Rules of Civil Procedure) that questions of law or fact common to class members predominate over any questions affecting only individual members. The Court held that the plaintiff did not need to prove materiality at class certification for two reasons. First, the Court explained that, because the question of materiality is an objective one that involves the significance of a misrepresented or omitted fact to a reasonable investor, materiality can be proved through evidence common to the class. Second, the Court stated that there is no risk that the failure of proof on the common question of materiality will result in individual questions predominating. The Court explained that, because materiality is an essential element of a Section 10(b) claim, a plaintiff's failure to present sufficient evidence of materiality at summary judgment or trial would end the case and no claim would remain in which individual reliance issues could potentially predominate.

The *Amgen* decision is significant because it eliminates one of the arguments that defendants often make in opposition to class certification in securities fraud cases. For more information on the *Amgen* case, please see our client note at:

http://www.shearman.com/supreme-court-decides-amgen--allows-plaintiff-class-to-be-certified-without-separate-materiality-inquiry-03-01-2013/.

Gabelli v. SEC: US Supreme Court Rejects SEC's Request for Exception to Statute of Limitations

In February 2013, the US Supreme Court held that, in civil actions brought by the SEC in which 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 *Gabelli*, the SEC brought a civil enforcement action against the chief operating officer and portfolio manager of an investment advisor for allegedly allowing one investor to engage in market timing in the fund. The defendants moved to dismiss the complaint because the SEC did not file the suit until April 2008, which was more than five years after the alleged market timing ended in August 2002. The district court agreed and dismissed the SEC's civil penalty claim as time-barred, but a federal appeals court reversed.

Before the Supreme Court, the SEC argued that, because the underlying violations sound in fraud, the Court should apply the "discovery rule" and the statute of limitations should not begin to run until the claim is discovered or could have been discovered through the exercise of reasonable diligence. The Court rejected the SEC's argument and ruled that the discovery rule does not apply to government enforcement actions for civil penalties. The Court first focused on the plain language of the statute and stated that the most natural reading of the statute is that a claim first accrues when the defendant's allegedly fraudulent conduct occurred, not when the claim is discovered. In addition, the Court explained that there is no basis to extend the discovery rule to the SEC because, unlike a private party who has no reason to suspect fraud, the SEC's very purpose is to root out fraud and has many tools to discover it, including the power to subpoena documents and witnesses and to pay monetary awards to whistleblowers. Finally, the Court stated that the SEC should not have the benefit of the discovery rule because, unlike a private plaintiff that seeks compensation for its losses, the SEC in this case seeks civil penalties that are intended to punish and label the defendants as wrongdoers. In such situations, the Court stated that the defendants should have some certainty about when the limitations period expires and not have it hinge on speculation about what the Government knew, when it knew it or when it should have known it.

The *Gabelli* decision serves as an important check on the powers of the SEC and other government enforcement agencies and provides a clear limitation on the government's ability to bring claims for civil penalties. More information on the *Gabelli* case is available at:

http://www.shearman.com/supreme-court-rejects-secs-request-for-exception-to-statute-of-limitations-in-gabelli-03-01-2013/.

Meyer v. Greene: The Eleventh Circuit Rules that the Disclosure of an SEC Investigation is Insufficient to Plead Loss Causation

In February 2013, a federal appeals court ruled that an announcement of an investigation by the SEC followed by a decline in a company's stock price is insufficient to plead loss causation in a federal securities fraud case. In *Meyer*, the plaintiffs alleged that the St. Joe Company, one of the largest real estate developers in Florida, made material misstatements and omissions in its SEC filings by overstating the value of its real estate holdings and failing to take an impairment charge after the real estate market in Florida crashed in 2008. The plaintiffs asserted that the truth about St. Joe's misrepresentations emerged, in part, when St. Joe disclosed that the SEC had initiated an informal enquiry into the company's policies and practices concerning the impairment of its real estate assets. After the defendants filed a motion to dismiss, the district court dismissed the case in its entirety.

On appeal, the federal appeals court affirmed that district court's decision and held that the commencement of an SEC investigation, without more, is insufficient to constitute a corrective disclosure for purposes of establishing loss causation. The Court noted that stock prices may fall upon the announcement of an SEC investigation but only because the investigation may be seen to portend an added risk of future corrective action. It does not mean that the investigation, in and of itself, reveals to the market that a company's previous statements were false or fraudulent. As a result, the Court ruled that St. Joe's disclosure of the SEC investigation does not qualify as a corrective disclosure for purposes of pleading loss causation.

This decision is noteworthy because it is the first federal appellate decision to hold that the announcement of an SEC investigation, without more, is insufficient to plead loss causation. This decision adds weight to the growing number of district court decisions from around the US that have reached similar conclusions.

More information on the *Meyer* case is available at:

http://www.shearman.com/The-Eleventh-Circuit-Rules-that-the-Disclosure-of-an-SEC-Investigation-is-Insufficient-to-Plead-Loss-Causation-03-19-2013/.

In re LIBOR-Based Financial Instruments Antitrust Litigation: Federal Court Dismisses Antitrust Claim Against Banks Involved In Alleged LIBOR Manipulation

In March 2013, a federal court in New York granted in part and denied in part the defendants' motions to dismiss the class action lawsuit that had been filed against certain banks for allegedly manipulating the London Interbank Offered Rate ("LIBOR") in violation of the antitrust laws, the federal civil Racketeer Influenced and Corrupt Organizations Act ("RICO") and the Commodities Exchange Act ("CEA").

First, the court dismissed the plaintiffs' antitrust claim based on a lack of standing. In order to have standing to state an antitrust claim, a plaintiff must allege plausible facts that it suffered an injury and that the injury was caused by the defendants' anticompetitive conduct. Here, the court ruled that, even if the plaintiffs were harmed by the defendants' manipulation of LIBOR, the plaintiffs could not allege that their injury resulted from anticompetitive conduct because LIBOR is not set through a competitive process. As a result, the court ruled that the plaintiffs did not have standing to assert an antitrust claim.

Second, the court dismissed the plaintiffs' federal civil RICO claim as barred by the Private Securities Litigation Reform Act ("PSLRA"). Under the PSLRA, a plaintiff is prohibited from bringing a RICO claim where the alleged predicate acts for the RICO claim could form the basis of a securities fraud claim. Here, the court ruled that the allegations underlying the plaintiffs' RICO claim i.e., that the defendants made misleading statements and omissions in connection with the purchase and sale of LIBOR-based financial instruments could have been subject to a securities fraud action. As a result, the court ruled that the plaintiffs' RICO claim was barred by the PSLRA.

Third, the court denied in part and granted in part the defendants' motion to dismiss the plaintiffs' CEA claim. Under the CEA, a plaintiff must allege, among other things, that the defendants intentionally caused an artificial market price. Here, the court ruled that the plaintiffs stated a claim for commodities manipulation because (i) the plaintiffs purchased Eurodollar futures contracts, (ii) the price underlying Eurodollar futures contracts was LIBOR, and (iii) the plaintiffs alleged sufficient facts that the defendants intentionally manipulated LIBOR. The court, however, limited the scope of plaintiffs' CEA claim by ruling that the claim was barred, in part, by the CEA's two-year statute of limitations. Specifically, the court held that well-publicised reports and news articles in April and May 2008 placed the plaintiffs on notice that they might have been injured by alleged manipulation of LIBOR. Because the plaintiffs did not file their complaint until more than two years after they were put on inquiry notice, the court ruled that, at a minimum, the plaintiffs' CEA claims based on Eurodollar futures contracts entered into from the beginning of the class period (August 2007) until 29 May 2008 were time barred.

This is the first ruling related to the well-publicised allegations that certain banks manipulated LIBOR and will likely have a significant impact on the resolution of motions to dismiss in other lawsuits that assert similar claims.

Recent SEC/DOJ Enforcement Matters

RBS LIBOR Investigation

In February 2013, The Royal Bank of Scotland plc and RBS Securities Japan Limited entered into agreements with the Department of Justice ("DOJ"), the Commodities Futures Trading Commission ("CFTC") and the UK Financial Services Authority ("UK FSA") to resolve multi-year investigations into RBS's alleged manipulation of LIBOR for the yen and Swiss franc. In the agreements, RBS acknowledged that certain of its employees had worked with co-workers and employees at other banks to manipulate LIBOR in order to enhance the profits they earned from trading derivatives linked to LIBOR.

RBS Securities Japan agreed to plead guilty to felony wire fraud charges, and The Royal Bank of Scotland plc agreed to enter into a deferred prosecution agreement whereby it would continue to cooperate with the DOJ in exchange for the deferral of criminal wire fraud and antitrust charges.

In addition, RBS agreed to pay more than $612 million in penalties and disgorgement - $325 million in the CFTC action, $150 million in the DOJ action and $137 million in the UK FSA action. RBS also agreed to take certain remedial actions, including implementing firewalls to prevent improper communications between traders and rate submitters, enhancing auditing and monitoring procedures, developing a training program for all employees who are involved in the rate submitting process and making regular reports to the regulators regarding its compliance efforts.

Numerous regulators around the world are currently investigating the alleged manipulation of LIBOR, TIBOR, and EURIBOR rates. RBS is the third financial institution to enter into settlement agreements with the regulators (Barclays was the first in June 2012 and UBS was the second in December 2012), and RBS Securities Japan is the second entity to plead guilty to a criminal offense related to LIBOR manipulation (UBS Japan was the first).

EU DEVELOPMENTS

European Securities and Markets Authority ("ESMA") Publishes an Update of the Committee of European Securities Regulators ("CESR") Recommendations Regarding Mineral Companies

On 20 and 22 March 2013, ESMA published an update of the CESR recommendations for the consistent implementation of the Prospectus Regulation (809/2004). The update amends the recommendations relating to disclosures by mineral companies, which seek to:

- clarify, for the definition of a mineral company, the materiality concept within the meaning of "material mineral projects";
- change the scope and structure of the exemption from the need for a prospectus to include a Competent Person's Report;

- include the Russian NAEN Code within the list of Acceptable Internationally Recognised Mineral Standards as regards mining reporting; and
- clarify certain other aspects of the recommendations.

The update can be viewed at: http://www.esma.europa.eu/system/files/2013-319.pdf.

Revised ESMA Framework for Third Country Prospectuses

On 20 March 2013, ESMA published an opinion setting out an updated framework for the assessment of third country prospectuses under Article 20 of the Prospectus Directive (2003/71/EC) ("PD"). The framework sets out ESMA's view on how a third country issuer that has a prospectus in accordance with a third country's legislation can meet the requirements of the PD. Where the PD requires additional information to that required by the third country's prospectus regime, the framework identifies the information that can be added to the third country prospectus as an equivalence "wrap" so that the resulting document meets the requirements of the PD.

The revised framework can be viewed at:

http://www.esma.europa.eu/system/files/2013-317.pdf.

ESMA Publishes Feedback Statement on the Role of the Proxy Advisory Industry

On 19 February 2013, ESMA published a final report and feedback statement setting out its response to the issues raised in its consultation on the role of the proxy advisory industry. Proxy advisors are firms that provide advisory services to investors, mainly institutional investors, in relation to the exercise of their voting rights as shareholders of listed companies.

In light of the responses received during consultation, ESMA concluded that it has not been provided with clear evidence of market failure in relation to how proxy advisors interact with investors and issuers, and therefore considers that binding measures are not necessary. Instead, ESMA supports encouraging the industry to develop its own code of conduct. ESMA has issued a set of principles as guidance to those who will draft such a code.

ESMA will review the development of the code by February 2015. If no substantial progress has been made by that time, ESMA may reconsider its current policy decision and proceed with more formal measures.

The feedback statement can be viewed at:

http://www.esma.europa.eu/system/files/2013-84.pdf.

European Commission Publishes an Indicative Roadmap for its Revision of Shareholders' Rights Directive

In our January 2013 newsletter, we reported that the European Commission published in December 2012 an action plan on European company law and corporate governance. The two roadmaps outlined below and published by the European Commission in February 2013 provide further detail as to the issues that two particular initiatives under the action plan are intended to tackle.

The first roadmap concerns possible revisions to the Shareholders' Rights Directive (2007/36/EC). The main objectives of that initiative are:

- improving disclosure of voting policies by institutional investors in order to raise awareness on corporate governance, enable ultimate investors to optimise investment decisions, facilitate a dialogue between investors and companies and encourage shareholder engagement;
- harmonising disclosure requirements with regards to executive remuneration, and a mandatory shareholder approval vote on the remuneration policy and report;
- ensuring better transparency of related party transactions and granting shareholders a right of approval for most significant transactions; and
- making proxy advisors more transparent as regards the methodology applied for the preparation of their advice and their possible conflicts of interest.

The indicative roadmap can be viewed at: http://ec.europa.eu/governance/impact/planned_ia/docs/2013_markt_034_shareholders_rights_directive_en.pdf.

European Commission Publishes an Indicative Roadmap for Enhancing the EU Corporate Governance Framework

The second roadmap concerns the initiative for enhancing the EU corporate governance framework and, like the earlier-mentioned roadmap, outlines specific issues to be tackled by this initiative under the action plan. The main objectives of the initiative are:

- improving the functioning of the 'comply or explain' approach within the EU corporate governance framework; and
- enhancing the quality of corporate governance explanations provided by companies departing from corporate governance codes provisions; specifically, these explanations should provide investors with better information in order to assess whether the deviations from best corporate governance practices are justified.

The indicative roadmap can be viewed at: http://ec.europa.eu/governance/impact/planned_ia/docs/2013_markt_033_corporate_governance_framework_en.pdf.

European Parliament Publishes Report on Corporate Social Responsibility ("CSR"): Promoting Society's Interests and a Route to Sustainable and Inclusive Recovery

On 6 February 2013, the European Parliament plenary session adopted, in the form of a report, two non-legislative resolutions on CSR relating to:

- an accountable, transparent and responsible business behaviour and sustainable growth; and
- the promotion of society's interests and a route to sustainable and inclusive recovery.

The report can be viewed at:

http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-%2f%2fEP%2f%2fNONSGML%2bREPORT%2bA7-2013-0023%2b0%2bDOC%2bPDF%2bV0%2f%2fEN.

ESMA Publishes Consultation Paper on Draft Regulatory Technical Standards on Specific Situations that Require the Publication of a Supplement to the Prospectus

On 15 March 2013, ESMA published a consultation paper regarding proposed regulatory and technical standards ("RTS") that would establish situations where a supplement to an issuer's prospectus would be automatically required under the Prospectus Directive.

The draft RTS sets out 10 circumstances in which there will always be a requirement to publish a supplement to a prospectus. These are:

- publication of new annual audited financial statements;
- publication of a profit forecast for equity securities and depositary receipts;
- publication of a profit estimate for an annual financial period;
- a change of control of the issuer;
- a new public takeover bid for equity securities of the issuer, and the outcome of such a bid;
- a working capital statement included in the prospectus ceases to be valid;
- admission to trading is sought, or an offer to the public is made, by the issuer in an additional EU member state which was not foreseen in the prospectus;
- a new significant financial commitment is undertaken which is likely to result in a significant gross change (i.e. a variation of more than 25%, relative to one or more indicators of the size of the issuer's business, in the situation of an issuer) for securities;
- a judgement or other concluding event occurs in any governmental, legal or arbitration proceedings which were disclosed in the prospectus; and
- an increase in the aggregate nominal value of the programme.

The draft RTS also specifies the minimum content of a supplement to a prospectus that is required in each of the specified circumstances above.

The examples provided by the paper are not intended to be exhaustive situations in which the requirement to publish a supplement will arise. The issuer (or, as the case may be, the offeror or the person asking for admission to trading of the relevant securities on a regulated market) should also assess the significance or materiality of any changes. This is without prejudice to the powers of the competent authority of the home member state also to require a supplement to be published.

The consultation paper can be viewed at:

http://www.esma.europa.eu/system/files/2013-316.pdf.

Commission Legislative Proposals on Anti-money Laundering

On 8 February 2013 the Commission adopted two proposals to reinforce the EU's existing legislation on anti-money laundering and fund transfers in the form of:

- a proposed directive on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing ("Fourth AML Directive"); and

- a proposed regulation on information accompanying transfers of funds to secure "due traceability" of these transfers.

The proposals update and improve the EU's existing Third Anti-Money Laundering Directive ("Third AML Directive") and the Fund Transfers Regulation (Regulation 1781/2006) by remedying three main areas of weakness within the existing framework:

- inconsistency with recently revised international AML standards;
- inconsistent interpretation of the EU legislation across Member States; and
- inadequacies and loopholes.

The Fourth AML Directive proposes the following:

- Member States would no longer decide that certain natural or legal persons do not fall within the scope of the rules. Any exemptions will only be available if specific criteria are met;
- customer due diligence is simplified and some of the exemptions that existed under the Third AML Directive no longer apply;
- to improve clarity and consistency across the Member States a clear mechanism is provided for the identification of beneficial owners;
- widening the scope of people to be considered as politically exposed persons (people who carry out important public functions of state);
- the scope of the directive is broader than its predecessor and accounts for new threats and vulnerabilities, including tax crimes, gambling services and all persons dealing in goods or providing services for cash payment of €7,500 and above; and
- each Member State will be tasked with formally establishing a centralised financial intelligence unit ("FIUs") to be tasked with receiving, analysing and disseminating disclosures of information.

The two proposals also foresee a reinforcement of the sanctioning powers of the national regulators by introducing minimum principle-based rules to strengthen administrative sanctions and a requirement for regulators to coordinate when dealing with cross-border transactions.

The Commission also published FAQs and an Impact Assessment on the proposed legislation. The proposals are now subject to the European legislative process.

UK DEVELOPMENTS

FSA Fines Prudential and Censures CEO for Failing to Inform Regulator of 2010 Acquisition Plans

On 27 March 2013, the Financial Services Authority ("FSA" and now the Financial Conduct Authority) fined companies in the Prudential Group ("Prudential") a total of £30 million for breaching FSA Principles and UKLA Listing Principles. The fines were related to Prudential's failure to inform the FSA at the appropriate time that it was seeking to acquire AIA, the Asian subsidiary of AIG, in 2010. This was a breach of the principle that firms need to deal with the FSA in an open and cooperative manner – particularly since it did not disclose the proposed transaction even when the FSA asked detailed questions about Prudential's strategy for growth in the Asian market and its plans for raising equity and debt capital.

The transaction had the potential to impact upon the stability and confidence of the financial system, and the late disclosure put an immense amount of pressure on the FSA to decide whether or not to approve or reject the deal on regulatory grounds within a short timeframe.

The fine and censure demonstrate the effect of the FSA Principles and the UKLA Listing Principles, particularly when non-compliance with it has a material effect on the regulators and the financial system.

London Stock Exchange ("LSE") Publishes Final Draft Rulebook

On 27 March 2013, the LSE published the final rulebook for the High Growth Segment of the Main Market. This followed consultation for the draft version on 13 February 2013. The criteria for admission include:

- at least 10% of the number of securities to be admitted must be in public hands;
- the value of securities in public hands must be at least £30 million, the majority of which must be raised at admission;
- the issuer must be able to demonstrate growth in revenue of at least 20% over the prior three financial years; and
- the issuer must be duly incorporated or otherwise validly established in an EEA state and be a public company (or other similar EEA corporate structure).

The rulebook also includes sections on continuing obligations and key advisers.

As well as the rulebook, issuers will be required to comply with the Disclosure Rules and Transparency Rules, the Prospectus Rules and the Admission and Disclosure Standards.

The LSE confirms that companies, and potential key advisers on their behalf, may apply for admission for trading on the High Growth Segment from 27 March 2013. For that purpose, the LSE has published the various approval and application forms on its website, including an updated Form 1 to be used for all applications for admission to trading for all markets from 27 March 2013.

The rulebook can be viewed at:

http://www.londonstockexchange.com/traders-and-brokers/rules-regulations/change-and-updates/stock-exchange-notices/2013/n0413_attach1.pdf.

The Department for Business Innovation & Skills ("BIS") Publishes its Second Consultation on Revised Directors' Remuneration Reporting Regulations

On 12 March 2013, BIS published a second version of the draft Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 for consultation. This follows a formal consultation during 2012 and subsequent discussions with a range of stakeholders on the government's proposed changes to regulations governing directors' remuneration reporting by quoted companies.

The new legal framework is expected to take effect on 1 October 2013 and affect annual general meetings ("AGMs") held in reporting years starting on or after that date.

We discussed these proposed changes in the July 2012 edition of our newsletter. The key changes to the draft regulations published in June 2012 include:

- moving the requirement to disclose the percentage increase in remuneration of the CEO and relative importance of spend on pay from the policy part to the implementation part;

- targets to be disclosed in the policy part in the year the policy is being approved and in the implementation part for the years when a resolution to approve the policy is not proposed;
- in the policy part, a new requirement to disclose the principles a company would apply to agreeing a remuneration package for a new director, including the maximum level of salary which may be awarded;
- the requirement to disclose scenario charts in the policy part and a performance graph in the implementation report have been amended in line with the report published by the Financial Reporting Lab;
- flexibility to include additional columns in the single figure remuneration table, a separate table for non-executive directors, and more generally in the report any additional information the directors think fit; and
- in the implementation report, a new requirement to disclose payments made in the relevant financial year to past directors.

It is proposed that the final regulations will be laid before Parliament during the spring but after the Enterprise and Regulatory Reform Bill 2012-2013 has received Royal Assent.

The draft Regulations can be viewed at:
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/138335/bis-13-717-draft-large-and-medium-sized-companies-and-groups-accounts-and-reports-amendment-regulations-2013.pdf.

The first consultation from June 2012 can be viewed at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31358/12-888-directors-pay-consultation-remuneration-reporting.pdf.

Financial Reporting Lab Publishes a Report on Scenario and Performance Charts

On 5 March 2013, the Financial Reporting Council's Financial Reporting Lab published a report on investors' and companies' views of government proposals that directors' remuneration reports should include:

- a performance chart – demonstrating historic CEO pay and company performance; and
- scenario charts – a set of charts indicating what total pay each executive director might be expected to receive under the company's remuneration policy given various levels of company performance.

The report recommends a different approach to the disclosure set out in the government's proposed performance chart and also recommends a revision of the government's proposal for scenario charts. In addition, the report follows up on various points arising from the Financial Reporting Lab's previous report on the presentation of a single figure for a directors' total remuneration in the revised format of directors' remuneration reports.

The report can be viewed at:

http://frc.org.uk/Our-Work/Publications/Financial-Reporting-Lab/Lab-project-report-Reporting-of-pay-and-performanc.aspx.

BIS Publishes Frequently Asked Questions on Directors' Remuneration Reforms

On 22 March 2013, BIS published a document setting out frequently asked questions ("FAQs") on the new legal framework for voting on directors' remuneration in quoted companies mentioned above. The aim of the FAQs is to help companies, investors and other stakeholders understand how and when they will be affected by the reforms.

The FAQs provide a factual explanation of the legislative reforms, and cover the scope of the reforms, timing of the new regime, voting procedure, remuneration reports, restrictions on remuneration and loss of office payments, contracts and other legal agreements, unauthorised payments and miscellaneous queries.

The FAQs can be viewed at:
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/158048/13-727-directors-remuneration-reforms-faq.pdf .

National Association of Pension Funds ("NAPF") Writes to FTSE 350 Urging Executive Pay Restraint and Reform

On 4 March 2013, the NAPF published an open letter to the chairmen of remuneration committees of FTSE 350 companies. This reiterates comments about executive pay in the NAPF's November 2012 corporate governance policy and voting guidelines (reported in our January 2013 newsletter) with some shifts in emphasis, and also makes some new observations. Key points include:

- base pay increases to be capped at inflation and to be in line with the rest of the workforce, with a sound and compelling rationale if there is any divergence from this principle;
- performance conditions for variable remuneration should be genuinely stretching and relate to long-term growth;
- NAPF members will "push back" against peer group benchmarking of executive pay; and
- remuneration committees should use discretion (implicitly to revise values downwards at vesting) to ensure that executive bonuses and share awards align with long-term business success and shareholders' returns on capital. The letter also comments that NAPF members may oppose the re-election of the chairman where a committee does not appropriately exercise its authority over pay.

In 2012, shareholder concern about executive reward became more visible with significant opposition to remuneration policies at a number of large companies. The NAPF expects similar opposition to remuneration reports (and possibly also to committee member re-election) during the 2013 AGM season, where executive pay is poorly aligned with shareholder interests.

The letter also asks companies to consider a recent NAPF discussion paper on executive pay, when assessing their remuneration policies ahead of the expected introduction of the shareholder binding vote on 1 October 2013.

The letter can be viewed at:

http://www.napf.co.uk/PressCentre/NAPFbuzz/~/media/Policy/Documents/0293-FTSE350-Letter.ashx.

PIRC Publishes its UK Shareholder Voting Guidelines 2013

On 14 February 2013, the Pensions Investment Research Consultants ("PIRC") published the 17th edition of its UK Shareholder Voting Guidelines. The guidelines replace the version published in February 2012. In the revised guidelines, PIRC gives greater emphasis on the management and protection of shareholder capital and introduces a tougher approach to remuneration issues.

The key change is the announcement that PIRC will oppose the introduction of new long-term incentive schemes, as it believes such schemes are fundamentally flawed, no longer in practice long-term and do not incentivise. PIRC will also oppose director bonus plans that include performance targets which represent responsibilities that would be expected to be fulfilled by directors.

PIRC will not support the approval of the report and accounts, re-election of relevant committee members and, in some instances, the auditor where:

- the reporting auditor is also the adviser to the remuneration committee;
- there is a likely liability, or likely contingent liability, for any element of deferred pay that has not been provided for in the accounts; or
- it is clear that the company's adherence to IFRS has led to a failure of the accounts to provide a true and fair view.

PIRC also encourages greater shareholder scrutiny of the role of remuneration consultants, due to their responsibility for the majority of schemes operated by UK listed companies today and their vested interest in creating complex and accommodating outcomes.

The press release for the guidelines can be viewed at:

http://www.pirc.co.uk/news/pirc-2013-guidelines-set-out-new-approach.

Executive Remuneration Principles Published by Pension Investment Bodies

On 7 February 2013, a group of bodies involved in pension investment management, including Hermes EOS and the NAPF, published principles for investee companies' executive remuneration. The aim is to encourage change to remuneration structures to better support long-term business success. The principles call for:

- executives to hold material levels of shares over a truly long term (at least ten years and whether or not the executive still remains in his or her post, in contrast to the typical three year vesting period for long-term incentive plan share awards);
- less focus on the short and medium term when setting performance conditions for executive pay (which favours metrics such as earnings per share and total shareholder return). Instead, performance conditions should encourage specific behaviours linked to long-term strategic success and the desired corporate culture throughout the organisation;
- simple, understandable pay schemes that link reward to returns for long-term shareholders, rather than multiple long-term incentive schemes and multiple outstanding awards for each executive;
- remuneration committees to fully justify how their decisions will deliver long-term business success.

The authors intend to discuss the principles with companies and shareowners over the coming months, with the intention of refining them into an authoritative guide against which shareholders can assess companies' executive pay policies and practice.

The principles can be viewed at:

http://www.napf.co.uk/PressCentre/NAPFbuzz/~/media/Policy/Documents/0290-Hermes-EOS-NAPF-Pay-Principles.ashx.

Institute of Chartered Secretaries and Administrators ("ICSA") Publishes Guidance on Enhancing Dialogue Between Companies and Investors

On 14 March 2013, ICSA published its guidance, Enhancing Stewardship Dialogue. A key principle of the guidance, which was developed in consultation with companies and investors, is that there should be a regular and consistent process of engagement, over time, between a company and its key investors, in order to establish, develop and maintain relationships.

The guidance is intended to provide practical advice on:

- making meetings between companies and institutional investors more productive – helping make the best use of all participants' time, and creating the optimum conditions for dialogue;
- creating a more meaningful dialogue between companies and institutional investors on strategy and long-term performance, outside the traditional results season;
- improving the feedback process between companies and institutional investors on the quality of meetings; and
- using the feedback to improve engagement practices.

It includes an example of an engagement strategy, a checklist for setting up and structuring meetings and a non-exhaustive framework for discussions on long-term strategy and performance.

The guidance is intended to be flexible and non-prescriptive, and used as a health check for companies.

The guidance can be viewed at: https://www.icsaglobal.com/assets/files/pdfs/guidance/Enhancing_stewardship_dialogue/icsastewardshipreport.pdf.

Trade Unions Publish Voting and Engagement Guidelines

On 26 March 2013, the Trades Union Congress, Unite and UNISON announced that they had formed a group called the Trade Union Share Owners. Members of the Trade Union Share Owners will be working with PIRC to ensure that their staff pension funds take a common voting position in accordance with the new guidelines.

They have published their "Trade Union Voting and Engagement Guidelines" and these guidelines include policy positions on the board, directors' remuneration, CSR and company reporting and certain other strategic and financial issues.

The guidelines can be viewed at: http://www.tuc.org.uk/tucfiles/557/TUC_Trade_Union_Voting_and_Engagement_Guidelines_March_2013.pdf.

Share Buybacks Draft Regulations Published

On 19 March 2013, a revised draft of the Companies Act 2006 (Amendment of Part 18) Regulations 2013 was published, together with an explanatory memorandum. The first draft of the regulations was published in October 2012 as part of the BIS consultation on the implementation of the Nuttall Review (as reported in our January 2013 newsletter), and in February 2013, the government published its response to the consultation.

In its response to the consultation, the government stated that it intends to:

- allow multiple off-market share buybacks to be authorised in advance via a single ordinary resolution where these are connected to an employee share scheme;
- introduce a simplified regime (solvency statement and special resolution) for enabling private companies to finance buybacks connected to an employee share scheme out of share capital;
- allow private limited companies to finance the buyback of shares (for purposes of or pursuant to an employees' share scheme) using small amounts of cash (not exceeding the lower of £15,000 or 5% of share capital in any financial

year) that do not have to be identified as distributable reserves, subject to the signing of a solvency statement and a special resolution if there is no provision in the company's articles to do so;

- allow all companies limited by shares (including private and unlisted public companies) to hold their own shares in treasury; and
- allow private companies to pay for their shares in instalments (where the buyback is for the purposes of or pursuant to an employees' share scheme). Maximum time limits for such payments will not be imposed.

The government response to the consultation can be viewed at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81699/bis-13-590-employee-ownership-and-share-buy-backs-implementation-of-nuttall-review-recommendation-v-government-response-to-consultation.pdf.

The substantive amendments made to the October version of the draft regulations are limited to the changes that are necessary to reflect the government's position as summarised above.

The draft regulations are intended to enter into force on 30 April 2013. The government plans to conduct a review three years after enactment.

The draft regulations can be viewed at:

http://www.legislation.gov.uk/ukdsi/2013/9780111537145.

Financial Reporting Council ("FRC") Consults on Implementing Sharman Panel Recommendations

On 30 January 2013, the FRC published a consultation paper setting out proposed measures to implement a number of the recommendations made by the Sharman Panel (as covered in our January 2012 newsletter) to improve the reporting regime relating to going concern and liquidity risks.

The consultation paper includes the following key proposals:

- introducing revised guidance for directors on-going concern which reflects the Sharman Panel's recommendations. The revised guidance promotes a more continuous assessment of going concern, integrated with the process for setting strategy, managing risks and running the business model in the longer term. The revised guidance will replace the existing guidance on-going concern for directors as issued by the FRC in October 2009;
- introducing supplementary guidance for banks which addresses particular issues relating to the going concern risks affecting the banking sector; and
- making a number of related amendments to International Standards on Auditing (UK and Ireland). These amendments are aimed at enhancing the role of the auditor in relation to going concern.

The closing date for responses to the consultation is 28 April 2013. The current intention is that the revised guidance for directors, supplemental guidance for banks and the related amendments to auditing standards will apply to financial years beginning on or after 1 October 2013.

The consultation paper can be viewed at:

http://www.frc.org.uk/getattachment/f1b20d17-151f-49ec-a556-6756a4893205/Sharman-Implementation-Consultation-Paper.aspx.

ICSA Publishes Guidance on Liability of Non-Executive Directors

On 18 January 2013, ICSA published a guidance note on the liability of non-executive directors ("NEDs"): care, skill and diligence. The guidance includes steps that NEDs can take to help them demonstrate to a regulator or a court that they have exercised care, skill and diligence in the execution of their role and responsibilities.

The guidance highlights areas of best practice for NEDs, including:

- carrying out their own due diligence before joining a board. Guidance on the enquiries a prospective director should make is contained in a separate ICSA note published in May 2011;
- understanding that more is expected from a director with a specific skill or experience;
- ensuring they can devote the time necessary to discharge their responsibilities;
- avoiding conflicts of interest;
- providing input into their induction programme and taking responsibility for their on-going training and continuous development;
- being prepared to provide independent oversight and constructive challenge to the board;
- ensuring they receive a schedule of future board and committee meetings planned well in advance so they have the opportunity to attend;
- insisting on receiving high-quality information sufficiently in advance of meetings, and any other important information between meetings when it becomes available;
- taking independent professional advice at the company's expense if they consider it necessary to discharge their responsibilities as directors; and
- making decisions objectively in the interests of the company.

The guidance can be viewed at:

https://www.icsaglobal.com/assets/files/pdfs/guidance/Guidance-notes-2013/Directors-duty-to-exercise-care-skill-and-diligence-13012013.pdf.

UK Listing Authority Publishes Fifth Primary Market Bulletin

As reported in our January 2013 newsletter, on 7 December 2012, the UKLA published its fourth Primary Market Bulletin announcing the launch of the UKLA Knowledge Base and the publication of 80 new and revised UKLA technical and procedural notes on the Listing Rules, Prospectus Rules and Disclosure and Transparency Rules.

On 25 February 2013, the UKLA published its fifth Primary Market Bulletin. The Bulletin includes a summary of the UKLA's consultation on five new technical notes to supplement those in the UKLA Knowledge Base on the Listing Rules, Prospectus Rules and Disclosure and Transparency Rules. The consultation also covers proposed amendments to two existing procedural and three technical notes.

The new technical notes relate to:

- whether a parent company giving a guarantee to a subsidiary so that it can take advantage of the exemption from the need to obtain an audit of its accounts in a financial year will constitute a class one transaction - the guidance is that it will only not do so where the subsidiary is 100% owned by the parent;

- the obligation not to delay the disclosure of inside information during the period in which issuers are preparing their financial reports;
- issues relating to zero-coupon bonds;
- the definition of 'sponsor services'; and
- the circumstances in which a sponsor must make a notification to the FSA. Following changes to the notification regime in October 2012, the UKLA proposes to delete technical note UKLA/TN/702.1 (Sponsor: regular review and annual confirmation for sponsors) as it is not longer relevant.

The UKLA also proposes to amend the procedural note on the eligibility review process, by making the eligibility review and prospectus review run simultaneously, rather than sequentially. Other amendments concern technical notes relating to supplementary prospectuses, risk factors and final terms.

Comments are requested by 8 April 2013 and, subject to feedback, the UKLA intends the notes to form part of the UKLA Knowledge Base and constitute formal FSA guidance.

The fifth Primary Market Bulletin can be viewed at:

http://www.fsa.gov.uk/static/pubs/ukla/ukla-bulletin-no5.pdf.

Law Commission Announces Review of Fiduciary Duties of Investment Intermediaries

On 26 March 2013, the Law Commission announced that it had started work on a review into the fiduciary duties of investment intermediaries. The review is commissioned jointly by BIS and the Department for Work and Pensions and follows the recommendation of the Kay Review of UK equity markets that the Commission be asked to review the legal concept of fiduciary duty as applied to investment.

BIS set the scope of the Law Commission's terms of reference, and these include:

- investigating the extent to which the law on fiduciary duties applies to intermediaries (including investment managers and pension scheme trustees) investing on behalf of others and to those providing advice to those undertaking investment activity;
- evaluating what those fiduciary duties require or permit intermediaries to consider when developing an investment strategy in the best interests of the ultimate beneficiaries, and whether those duties are conducive to developing such a strategy;
- consulting stakeholders across the equity investment chain on what the content and application of fiduciary duties in this context is or should be;
- considering whether fiduciary duties, as established in law or as applied in practice, are conducive to investment strategies that are in the best interests of the ultimate beneficiaries; and
- identifying any areas where changes ought to be made in relation to these criteria and making recommendations.

The Law Commission is seeking views on whether the law of fiduciary duties causes problems in practice. It plans to publish a consultation paper in October 2013. A final report, with recommendations, will follow by June 2014.

The Law Commission's terms of reference can be viewed at:
http://lawcommission.justice.gov.uk/docs/kay_final_terms_of_reference.pdf.

Guidelines Monitoring Group Publishes Updated Guidelines for Good Practice Reporting by Portfolio Companies

On 20 February 2013, the Guidelines Monitoring Group published an updated version of its guidelines on good practice reporting by private equity portfolio companies under the Walker Guidelines. The content of the guidelines remains unchanged from the version issued in March 2012. The guidelines do however include updated examples of reporting that the Guidelines Monitoring Group considers to represent good practice.

The Guidelines Monitoring Group notes that overall the quality of reporting reached a similar standard to the FTSE 350 but urges all qualifying companies to aim for best practice.

The guidelines can be viewed at:

http://walker-gmg.co.uk/sites/10051/files/walker_gmg_good_practice_reporting_guide_february_2013_-_final.pdf.

DEVELOPMENTS SPECIFIC TO FINANCIAL INSTITUTIONS

EU Developments

Obligations Coming into Force under EMIR

The European Regulation on over the counter derivatives, central counterparties and trade repositories ("EMIR") came into force on 16 August 2012. EMIR applies to:

- a financial counterparty, which are entities such as banks, investment firms, credit institutions, insurers, registered UCITS funds, pension funds and alternative investment fund managers;
- a non-financial counterparty ("NFC") which is established in the EEA and is not a financial counterparty (i.e. corporates); and
- a non-EU entity that would be subject to certain obligations under EMIR if the counterparty were established in the EU.

There are four key obligations under EMIR, some of which already require compliance and others for which compliance is imminent. The obligations are:

- Applying risk mitigation techniques to OTC derivative contracts:
  - From 15 March 2013, all counterparties will need to ensure the timely confirmation of the terms of the OTC derivative contracts that they enter into.
  - From 15 September 2013, counterparties will also need to put procedures in place for portfolio reconciliation and compression and dispute resolution.
- Reporting all derivatives contacts (OTC, exchange-traded, intragroup and trades with FCs and other NFCs) to a registered trade repository:
  - From 23 September 2013, credit and interest rate derivatives will need to be reported to a registered trade repository. If no repository is registered by 1 April 2013, then the obligation applies 90 days from registration of a trade repository.
  - From 1 January 2014, all other derivatives will need to be reported to a registered trade repository. If no repository is registered by 1 October 2013, then the obligation applies 90 days from registration of a trade repository.

- An NFC must notify regulators when the clearing threshold has been exceeded or is no longer exceeded:
    - From 15 March 2013, an NFC that exceeds the clearing threshold (an "NFC+") must notify both ESMA and the relevant regulator (in the UK, this is the Financial Conduct Authority).
- Clearing OTC derivatives that are subject to the clearing obligation through a central counterparty ("CCP"):
    - From 2014, the clearing obligation will come into force on a phased basis as asset classes are determined to be subject to the clearing obligation by the European Commission.

Regulatory and Implementing Technical Standards

In our previous update we reported that the Commission had adopted nine regulatory and implementing technical standards, or RTS. The implementing technical standards were published in the Official Journal on 21 December 2012 and came into force on 10 January 2013. The regulatory technical standards were published in the Official Journal on 23 February 2013 and came into force on 15 March 2013.

The RTS are available at :

http://eur-lex.europa.eu/JOHtml.do?uri=OJ:L:2013:052:SOM:EN:HTML.

The ITS are available at:

http://eur-lex.europa.eu/JOIndex.do?year=2012&serie=L&textfield2=352&Submit=Search&_submit=Search&ihmlang=en.

On 15 March 2013, ESMA published an opinion annexing a revised draft RTS on CCP colleges. ESMA submitted the draft RTS in September 2012; however, the Commission did not endorse the draft RTS, because it considered the RTS to be incompatible with EMIR and that ESMA had exceeded the mandate given to them under EMIR to specify details of the practical arrangements of the agreement for the establishment and functioning of CCP colleges. The Commission has three months to decide whether or not to adopt the revised draft RTS. Following that adoption, the European Parliament and the European Council may object within one month of an adoption if the Commission adopts the draft RTS as submitted by ESMA or within three months of the adoption if the Commission adopts the draft RTS but with amendments.

There are still two RTS outstanding under EMIR. The first is an RTS on the risk mitigation techniques for OTC derivatives that are not centrally cleared, which is to be prepared jointly by the ESA's. This RTS has been delayed to take account of the development of international standards on the matter, in particular the work of the Basel Committee and IOSCO on margin for uncleared derivative trades. The second is an RTS on the contracts that are either considered to have a direct substantial and foreseeable effect in the Union or to prevent the evasion of EMIR to be prepared by ESMA. These standards have been delayed so that ESMA can take into account the on-going discussions with regulators in other jurisdictions on the international reach of their provisions. The Commission will set a new deadline for the delivery of both RTS.

In addition, ESMA will prepare draft RTS each time it makes a determination that a class of assets is subject to the clearing obligation, following the authorisation or recognition of a CCP.

ESMA FAQs on EMIR

ESMA published its FAQs on EMIR on 20 March 2013. The FAQs include questions on the definition of OTC derivatives, CCPs, porting and collateral and trade repositories ("TRs"). The FAQs are intended for regulators but are also available to assist market participants and investors. The FAQs will be updated from time to time by ESMA.

The FAQs are available at:

http://www.esma.europa.eu/system/files/2013-324.pdf.

Guidelines on Interoperability Arrangements

On 15 March, ESMA published its final Guidelines and Recommendations for establishing consistent, efficient and effective assessments of interoperability arrangements. The Guidelines and Recommendations will be used by national regulators assessing applications for CCP authorisations under EMIR which include pre-existing or new interoperability arrangements. The Guidelines and Recommendations become effective one month after they have been published by ESMA on its website in the EU official languages. National regulators must notify ESMA whether they intend to comply with the Guidelines and Recommendations. The Guidelines cover legal risk, access, management of risk, deposit of collateral and cooperation between national regulators.

The Guidelines and Recommendations are available at:

http://www.esma.europa.eu/system/files/2013-323.pdf.

Practical Guidance for the Recognition of Third Country CCPs by ESMA

ESMA has published practical guidance to assist third country CCPs in their applications for recognition. The guidance includes useful information on how ESMA expects third country CCPs to communicate with ESMA about applications, the application process, relevant deadlines and notification of ESMA's decision on the application.

The guidance is available at:

http://www.esma.europa.eu/system/files/tc-ccp_applications.pdf.

Commission Extends Deadlines for ESMA Technical Advice on EMIR Third Country Equivalence

The Commission has extended the deadlines for ESMA to provide technical advice on the equivalence between certain third country legal and supervisory frameworks in respect of EMIR from 15 March to 15 June 2013 for the US and Japan and from 15 June to 15 July 2013 for Switzerland, Australia, Canada, Dubai, India, Singapore and Hong Kong. ESMA has been asked to provide advice in relation to the supervision of CCPs and TRs as well as the legal frameworks for obligations for clearing, reporting, non-financial counterparties and risk mitigation techniques for OTC trades that are not cleared by a CCP.

Commission Report on the International Treatment of Central Banks and Public Entities Managing Public Debt

Under Article 1 of EMIR, EU central banks and public bodies responsible for managing public debt are exempt from EMIR and do not need to comply with the clearing, reporting and risk mitigation obligations. Under Article 1(6) of EMIR, the Commission was requested to analyse the international treatment of those bodies in the legal framework of other jurisdictions. The Commission published its report on 22 March 2013. The Commission has analysed the frameworks in Japan, the US, Switzerland, Australia, Hong Kong and Canada in this regard. The Commission concludes that a delegated act is required to exempt the central banks and public bodies managing public debt in the US and Japan, both of which have final rules on OTC derivatives and which have reciprocal arrangements in place. The Commission will monitor developments in the other jurisdictions to assess whether further delegated acts are required in future.

CRA III Update

On 16 January 2013, the European Parliament voted in favour of further amendments to the EU Regulation on CRAs ("CRA III").

The new provisions that have been agreed are:

- reduced over-reliance on credit ratings. Financial institutions are required to strengthen their own credit risk assessment and not rely solely on external credit ratings;
- improved quality of ratings of sovereign debt of EU Member States. To avoid market disruption, CRAs will be required to set up a calendar for sovereign debt rating which will be limited to three ratings per year for unsolicited ratings. Furthermore, these ratings should be published only after markets in the EU have closed and at least one hour before markets reopen;
- CRAs to be liable for ratings. The new rules ensure that a rating agency can be held liable if it infringes, intentionally or with gross negligence, the CRA Regulation thereby causing damage to an investor;
- reduced conflicts of interest. CRAs will have to disclose publicly if a shareholder with 5% or more of the capital or voting rights of the CRA holds 5% or more in a rated entity. It is prohibited for a shareholder of a CRA with 10% or more of the capital or voting rights to hold 10% or more of a rated entity; and
- improved transparency. All ratings will be published on a European Rating Platform which will improve comparability and visibility of all ratings.

CRA III must still be formally adopted by the European Council and published in the Official Journal before it comes into force. Following that, a number of regulatory technical standards will need to be prepared before some of the provisions come into effect.

ESMA Annual Report on CRAs

On 18 March 2013, ESMA published a press release with regard to its second Annual Report on its supervision of CRAs in the EU. The report identifies progress by CRAs in their activities including improved disclosure of methodologies and ratings, internal control resources, and involvement of senior management in governance and record-keeping practices.

However, the Report finds that CRAs have not sufficiently embedded the main requirements of the CRA Regulation and cites the following areas for improvement:

- the consistent application and comprehensive presentation of rating methodologies;
- the empowerment and resourcing of analytical and control functions;
- the monitoring and surveillance of ratings; and
- the reliability of IT infrastructures.

ESMA Guidelines on Short Selling

On 1 February 2013, ESMA published its final report on guidelines on the market maker and primary dealer exemptions under Article 17 of the Short Selling Regulation ("SSR").

Article 17 provides exemptions to the SSR for market making activities and primary market operations. Market makers and authorised primary dealers must notify their national regulator that they are intending to use the relevant exemption 30 days before they do so.

The key elements of the guidelines include the following:

- the scope of the exemptions;

- how the relevant regulator for notification is determined, including in relation to notifying entities from third countries;
- qualifying criteria of eligibility for the exemptions; and
- guidance on the notification process of the intent to use the exemptions and the content of such notifications.

The final report can be found here:
http://www.esma.europa.eu/system/files/2013-158.pdf.

Following the publication of the official translations of the Guidelines on 2 April 2013, ESMA expects the Guidelines to become effective and to be applied across the EU from 2 June 2013.

ESMA Q&A and Call for Evidence on Short Selling

On 29 January 2013, ESMA published its second update of the Q&A on the application of the SSR. The Q&A was intended to provide clarity on the Regulations and also to promote common supervisory approaches and practices amongst the EU's national securities market regulators.

The Q&A can be found at:

http://www.esma.europa.eu/system/files/2013-159.pdf.

On 12 February 2013, ESMA published a call for evidence on the evaluation of the effects of the SSR. The call for evidence responds to the Commission's December 2012 request for technical advice from ESMA.

Responses to the call for evidence were due by 15 March 2013. ESMA must deliver its technical advice to the Commission by 31 May 2013 and will contribute to the Commission report to the European Parliament which must be delivered by 30 June 2013.

The call for evidence can be found at:

http://www.esma.europa.eu/system/files/2013-203.pdf.

Recovery and Resolution Planning: Financial Markets Law Committee ("FMLC")

On 22 February 2013, the FMLC published a report dated 18 February 2013 on the European Commission's proposed Recovery and Resolution Directive ("RRD").

The FMLC considers certain legal uncertainties arising from the RRD. The first part of the report examines specific issues of legal uncertainty that may arise from the drafting of the RRD including the definitions, objectives and general principles of the RRD, the powers and safeguards within the RRD and the use of the bail-in power conferred by the RRD. The report also examines legal uncertainties that may arise from the application of the RRD in certain situations such as the treatment of netting under the RRD, the effect of the tool conferred by the RRD on solvent and robust subsidiaries and the stringent restrictions on counterparties' rights to exercise termination rights under financial contracts under the RRD. Recommendations to address the issues identified are set out in each section of the report, and specific drafting comments are set out in an Appendix to the report.

EBA Consultation Paper on Draft RTS under the Proposed RRD

On 11 March 2013, the EBA published a consultation paper on draft RTS under the proposed RRD.

Article 3 of the draft RTS sets out the following five essential elements of the recovery plan:

- a summary of the recovery plan;

- information on governance, including the conditions and procedures necessary to ensure a timely implementation of the recovery options;
- a strategic analysis, including of the institution's core business lines and critical functions, as well as the different recovery options designed to respond to financial stress scenarios;
- a communication and disclosure plan, including internal and external communication arrangements; and
- an analysis of any preparatory measures taken or to be taken to facilitate the implementation and effectiveness of the recovery plan.

The EBA will submit the final draft RTS to the Commission within 12 months from the date of entry into force of the RRD. The EBA's consultation runs until 11 June 2013.

The consultation paper can be found at:

http://eba.europa.eu/cebs/media/Publications/Consultation%20Papers/2013/EBACP-01/EBA-CP-2013-01-CP-on-draft-RTS-on-Content-of-Recovery-Plans.pdf.

EBA Recommendation on the Development of Recovery Plans

On 23 January 2013, the EBA adopted a formal Recommendation to ensure that major EU cross-border banks develop group recovery plans by the end of 2013. The plans must be submitted to national regulators. Group plans will be discussed by relevant colleges of supervisors. The Recommendations includes a template for group recovery plans.

The EBA intends the Recommendation to fill the interim period before a comprehensive legislative framework for the recovery and resolution of credit institutions is implemented at EU level following the proposal by the European Commission published in June 2012 which is currently going through the EU legislative process.

The recommendation can be found at:

http://eba.europa.eu/cebs/media/Publications/Recommendations/EBA_Recommendation-on-Recovery-Plans.pdf.

ESMA Guidelines on Remuneration under the Alternative Investment Fund Managers Directive ("AIFMD")

On 11 February 2013, ESMA published its final guidelines on remuneration policies under the AIFMD which aim to ensure the uniform and consistent application of the provisions on remuneration in the AIFMD across the EU. Key elements of the guidelines include:

- the categories of staff members the provisions apply to;
- the types of remuneration covered by the guidelines;
- governance arrangements relating to remuneration;
- proportionality;
- the remuneration committee;
- general requirements for risk alignment;
- the remuneration policy, in general;
- disclosure;
- AIFMs that are part of a group; and
- the financial situation of the AIFM.

The guidelines will apply from 22 July 2013, subject to the transitional provisions of the AIFMD.

The guidelines can be found at:

http://www.esma.europa.eu/system/files/2013-201.pdf.

Commission Delegated Regulation under AIFMD

On 22 March 2013, the Commission Delegated Regulation on exemptions, general operating conditions, depositories, leverage, transparency and supervision was published in the Official Journal of the EU. The Regulation enters into force on 11 April and will apply from 22 July 2013. The Regulation covers:

- registration only – lighter regime for smaller EU-based managers;
- delegation;
- letter-box entities;
- co-operation agreements;
- transparency requirements;
- depositaries; and
- non-EU Managers: Action Points.

A detailed analysis of the Regulation is available in our client note at:

"AIFMD "Level 2" Published – "Time to Get Moving!".

European Commission Q&As on AIFMD

The European Commission has published the answers to a series of questions it has received on the AIFMD.

The questions concern:

- MiFID firms and MiFID activities;
- the definition of an alternative investment fund ("AIF");
- scope and exemptions; and
- transitional provisions.

The European Commission website has the questions and answers on its website, available at:

http://ec.europa.eu/yqol/index.cfm?fuseaction=legislation.show&lid=9.

UK Developments

Regulations Implementing EMIR

The Financial Services and Markets Act 2000 (Over the Counter Derivatives, Central Counterparties and Trade Repositories) Regulations 2013 were published on 12 March 2013. The Regulations came into force on 1 April 2013.

Although EMIR is a regulation and therefore directly applicable in the UK, some legislation is necessary to ensure that UK laws comply with EMIR. Therefore the Regulations implement the following:

- amendments to Part 18 of the FSMA to include CCPs authorised under EMIR as a new category of recognised clearing house and disapplication of provisions that are now inconsistent with EMIR;
- disapplication of most of the recognition requirements for clearing houses in the case of CCPs authorised under EMIR in amendments to the Financial Services and Markets Act 2000 (Recognition Requirement for Investment Exchanges and Clearing Houses) Regulations 2001;
- designating the Bank of England, the Financial Conduct Authority and the Prudential Regulation Authority as competent authorities for different purposes under EMIR; and
- amending Part VII of the Companies Act 1989 relating to the segregation and transfer of positions and collateral on the default of a clearing member.

Banking Reform Bill

On 4 February 2013, the Financial Services (Banking Reform) Bill was introduced to Parliament. The Bill is designed to implement the key recommendations of the Independent Commission on Banking (“ICB”), including ring fencing. The draft legislation has been scrutinised by the Parliamentary Commission on Banking Standards (“PCBS”) and the Government has made a series of amendments to the Bill based on their recommendations.

The key elements of the Bill are the following:

- ring-fencing proposals. This will require the separation of retail deposits from wholesale or investment banking activities (except for banks below a de minimis threshold). Ring fenced banks will have to meet regulatory requirements on a standalone basis, and be legally, economically and operationally independent of the rest of the wider corporate group;
- depositor preference. The Bill proposes to amend the Insolvency Act 1986 to ensure that deposits protected under the Financial Services Compensation Scheme (“FSCS”) are preferential debts and will therefore rank above other unsecured debts upon insolvency;
- loss absorbency. The Bill will give the HM Treasury power to make regulations governing the way in which the new Prudential Regulation Authority may use its powers under FSMA to impose debt requirements on banks;
- the Bill will impose statutory duties on the FSCS, such as the requirement to operate the scheme swiftly and efficiently for the benefit of claimants, mitigate taxpayer costs and provide HM Treasury with accounting and management information; and
- the Bill allows for the HM Treasury to direct the FCA, the PRA, and the Bank of England to charge the firms they regulate a fee in respect of expenses incurred by HM Treasury in respect of its membership of certain international bodies.

The Government intends to have all legislation enacted by the end of this Parliament (2015). The Government is expected to implement the reforms by 2019.

New Regulatory Architecture

As of 1 April 2013, the FSA no longer exists in its current form, but in its place, and assuming its functions, three new bodies have come into existence:

<u>The Financial Policy Committee (“FPC”)</u>

The FPC is a committee of the Bank of England. It is responsible for macro-prudential regulation and will consider macro issues affecting economic and financial stability. It will respond to issues by directing the PRA, and if applicable the FCA, to take the necessary action (see, for example, the item below on Recommendations to the PRA).

The Prudential Regulation Authority ("PRA")

The PRA is established as a subsidiary of the Bank of England. It is responsible for the prudential regulation of all deposit-takers, including banks, building societies, credit unions, insurers and a small number of major investment firms (PRA authorised firms).

The Financial Conduct Authority

The FCA will be the UK financial services regulator responsible for the conduct of all firms currently regulated by the FSA, including firms authorised and subject to prudential supervision by the PRA (PRA authorised firms). The FCA will also be the prudential regulator for all firms other than PRA authorised firms.

For further information on these changes, you may wish to refer to our client note, "New UK Financial Services Regulators Established and New Rulebooks Come into Effect".

Recommendations from the FPC to the PRA

On 27 March 2013, the FPC published a news release concerning its meeting on 19 March 2013.

In the meeting, it was noted that after 2013 further increases in capital ratios will be required. Banks will need to transition to full Basel III compliance and meet the surcharge on systemically important banks and the new trading book capital regime. Further to this, banks will need to meet the requirements imposed by the Government's implementation of the ICB recommendations.

In light of this, the FPC issued recommendations for the PRA to:

- assess current capital adequacy using the Basel III definition of equity capital after: (i) making deductions from currently-stated capital to reflect an assessment of expected future losses and a realistic assessment of future costs of conduct redress; and (ii) adjusting for a more prudent calculation of risk weights;
- take steps to ensure that, by the end of 2013, major UK banks and building societies hold capital resources equivalent to at least 7% of their risk-weighted assets;
- consider applying higher capital requirements to any major UK bank or building society with concentrated exposures to vulnerable assets, where there are uncertainties about assets not covered in the FSA's assessment of future expected losses or risk weights analysis, or where banks are highly leveraged relating to trading activities;
- ensure that major UK banks and building societies meet the requirements in Recommendations 2 and 3 above by issuing new capital or restructuring balance sheets in a way that does not hinder lending to the economy. Any newly-issued capital, including contingent capital, would need to be clearly capable of absorbing losses in a going concern to enable firms to continue lending;
- ensure that major UK banks and building societies have credible plans to transition to meet the significantly higher targets for capital and the leverage ratio that will come into effect in 2019 after full implementation of Basel III, the trading book review and surcharge for systemically important banks, and after HM Government's implementation of the ICB proposals, in ways consistent with sustainable expansion of the UK economy; and
- together with the Bank of England develop proposals for regular stress testing of the UK banking system. The purpose of those tests would be to assess the system's capital adequacy.

The FPC will monitor implementation of these recommendations but does not intend to issue further recommendations on bank capital ahead of a future stress testing exercise.

FSA Finalises New Rules on Financial Benchmarks

The FSA issued a policy statement setting out finalised new rules and regulations for financial benchmarks, including the London Inter-Bank Offered Rate ("LIBOR"). Following the Wheatley Review of LIBOR, which was published in September 2012, and which recommended that LIBOR activities should be brought within the scope of statutory regulation, the Government inserted provisions into the Financial Services Act 2012 to allow the regulation of activities in relation to benchmarks. That legislation commenced on 1 April 2013. Initially, the only specified benchmark is LIBOR.

The FSA's policy statement sets out the Handbook text that applies to benchmark administrators and submitters to benchmarks. The key proposals include:

- benchmark administrators will be required to corroborate submissions and monitor for any suspicious activity, as well as having in place effective internal governance and oversight measures;
- those submitting data will be required to have in place a clear conflicts of interest policy and appropriate systems and controls, including having an objective methodology for determining submissions;
- administrators must maintain sufficient financial resources; and
- two new significant influence-controlled functions under the Financial Conduct Authority's approved persons regime for the administrator and submitting firms.

The new Handbook provisions came into force on 2 April 2013, immediately after the cutover to the UK's new regulatory structure. A review of the LIBOR-submitting firms' compliance with the new regulations will be carried out within the first year of the regulations coming into force.

The FSA policy statement is at:

http://www.fsa.gov.uk/static/pubs/policy/ps13-06.pdf.

The MF Global Decision

The High Court has decided that a client of an insolvent UK broker is entitled to a claim based on the client's open positions at market values at the primary pooling event ("PPE"), in this case the date MF Global entered special administration. The Court rejected the alternative submission that a claim should be based on the price the trades were subsequently closed out at (the hindsight principle).

You may wish to refer to our client note at:

"The "Hindsight" Principle Does Not Apply to Client Money Claims in UK Broker Insolvencies.

Recovery and Resolution Planning

On 22 February 2013, the FSA published an update on its work relating to recovery plans and resolution packs ("RRPs"). It is expected that rules formalising the RRP framework will be published soon after legal cutover (1 April 2013) in addition to an updated RRP information pack for firms. The following changes to the UK RRP regime have been made following the experience gained from RRP submissions to date:

- Recovery plans must be submitted once a year as part of a firm's normal risk management and submitted to supervisors for review when requested.

- Firms will not have to update their resolution information pack on an annual basis as a matter of process. Instead, firms should respond to requests for resolution planning information from their supervisors.

The update can be found at:

http://www.fsa.gov.uk/static/pubs/other/recovery-and-resolution-planning.pdf.

HM Treasury and FSA Consultations on Transposing the AIFMD

On 11 January 2013, HM Treasury published a consultation paper on transposing the AIFMD. The consultation paper set out the Government's proposed approach to key policy decisions on requirements for sub-threshold fund managers, marketing, private equity and transitional measures. Responses to the consultation were due by 27 February 2013.

On 22 January 2013, HM Treasury published a revised version of its first consultation paper clarifying the government's proposed approach towards sub-threshold alternative investment fund managers ("AIFMs") managing unregulated collective investment schemes ("UCIS"). The government intends to replicate the current approach towards UCIS operators and "to maintain a regulatory regime as close as possible to the status quo for such entities". AIFMD requirements that go beyond this will not be applied.

The new document is available at:

http://www.hm-treasury.gov.uk/d/consult_transposition_of_the_alternative_investment_fund_managers_directive_220113.pdf.

On 13 March 2013, a second consultation paper was published which covers issues such as the scope of application of the Directive, including charity funds, the European Venture Capital Funds ("EuVECA") and European Social Entrepreneurship Funds ("EuSEF") Regulations, marketing of EEA retail funds, third country retail funds, the application of the approved persons regime to internally managed investment companies and the application of the Financial Services Compensation Scheme ("FSCS") and Financial Ombudsman Service ("FOS") to AIFMs. Responses to the consultation were due by 5 April 2013.

The second consultation paper is available at:

http://www.hm-treasury.gov.uk/d/consult_transposition_of_the_aifmd_further_consultation_130313.pdf.

Following publication of its first consultation paper in November 2012, the FSA has published a second consultation paper on rules and guidance to transpose the AIFMD in the UK. The second consultation paper covers:

- delegation by AIFMs;
- amendments to organisational and conduct of business rules that will affect UK AIFMs;
- supplementary proposals for prudential rules;
- consumer redress;
- supplementary proposals on depositories and how some of the existing rules and guidance for the protection of client assets will apply to some depositories; and
- the regulator's approach to marketing and the exercise of passporting rights.

Responses to the consultation are due by 10 May 2013. A third consultation paper is expected soon after legal cutover from the FSA to the FCA. The FCA expects to publish a final policy statement in June 2013. However, the regulator hopes to confirm some of its policy positions before that date to give affected firms as much time as possible for their AIFMD preparations.

Member States are required to implement the AIFMD into national law by 22 July 2013. The AIFMD will be implemented in the UK through HM Treasury regulations and FCA (previously the FSA) rules. The government's consultation papers are accompanied by proposed regulations and the FSA's consultation papers include draft Handbook text.

The FSA consultation paper is available at:

http://www.fsa.gov.uk/static/pubs/cp/cp13-09.pdf.

Global Developments

Report on the Suitability Requirements for Complex Financial Transactions

On 21 January 2013, the International Organisation of Securities Commission ("IOSCO") published its final report on Sustainability Requirements for the Distribution of Complex Financial Products.

The report was prompted by concerns that customers were insufficiently protected with regard to the distribution of complex financial products by intermediaries (firms in the business of managing individual portfolios, providing investment advice, dealing in or distributing securities).

The report proposed nine principles on Sustainability Requirements:

- Principle 1 - intermediaries should be required to adopt and apply appropriate policies and procedures to distinguish between retail and non-retail customers. The classification of customers should be based on a reasonable assessment of the customer concerned, taking into account the complexity and riskiness of different products and services. The regulator should consider providing guidance to intermediaries in relation to customer classification;
- Principle 2 – irrespective of the classification of a customer as retail or non-retail, intermediaries should be required to act honestly, fairly and professionally and take reasonable steps to manage conflicts that arise in the distribution of complex financial products, including through disclosure, where appropriate;
- Principle 3 – investors should receive or have access to material information to evaluate the nature, costs and specific risks of the complex financial product. Any information communicated by intermediaries to their customers regarding a complex financial product should be communicated in a fair, comprehensible and balanced manner;
- Principle 4 – even when an intermediary sells to a customer a complex financial product on an unsolicited basis (no management, advice or recommendation), the regulatory system should provide for adequate means to protect customers from associated risks;
- Principle 5 – whenever an intermediary recommends to a customer that it purchase a particular complex financial product, including where the intermediary advises or otherwise exercises investment management discretion, the intermediary should be required to take reasonable steps to ensure that recommendations, advice or decisions to trade on behalf of such customer are based upon a reasonable assessment that the structure and risk-reward profile of the financial product is consistent with such customer's experience, knowledge, investment objectives, risk appetite and capacity for loss;
- Principle 6 – an intermediary should have sufficient information in order to have a reasonable basis for any recommendation, advice or exercise of investment discretion made to a customer in connection with the distribution of a complex financial product;

- Principle 7 – intermediaries should establish a compliance function and develop appropriate internal policies and procedures that support compliance with suitability obligations, including when developing or selecting new complex financial products for customers;
- Principle 8 – intermediaries should be required to develop and apply proper policies that seek to eliminate and incentives for staff to recommend unsuitable complex financial products; and
- Principle 9 – regulators and self-regulatory organisations should supervise and examine intermediaries on a regular and on-going basis to help ensure firm compliance with suitability and other customer protection requirements relating to the distribution of complex financial products. Enforcement actions should be taken by the national regulator, as appropriate. Regulators should consider the value of making enforcement actions public in order to protect investors and enhance market integrity.

The SEC has objected to the publication of the report indicating that they did not think the report accurately reflected the law in the United States.

The report can be found at:

https://www.iosco.org/library/pubdocs/pdf/IOSCOPD400.pdf.

IOSCO Report on the Protection of Client Assets

On 8 February 2013, IOSCO published a consultation paper on recommendations regarding the protection of client assets. The IOSCO report was partly motivated by the insolvencies of Lehman Brothers and MF Global and the ensuing difficulties for clients claiming money back from these intermediaries.

The report sets out eight principles designed to help regulators with their supervision of intermediaries that hold client assets.

- Principle 1 – an intermediary should maintain accurate and up-to-date records and accounts of client assets that readily establish the precise nature, amount, location and ownership status of client assets and the clients for whom the client assets are held. The records should also be maintained in such a way that they may be used as an audit trail;
- Principle 2 – an intermediary should provide a statement to each client on a regular basis, as well as on request, detailing the client assets held for or on behalf of such client;
- Principle 3 – an intermediary should maintain appropriate arrangements to safeguard the clients' rights in client assets and minimise the risk of loss and misuse;
- Principle 4 – where an intermediary places or deposits client assets in a foreign jurisdiction, the intermediary should understand and take into account the foreign regime to the extent necessary to achieve compliance with applicable domestic requirements;
- Principle 5 – an intermediary should ensure that there is clarity and transparency in the disclosure of the relevant client asset protection regime(s) and arrangements and the consequent risks involved;
- Principle 6 – where the regulatory regime permits clients to waive or to modify the degree of protection applicable to client assets or otherwise to opt out of the application of the client asset protection regime, such arrangements should be subject to the following safeguards:
    - The arrangement should only take place with the client's explicit written consent;

    - Before such consent is obtained, the intermediary should ensure that the client has been provided with a clear and understandable disclosure of the implications of giving such consent; and
    - If such arrangements are limited to particular categories of clients, clear criteria delineating those clients that fall within such categories should be defined;
- Principle 7 – regulators should oversee intermediaries' compliance with the applicable domestic requirements to safeguard client assets; and
- Principle 8 – where an intermediary places or deposits client assets in a foreign jurisdiction, the regulator should, to the extent necessary to perform its supervisory responsibilities concerning applicable domestic requirements, consider information sources that may be available to it, including information provided to it by the intermediaries it regulates and/or assistance from local regulators in a foreign jurisdiction.

The report can be found at:
http://www.iosco.org/library/pubdocs/pdf/IOSCOPD401.pdf

BCBS and IOSCO Consultation on Margin Requirements for Non-centrally Cleared Derivatives

The Basel Committee and IOSCO have published a second consultation paper on proposals for minimum standards for margin requirements for uncleared derivatives. Responses to the consultation were due on 15 March 2013. The proposals envisage a gradual phase-in of the requirements over a four year period starting in 2015 with the largest, most active and systemically risky derivative market participants.

Contact Us

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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