

GOVERNANCE & SECURITIES LAW FOCUS

JULY 2020/LATIN AMERICA
EDITION

Below is a summary of the main developments in U.S., EU, and U.K. corporate governance and securities law since our [last update in May 2020](#).

[See our page dedicated to the latest financial regulatory developments.](#)

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COVID-19: GENERAL INFORMATION AND RESOURCES

The outbreak of the novel coronavirus pandemic (**COVID-19**) has had and will continue to have wide-ranging implications for businesses, governments and institutions across markets and industries. As stated in our last update, Shearman & Sterling (**Shearman**) has created a dedicated resource hub containing information on the potential impact this pandemic may have on businesses, and what businesses can do to prepare and succeed in this rapidly evolving space going forward. The sections that follow cover select key topics that may be of particular interest at the time of writing. Given that developments in this space continue to evolve rapidly, we urge you to refer to this resource hub for real-time updates, as well as further details and information on these topics and others.

You are encouraged to contact our COVID-19 task force at any time at COVID_19_Task_Force@Shearman.com to discuss any questions or concerns you may have relating to this pandemic.

U.S. DEVELOPMENTS

Developments Related to COVID-19

SEC Provides Additional COVID-19 Disclosure Guidance Regarding Operations, Liquidity and Capital Resources

On June 23, 2020, the SEC's Division of Corporation Finance (**Division**) issued [Disclosure Guidance Topic No. 9A](#) (the **Guidance**), which provides additional views of the SEC staff (**Staff**) with regard to operations, liquidity and capital resources disclosures that companies should consider with respect to business and market disruptions related to COVID-19. The Guidance supplements [Disclosure Guidance Topic No. 9](#) issued on March 25, 2020. It states that the Division continues to encourage companies to provide disclosures that allow investors to evaluate the current and expected impact of COVID-19 through the eyes of management and to proactively revise and update disclosures as facts and circumstances change.

The Guidance notes that companies are undertaking a diverse range of operational adjustments in response to COVID-19, which include a transition to telework, supply chain and distribution adjustments, and suspending or modifying certain operations to comply with health and safety guidelines. These may have an effect on the company that would be material to an investment or voting decision. The Guidance indicates that affected companies should carefully consider their obligations to disclose that information to investors. In addition, companies are undertaking a diverse range of financing activities in response to COVID-19. The Guidance indicates that companies should provide robust and transparent disclosure about their response to short- and long-term liquidity and funding risks in the current economic environment, as well as any new uncertainties related to those efforts. While the Staff has observed companies making some of these disclosures in earnings releases, the Staff encourages companies to consider whether any of these disclosures should also be included in the management discussion and analysis (the **MD&A**.)

General Considerations

The Staff states that companies should consider a broad range of additional questions that are more specifically focused on the evolving impact of COVID-19 on their particular operations, liquidity and capital resources. These include:

- **Operational Challenges.** What are the material operational challenges that management and the Board of Directors are monitoring and evaluating? How and to what extent have you altered your operations, such as implementing health and safety policies for employees, contractors and customers to deal with these challenges, including challenges related to employees returning to the workplace? How are the changes impacting or reasonably likely to impact your financial condition and short- and long-term liquidity?

- **Liquidity Position and Outlook.** How is your overall liquidity position and outlook evolving? To the extent COVID-19 is adversely impacting your revenues, consider whether such impacts are material to your sources and uses of funds, as well as the materiality of any assumptions you make about the magnitude and duration of COVID-19's impact on your revenues. Are any decreases in cash flow from operations having a material impact on your liquidity position and outlook?
- **Financing Activities.** Have you accessed revolving lines of credit or raised capital in the public or private markets to address your liquidity needs? Are your disclosures regarding these actions and any unused liquidity sources providing investors with a complete discussion of your financial condition and liquidity?
- **Funding Sources.** Have COVID-19–related impacts affected your ability to access your traditional funding sources on the same or reasonably similar terms as were available to you in recent periods? Have you provided additional collateral, guarantees or equity to obtain funding? Have there been material changes in your cost of capital? How has a change, or a potential change, to your credit rating impacted your ability to access funding? Do your financing arrangements contain terms that limit your ability to obtain additional funding? If so, is the uncertainty of additional funding reasonably likely to result in your liquidity decreasing in a way that would result in you being unable to maintain current operations?
- **Covenants.** Are you at material risk of not meeting covenants in your credit and other agreements?
- **Metrics.** If you include metrics, such as cash burn rate or daily cash use, in your disclosures, are you providing a clear definition of the metric and explaining how management uses the metric in managing or monitoring liquidity? Are there estimates or assumptions underlying such metrics the disclosure of which is necessary for the metric not to be misleading?
- **Capital Expenditures.** Have you reduced your capital expenditures and if so, how? Have you reduced or suspended share repurchase programs or dividend payments? Have you ceased any material business operations or disposed of a material asset or line of business? Have you materially reduced or increased your human capital resource expenditures? Are any of these measures temporary in nature, and if so, how long do you expect to maintain them? What factors will you consider in deciding to extend or curtail these measures? What is the short- and long-term impact of these reductions on your ability to generate revenues and meet existing and future financial obligations?
- **Debt Obligations.** Are you able to timely service your debt and other obligations? Have you taken advantage of available payment deferrals, forbearance periods or other concessions? What are those concessions and how long will they last? Do you foresee any liquidity challenges once those accommodations end?
- **Customer Arrangements.** Have you altered terms with your customers, such as extended payment terms or refund periods, and if so, how have those actions materially affected your financial condition or liquidity? Did you provide concessions or modify terms of arrangements as a landlord or lender that will have a material impact? Have you modified other contractual arrangements in response to COVID-19 in such a way that the revised terms may materially impact your financial condition, liquidity and capital resources?
- **Supplier Arrangements.** Are you relying on supplier finance programs, otherwise referred to as supply chain financing, structured trade payables, reverse factoring or vendor financing, to manage your cash flow? Have these arrangements had a material impact on your balance sheet, statement of cash flows or short- and long-term liquidity, and if so, how? What are the material terms of the arrangements? Did you or any of your subsidiaries provide guarantees related to these programs? Do you face a material risk if a

party to the arrangement terminates it? What amounts payable at the end of the period relate to these arrangements, and what portion of these amounts has an intermediary already settled for you?

- **Subsequent Events.** Have you assessed the impact material events that occurred after the end of the reporting period, but before the financial statements were issued, have had or are reasonably likely to have on your liquidity and capital resources and considered whether disclosure of subsequent events in the financial statements and known trends or uncertainties in MD&A is required?

A Company's Ability to Continue as a Going Concern

The effects of COVID-19 have led to uncertainty among many companies regarding their ability to continue business operations as a going concern.

The Guidance states that management should provide appropriate financial statement disclosures when there is substantial doubt about a company's ability to continue as a going concern or such substantial doubt is alleviated by management's plans. The Guidance suggests questions for consideration in that regard, such as:

- **Substantial Doubt.** Are there conditions and events that give rise to the substantial doubt about the company's ability to continue as a going concern? For example, have you defaulted on outstanding obligations? Have you faced labor challenges or a work stoppage?
- **Management's Plans.** What are your plans to address these challenges? Have you implemented any portion of those plans?

The Division highlights that disclosures on disclosure controls and procedures and internal control over financial reporting may also be implicated by COVID-19. For additional accounting and audit-related matters companies should consider, please refer to the SEC's Office of the Chief Accountant (**OCA**) statement discussed below.

OCA statement on the Importance of High-Quality Financial Reporting in Light of COVID-19

Relatedly, on June 23, 2020, the OCA issued a [statement](#) on the importance of high-quality financial reporting in light of COVID-19 as a supplement to a previous [statement](#) issued on April 3, 2020. The statement emphasizes the importance of timely, high-quality, decision-useful information to investors and our public capital markets and highlights the essential role that participants in our financial reporting system play in the functioning of our markets and in the collective national effort to mitigate the COVID-19 pandemic. The statement discusses some of the significant accounting, auditing and financial reporting topics recently addressed by the OCA, including:

- significant estimates and judgments;
- disclosure controls and procedures and internal control over financial reporting;
- ability to continue as a going concern; and
- audit committees and auditor independence.

Staff Issues Statement Regarding Rule 302(b) of Regulation S-T in Light of COVID-19 Concerns

On June 25, 2020, the Staff issued a [statement](#) regarding Rule 302(b) of Regulation S-T clarifying measures companies may take to comply with manual signature and filing requirements in the context of the COVID-19 outbreak. Currently, SEC filings are normally made electronically and use typed, conformed signatures rather than actual manual signatures. However, under Rule 302(b), each signatory to documents electronically filed with the SEC under the federal securities laws is also required to "manually sign a signature page or other document authenticating, acknowledging or otherwise adopting his or her signature that appears in typed form within the electronic filing," and requires such signature before or at the time the electronic filing is made. Moreover, electronic

filers are required to retain such documents for a period of five years and furnish copies to the SEC or its Staff upon request.

Although the Staff states its expectation that all persons and entities subject to Regulation S-T will comply with the requirements of Rule 302(b) to the fullest extent practicable based on their particular facts and circumstances, it recognizes that under the current circumstances some signatories may experience difficulties satisfying the requirements of Rule 302(b) and, therefore, will not recommend enforcement action to the SEC with respect to the requirements of Rule 302(b) if:

- a signatory retains a manually signed signature page or other document authenticating, acknowledging or otherwise adopting his or her signature that appears in typed form within the electronic filing and provides such document, as promptly as reasonably practicable, to the filer for retention in the ordinary course pursuant to Rule 302(b);
- such document indicates the date and time when the signature was executed; and
- the filer establishes and maintains policies and procedures governing this process.

The Staff states that the signatory may also provide to the filer an electronic record, for example a photograph or PDF, of such document when it is signed. For example, a signatory working remotely should sign the document being filed at home and retain that page until he or she is back in the office, where it can be stored per typical procedure. The Staff reminds issuers and signatories of the presumption within Section 6 of the Securities Act that a signature is validly authorized, as well as its expectation that filers will maintain procedures to ensure that conformed signatures within a filing have been appropriately authorized.

The statement is temporary and remains in effect until the Staff provides public notice that it no longer will be in effect. Such notice will be published at least two weeks before the announced termination date.

OCA Issues Statement on COVID-19

On June 23, 2020, the OCA issued a [statement](#) highlighting the continued importance of high-quality financial reporting for investors in light of COVID-19, a follow-up to its [statement](#) on April 3, 2020, discussed in our May 2020 newsletter, shared with you.

As public companies prepare for filing their second-quarter financial results, the statement emphasizes the important role played by participants in the financial reporting system, with a steady flow of timely, decision-useful information to investors and public capital markets critical to the financial markets. In particular, the statement highlights the OCA's continued engagement with stakeholders throughout the financial reporting system, notably in connection with its work related to ensuring continued high-quality financial reporting and its engagement with the various regulators, international standard setters and audit committees.

OCA's Engagement and Work Related to High-Quality Financial Reporting

Given the paramount importance of the financial reporting system to investors, the statement stresses that it is critical that the reporting system accurately represents data it purports to represent. In the event that any material change occurs or is reasonably likely to materially affect a reporting entity's internal control over financial reporting, the statement urges that such change is disclosed by reporting companies in their quarterly filings in the fiscal quarter in which it occurred.

OCA's Engagement with the Financial Accounting Standards Board and Public Company Accounting Oversight Board

The OCA has continued to engage in dialogue with the Financial Accounting Standards Board (**FASB**) and the Public Company Accounting Oversight Board (**PCAOB**) in relation to addressing emerging issues and promoting high-quality

financial reporting during these times. In particular, the OCA is working closely with the FASB on issues related to the impact of COVID-19, providing feedback on standard-setting projects, observing FASB meetings and sharing its experiences on a wide range of other topics. In connection with the PCAOB's efforts throughout this unprecedented time, the OCA continues to coordinate closely with the PCAOB as it seeks to execute its strategic plan.

OCA's Engagement with International Standard Setters and Other Regulators

Given the global and interconnected nature of the financial markets, international accounting and audit-related standards are of paramount importance to the strength of the financial reporting system, global capital markets and investor protection. The OCA has been participating actively in the development of high-quality International Financial Reporting Standards (**IFRS**) standards, working closely with the International Organization of Securities Commissions' (**IOSCO**) Issuer Accounting, Audit and Disclosure committee to develop comment letters in response to proposals by the International Accounting Standards Board (**IASB**), as well as engaging in direct dialog with members of the IASB and its staff on topics of mutual interest, such as application of the IFRS leasing standard to rent concessions made as a consequence of COVID-19.

Further, the Monitoring Group, a global organization composed of regulators and others dedicated to advancing the public interest in audit-related standard setting and improving audit quality, has actively led the development of reform recommendations aimed at making the standard-setting system more responsive to the public interest by using a multi-stakeholder approach to the development of standards with the expectation that doing so will lead to improvements in audit quality around the world.

The SEC has also been engaging with other regulators, with its work within IOSCO to support the continued, faithful application of accounting and auditing standards so that investors continue to receive high-quality financial information during these times. On May 29, 2020, IOSCO issued a [statement](#) emphasizing the importance of complying with accounting and auditing standards as well as providing investors with complete, transparent and entity-specific disclosures that enable investors to better understand the risks that public companies are facing in the current environment.

OCA's Engagement with and the Vital Role of Audit Committees

The OCA continues to engage with audit committee members and related organizations in its efforts to promote high-quality financial reporting, with a commitment to be proactive in engaging with audit committee members to understand current market developments and to solicit their perspectives on improving the oversight of financial reporting.

SEC Issues FAQs on Reporting During COVID-19

On May 6, 2020, the Staff issued four [FAQs](#) relating to its order dated March 25, 2020 (**March Order**), extending deadlines for companies requiring additional time to comply with filing deadlines as a direct result of the impact of COVID-19 on their operations. A discussion of the March Order was included in our May 2020 newsletter, shared with you, and the FAQs reiterate the SEC's position, clarifying the applicability of the extended deadlines on the use of Form S-3.

As set out in the March Order, in order to be entitled to an extended filing exemption, a reporting company must disclose (i) that it is relying upon the March Order; (ii) a brief description of the reasons why the company could not complete the filing on a timely basis; (iii) the estimated date by which the filing is expected to be completed; and (iv) a company-specific risk factor explaining the impact, if material, of COVID-19 on its business. If a company is unable to make a timely filing due to its inability to furnish any required opinion, certification or report, it must attach a statement specifying why such person is unable to furnish its opinion, certificate or report as an exhibit to the Form 8-K or Form 6-K, as the case may be.

The SEC has also clarified that a registrant may continue to conduct shelf-takedowns from an already-effective registration statement (while relying on the March Order), provided that the registrant is in full compliance with Section 10(a) of the Securities Act. Although registrants relying on the March Order may be permitted to conduct a takedown using a prospectus that contains information older than 16 months, the onus lies on registrants and their legal advisers to determine when it is appropriate to update the prospectus, with registrants responsible for the accuracy and completeness of their disclosure.

Lastly, the FAQs have clarified that a registrant may file a new Form S-3 registration statement between the original due date of a required filing and the due date as extended by the March Order, even if the registrant has not filed the required periodic report prior to the filing of the registration statement. In such case, the Staff will consider the registrant to be current and timely in its reporting if the Form 8-K disclosing reliance on the March Order is properly furnished. However, the registrant will lose such eligibility if it fails to file the required report by the due date as extended by the March Order.

Nasdaq and NYSE Provide Temporary Relief from Continued Listing Standards

In response to the decline in the U.S. and global equity markets and general investor confidence, resulting in depressed pricing for companies that otherwise remain suitable for continued listing, the U.S. Securities and Exchange Commission (**SEC**) approved with immediate effect the rule changes proposed by the New York Stock Exchange (**NYSE**) and Nasdaq to their listing standards relating to the minimum price and minimum market capitalization continued listing standards by tolling the compliance periods through June 30, 2020. The approval of the SEC was received by the NYSE and Nasdaq on April 27, 2020, and on April 17, 2020, respectively.

NYSE

The NYSE relief as approved by the SEC provides companies with a longer period to regain compliance with the \$1.00 minimum price and the \$50 million stockholders' equity/average market capitalization continued listing standards. If a company received a notice of noncompliance from the NYSE with regard to such standards *after* the temporary relief took effect and did not regain compliance prior to June 30, 2020, it is subject to an 18-month cure period, starting on July 1, 2020, to rectify the noncompliance with the minimum price standard, and to a six-month cure period to rectify the noncompliance with the minimum stockholders' equity/market capitalization standard. For listed companies that were in a pending cure period when the temporary relief took effect and did not regain compliance prior to June 30, 2020, the compliance period was suspended and resumed on July 1, 2020.

Nasdaq

Similarly, on April 17, 2020, the SEC approved the Nasdaq temporary rule change to provide immediate temporary relief for companies from the continued listing bid price and market value of publicly held shares listing requirements through June 30, 2020. A Nasdaq-listed company that is noncompliant with these standards will usually be subject to a 180-day cure period, starting on the date such company receives the notice of noncompliance from NASDAQ. The relief effectively paused the cure period during the tolling period, and noncompliant companies have 180 days, which started on July 1, 2020, to regain compliance. The compliance periods for any company previously notified about noncompliance was suspended and resumed on July 1, 2020.

NYSE Reopens Trading Floor

As reported in our previous update, on March 23, 2020, the NYSE took the unprecedented step of closing its trading floors and moving exclusively to electronic trading. On May 26, 2020, the trading floor partially reopened. The NYSE stated that they were "beginning cautiously with fewer traders, and those that are on the floor are wearing masks and keeping a safe distance," describing some of the safety protocols it says were developed with public health experts together with state and federal officials.

Furthermore, in June, the NYSE announced that it would allow a limited number of market makers to return to its trading floor, adding to the 25% of participants who returned on May 26. NYSE's COO, Michael Blaugrund, stated in an interview, "The expectation is that we'll have the human designated market makers to provide the manual opening and closing auctions, which are critical for price discovery and liquidity."

Other SEC and NYSE Developments

SEC Adopts New Financial Statement Disclosure Requirements for Acquisitions and Dispositions

On May 21, 2020, the SEC announced it had adopted amendments to the rules for financial statement disclosure requirements, which are expected to improve the information that investors receive regarding the acquisition and disposition of businesses and to reduce complexity and compliance costs. The new rules change two of the three significance tests used to determine whether a company is required to disclose financial statements of an acquired business (which we refer to as a target) and the related pro forma financial statements, and whether a company is required to disclose pro forma financial statements in connection with a disposition, reduce the maximum number of years of target financial statements to two years from three years and raise the significance threshold for dispositions, among other changes.

The below offers a brief summary of these changes. For a more complete review of the new rules, please refer to our client publication.

Acquisitions

- *Significance Tests.* Target financial statements and related pro forma financial statements are required to be filed with the SEC in connection with an acquisition depending on the significance of the target acquisition to the acquiring company, measured using the following three tests: the investment test, the asset test and the income test (which are described in our client publication).
- *Periods Required.* The financial periods for which target financial statements will be required to be included in an SEC filing depends on the highest significance level determined under any one of the three tests listed above, with the lower of the pre-tax earnings and revenue components of the income test used for this purpose in the case of the income test.
- *50% Significance.* Significance in excess of 50% no longer requires the inclusion of three years of audited target financial statements as it did under the prior rules.
- *Individually Insignificant Acquisitions.* The new rules, largely similar to the prior ones, require that the following acquisitions be aggregated:
 - separate acquisitions after the date of the most recent audited balance sheet that do not exceed 20% significance individually and therefore do not trigger financial statements; and
 - any acquisitions that are significant in excess of 20% but are only probable or which only closed during the past 74 days but do not exceed 50% significance and therefore do not trigger financial statements yet.
- *Use of Pro Forma Financial Statements to Determine Significance.* As an alternative to using the annual financial statements in their most recent Form 20-F for the three tests, acquiring companies that have completed significant acquisitions and dispositions after the latest fiscal year end for which pro forma financial statements have been filed may now use such pro forma financial statements as the basis to determine significance of a new transaction provided that the company continues to use such pro forma financial statements to measure significance until its next annual report.

- *Omission of Target Financial Statements.* Under the new rules, target financial statements are no longer required to be included once the results of the target have been included in the acquiring company's audited financial statements for a complete fiscal year (at significance in excess of 40%) or for at least nine months (at significance greater than 20% but not in excess of 40%).

Pro Forma Financial Statements

The new rules replace the existing pro forma adjustment criteria with simplified requirements. Specifically, the new rules contemplate three categories of adjustments that are made to the historical amounts: "Transaction Accounting Adjustments," "Autonomous Entity Adjustments" and "Management's Adjustments."

Management's Adjustments can be used in the company's discretion if, in management's opinion, such adjustments would enhance an understanding of the pro forma effects of the transaction. If Management's Adjustments are used, they must be presented in the explanatory notes to the pro forma financial statements. Each Management's Adjustment must have a reasonable basis and must be limited to the effect of synergies and dis-synergies on the existing financial statements that form the basis for the pro forma income statement as if the synergies and dis-synergies existed as of the beginning of the fiscal year presented. If Management's Adjustments are being used, the pro forma financial statements must reflect all Management's Adjustments that are, in the opinion of management, necessary to a fair statement of the pro forma financial statements presented and a statement to that effect must be disclosed.

Dispositions

The SEC's rules require the presentation of pro forma financial statements for significant dispositions that are probable or have been consummated but have not yet been reflected in the disposing company's audited annual financial statements as discontinued operations. The amendments raise the significance threshold for dispositions to 20% from 10%, which brings it in line with the significance threshold for acquisitions.

While the new rules are mandatory only for fiscal years beginning after December 31, 2020, companies are permitted to immediately elect voluntary early compliance with the new rules provided that the new rules are applied in their entirety.

NYSE Issues New Proposal on Direct Listings

On June 22, 2020, the NYSE filed a new proposed rule change seeking to modify its listing rules to allow companies to use direct listings to raise capital and issue new securities. In a direct listing, a company's existing shares are publicly listed on a stock exchange without an underwritten initial public offering. This option has received attention recently due to the high-profile direct listings of companies such as Spotify, although the number of direct listings has remained limited.

The NYSE seeks to make direct listings available to companies wishing to raise capital in a primary offering, in addition to resales by existing shareholders in the secondary market. A company would qualify for a primary direct listing if it sells at least \$100 million in market value of shares in the opening auction. If a company does not meet this requirement, it will qualify if the aggregate of the market value of publicly held shares immediately prior to listing together with the market value of shares the company will sell in the opening auction totals at least \$250 million with such market value calculated using a price per share equal to the lowest price of the price range established by the company in its registration statement.

The previous NYSE rule change, which was rejected by the SEC in December 2019, would have eased compliance with the initial listing distribution requirement to have at least 400 round lot holders by giving companies meeting certain market capitalization thresholds a 90-day grace period to meet the distribution criteria. The revised NYSE rule change eliminates this 90-day grace period, which means that primary and secondary direct listings would continue

to be subject to the requirement to have 400 shareholders at the time of initial listing. Consequently, the proposal is substantially narrowed and many private companies that do not have the required number of round lot holders will be precluded from pursuing a direct listing.

The new proposal offers a granular, mechanical breakdown of how direct listings would be executed. Namely, the new proposal would require that the SEC registration statement include the price range and the number of shares to be sold for a primary direct listing and that the opening auction price be within the disclosed price range. The company would be required to submit a limit order for the number of shares that it wishes to sell in the opening auction with the limit set at the bottom end of the price range.

The rule change would take effect 45 days at minimum following its publication in the Federal Register.

SEC and PCAOB Statement on Emerging Markets Risks: An Essential Disclosure Resource

On April 21, 2020, the SEC and PCAOB released a [joint statement](#) advising U.S. issuers and investors of the continuing material risks associated with exposure to emerging markets, and, in particular, China. While the statement does not create any new reporting obligations, it does provide an indication of the expectations of regulators for disclosure documents. As investor choice is a cornerstone of the U.S. capital markets regulatory framework and emerging markets can be a valuable component of an investment portfolio, the new guidance aims to inform investors, issuers, funds and financial professionals of the substantial risks in emerging markets investments and to provide assistance to registrants reviewing their own disclosure materials.

Based on the commitment of the SEC and the PCAOB to high-quality disclosure standards, the statement notes that boilerplate disclosures are generally not sufficient to detail the increased risks and uncertainties that result from operations and activities in emerging markets relative to more established jurisdictions. The statement identifies greater risks in emerging markets from two primary sources: loose financial reporting and audit requirements resulting from the lack of regulatory oversight in emerging markets, and the limited scope of remedies available to registrants and investors active in those jurisdictions.

Companies based in emerging markets, or with significant operations in emerging markets as well as their audit committees, must carefully consider the circumstances and the environment in which they operate. All material risks must be prominently stated in disclosure documents in plain English and with specificity. Additionally, registered funds and investment professionals must similarly consider the risks from emerging markets for their particular investments, and clearly and appropriately outline those specific risks to their investors in prospectuses and other disclosure documents. Disclosures should adequately communicate to investors that emerging market risks:

- are often significant;
- vary from jurisdiction to jurisdiction and company to company; and
- are only some of the relevant factors necessary for informed decision making, including portfolio and index construction.

Senate Passes Bill to Delist China Firms Barring Audit Reviews

On May 20, 2020, the U.S. Senate passed the Holding Foreign Companies Accountable Act (the **HFCAA**) to limit access to U.S. capital markets for public companies who do not comply with U.S. audit and financial reporting requirements. Senators John Kennedy and Chris Van Hollen, who together introduced the bill, released [statements](#) that make it evident that the bill is aimed at Chinese companies which refuse to allow the PCAOB to inspect their audits.

Specifically, the bill amends the Sarbanes-Oxley Act of 2002 to require that foreign companies utilize a PCAOB-inspected registered public accounting firm. It further requires that foreign companies establish that they are neither

owned nor controlled by a foreign government. If the bill is enacted into law, the SEC must write a new rule enforcing the provisions therein and delist securities of companies that fail to meet the new reporting requirements for three consecutive years. The bill has support from SEC Chairman John Clayton, who shared his [thoughts](#) on the bill and concluded that the proposed law is a sensible way to address the longstanding issue of foreign companies creating an unlevel playing field for investors by refusing to submit to U.S. regulatory oversight.

The PCAOB maintains this [list](#) of public companies that are audit clients of PCAOB-registered firms from non-U.S. jurisdictions where the PCAOB is denied access to conduct inspections and are therefore at risk of being delisted if the HFCAA is enacted into law.

SEC Investor Advisory Committee Approves Recommendations to Include Environmental, Social and Governance Factors in public company disclosure filings requirements

On May 14, 2020, the SEC Investor Advisory Committee, in a 13-4 (four abstentions) [decision](#), approved the investor-owned subcommittee's recommendations to update the public company disclosure filings requirements and include environmental, social and governance (**ESG**) factors.

The subcommittee gave the following reasons for its recommendations:

- investors require reliable, material ESG information upon which to base investment and voting decisions;
- issuers should directly provide material information to the market relating to ESG issues used by investors to make investment and voting decisions;
- requiring material ESG disclosures will level the playing field between issuers;
- the continued flow of capital to the U.S. markets and to U.S. issuers of all sizes must be ensured; and
- the U.S. should take the lead on disclosure of material ESG.

With this vote, the SEC Investor Advisory Committee takes a stand in the debate on ESG disclosures and sides with proponents of a new disclosure framework. Believing that the materiality standard is sufficient, opponents of mandatory ESG disclosures [argue](#) that securities regulators should not act as environmental regulators. On the other hand, supporters [argue](#) that the broad materiality standard did not result in consistent, reliable and comparable disclosures of information that investors need.

Regardless of the direction the SEC takes, investors routinely consider ESG factors in their decisions. This trend is supported by a growing number of issuers who are reconsidering their ESG disclosures and compliance practices.

President Trump Announces New SEC Commissioner, Caroline A. Crenshaw, to Replace Former Member, Robert Jackson

On June 18, 2020, President Trump [nominated](#) attorney Caroline Crenshaw to fill a seat on the SEC vacated by former commissioner Robert Jackson earlier this year. Ms. Crenshaw, a former counsel to Mr. Jackson, would be the second of two Democrat commissioners, along with two Republicans and Chairman Jay Clayton. As a senior counsel at the SEC, Ms. Crenshaw worked on enforcement, investment management and corporate governance matters. Before joining the SEC, she worked on similar matters in the private sector on behalf of public companies, broker-dealers and investment advisors.

Noteworthy U.S. Securities Litigation and Enforcement

SEC Brings Enforcement Actions against Companies for Misleading COVID-19 Statements

On January 30, 2020, Jay Clayton, Chairman of the SEC, announced that the agency would monitor and provide guidance to issuers and other market participants regarding disclosures related to COVID-19. In a follow-up

announcement on March 23, 2020, Stephanie Avakian and Steven Peikin, co-directors of the SEC's Division of Enforcement, issued a public statement that reminded public companies, officers and directors of their responsibilities related to proper disclosure and noted the SEC's ongoing scrutiny of issuers and other market participants. They also provided an alert that the "Enforcement Division is committing substantial resources to ensuring that our Main Street investors are not victims of fraud or illegal practices in these unprecedented market and economic conditions." As part of its monitoring effort, the Enforcement Division created the Coronavirus Steering Committee to respond to COVID-19–related enforcement issues, including microcap fraud and insider trading.

Further to the SEC's announcements and creation of the Coronavirus Steering Committee, the SEC in recent weeks has begun charging companies and alleging violations of Section 10(b) of the Securities Exchange Act for misleading claims about personal protective equipment, testing and thermal imaging equipment, among other COVID-19–related statements. The following are notable COVID-19–related actions instituted by the SEC:

- *SEC v. Praxsyn*, No. 9:20-cv-80706 (S.D. Fla. April 28, 2020). On April 28, 2020, the SEC charged Praxsyn, a Florida-based company, and its CEO in the U.S. District Court for the Southern District of Florida for allegedly issuing false and misleading press releases in February and early March that claimed the company was negotiating the sale of millions of N95 masks that it could supply to purchasers. The SEC alleged that Praxsyn never had any masks, let alone N95 masks, in its possession. Nor did Praxsyn make any orders for masks or reach any specific agreement with a supplier or manufacturer of masks. According to the SEC, the purported "negotiations" with purchasers consisted of two email inquiries without any agreement ever reached. After receiving regulatory inquiries, Praxsyn admitted in a later press release that it never had any masks available to sell. The SEC seeks permanent injunctive relief and civil penalties against Praxsyn as well as an officer and director bar against its CEO;
- *SEC v. Turbo Global et al.*, No. 8:20-cv-01120 (M.D. Fla. May 14, 2020). On May 14, 2020, the SEC filed a complaint against Turbo Global Partners, Inc. and its CEO in the U.S. District Court for the Middle District of Florida for false and misleading statements in late March and early April 2020 regarding a "multi-national public-private-partnership" to sell thermal scanning equipment. The thermal scanning equipment supposedly could detect individuals running a high fever and identify people potentially infected with COVID-19. The SEC alleges that Turbo Global issued a press release—attributed to a corporate partner's CEO—that claimed its technology was "99.99% accurate" and designed to be deployed in each state immediately. The SEC, however, claims that in reality, Turbo Global had no agreement to sell the equipment, no partnership with any government agency and the CEO of the corporate partner never made the statements falsely attributed to him. The SEC noted that Turbo Global's CEO is a recidivist securities violator and was previously charged for making fraudulent securities sales in 1999 for which he received a permanent injunction. As a result of the alleged conduct, the SEC seeks civil penalties and permanent injunctive relief against Turbo Global and an officer and director bar against its CEO;
- *SEC v. Applied BioSciences Corp.*, No. 1:20-cv-03729 (S.D.N.Y. May 14, 2020). On May 14, 2020, the SEC also brought charges against Applied BioSciences, a microcap company, in the U.S. District Court for the Southern District of New York for making misleading claims that Applied BioSciences was offering and shipping COVID-19 home test kits. According to the SEC's complaint, Applied BioSciences shifted its focus in March 2020 from cannabinoid-based products to COVID-19-related products. Specifically, the company announced that it was prepared to sell a 15-minute finger prick test for COVID-19 to the general public. The SEC alleges that Applied BioSciences did not disclose that the Food and Drug Administration had not approved or authorized the sale of any COVID-19 home test kit. The SEC also alleges that Applied BioSciences did not actually intend to sell, much less ship, any test kits to the general public because it screened potential purchases to a limited universe of nursing homes, schools, military, first responders or in

consultation with medical professionals. The SEC seeks permanent injunctive relief and civil penalties against Applied BioSciences;

- *SEC v. Nielsen*, No. 5:20-cv-03788 (N.D. Cal. June 9, 2020). On June 9, 2020, the SEC charged Jason Nielsen, a penny stock trader, in the U.S. District Court for the Northern District of California with conducting a “pump-and-dump” scheme by making misleading statements that the company had developed an “approved” COVID-19 blood test. The SEC alleges that Nielsen repeated the false assertion that Arrayit Corporation, a California biotechnology company, had developed a COVID-19 test in an online investment forum to drive up the stock price without disclosing his large position in Arrayit shares. The SEC further alleges that Nielsen engaged in “spoofing” by placing and then cancelling large orders of Arrayit shares, resulting in a false impression of high demand for Arrayit stock. The SEC seeks civil money penalties, permanent injunctive relief, a penny stock bar and disgorgement with prejudgment interest against Nielsen; and
- *SEC v. Gomes et al.*, No. 1:20-cv-11092 (D. Mass. June 9, 2020). On June 9, 2020, the same day that the SEC brought charges against Nielsen, the SEC filed an emergency action and obtained an asset freeze in the U.S. District Court for the District of Massachusetts against five individuals and six offshore entities in connection with an alleged fraudulent microcap scheme. According to the SEC, Nelson Gomes and several others facilitated stock dumps of shares for more than 20 penny stock companies, generating proceeds in excess of \$25 million through brokerage accounts. The SEC complaint alleges that the individuals enabled undisclosed corporate control persons to conceal their identities while dumping their company’s stock into the market without public registration. In doing so, the control persons allegedly defrauded investors by misleading them to believe that they were purchasing shares in the ordinary course of the market, but the shares were actually sold by company insiders. Although the alleged conduct dates back to January 2018, several of the more recent stock sales were allegedly boosted by promotional campaigns capitalizing on the COVID-19 pandemic. For instance, the SEC claims that the promotions asserted one of the offshore entities could produce medical quality face masks and another offshore entity had automated kiosks for retailers’ use that did not require employee contact. In a parallel action, the U.S. Attorney’s Office for the District of Massachusetts announced criminal charges against Shane Schmidt, one of the individuals involved in the fraudulent stock dumping scheme.

The enforcement actions noted above demonstrate the SEC’s stated commitment to closely monitor the market for instances of fraud that exploit the COVID-19 pandemic. The SEC’s initial enforcement actions thus far suggest that the SEC’s focus is on companies with low or micro market capitalizations that are involved in COVID-19-related scams. Time will tell whether the SEC’s focus expands and what other areas the SEC chooses to devote its enforcement resources during the pandemic.

U.S. Supreme Court Upholds SEC Ability to Seek Equitable Disgorgement of Net Profits, But Limits Broader Disgorgement Theories

On June 22, 2020, the U.S. Supreme Court upheld the ability of the SEC to seek disgorgement in civil actions brought in federal district court as a form of “equitable relief,” at least to the extent the disgorgement is of a defendant’s “net profits” and the disgorged funds are returned to a defendant’s victims. *Liu v. SEC*, No. 18–1501, ___ S.Ct. ___ (June 22, 2020). Although the Court previously held in *Kokesh v. SEC*, 137 S. Ct. 1635 (2017), that disgorgement sought by the SEC could be viewed as a “penalty” for purposes of calculating the statute of limitations, the Court rejected the argument that all forms of disgorgement are impermissible penalties that fall beyond the SEC’s mandate. The *Liu* decision is ostensibly a win for the SEC in that it upheld the SEC’s ability to obtain disgorgement. But by focusing on ensuring that a given disgorgement order constitutes “equitable relief,” the Supreme Court has placed important limits

on the manner in which the SEC may obtain disgorgement that could impact the way the SEC pursues enforcement actions.

Liu originated with an enforcement action brought by the SEC in federal court against a husband and wife pair who solicited nearly \$27 million from foreign investors under the EB-5 Immigrant Investor Program, allegedly based on fraudulent misrepresentations. The district court ruled for the SEC and awarded disgorgement equal to the full amount raised from investors, less the \$234,899 that remained in the corporate accounts for the project, but there was no clear indication that such funds would be returned to investors. On appeal, the petitioners argued that the SEC lacked the power to seek such disgorgement, claiming that it was effectively a “penalty” and not “equitable relief,” and thus not authorized. The U.S. Court of Appeals for the Ninth Circuit affirmed, and the Supreme Court granted certiorari.

Before the Supreme Court, the parties focused their briefing on the broad question of whether any form of disgorgement could be ordered. The Court held that it could be so ordered but remanded for the lower courts to determine whether the specific disgorgement award should be upheld or modified. In doing so, the Court set forth certain key principles to guide both the *Liu* court and district courts more broadly.

The Supreme Court emphasized that disgorgement must be “equitable relief” within the meaning historical precedent, and went on to address three areas in which SEC disgorgement awards may be in tension with that principle: (1) where the SEC fails to return funds to victims; (2) where it imposes joint-and-several liability; and (3) where it declines to deduct business expenses from the award such that the amount disgorged is greater than a defendant’s “net profits” from the crime.

First, the Supreme Court held that an SEC disgorgement award must be “for the benefit of investors” to be consistent with 15 U. S. C. §78u(d). Thus, while the Supreme Court did not absolutely bar the practice of the SEC causing disgorged funds to be deposited with the U.S. Treasury, this decision will almost certainly raise the bar for what the SEC must demonstrate before it may obtain disgorgement that is not being returned to identified investors. That could have an impact on cases when the SEC’s theory is one of broad-based market harm, as there is often no attempt to show how individual investors were harmed, let alone which ones.

Second, the Supreme Court raised serious questions about the SEC’s ability to seek disgorgement on joint and several theories of disgorgement. While acknowledging that it may be appropriate in a case such as the one before it, where defendants were husband and wife, the Court noted that, in general, specificity will be required to ensure that a given defendant is being disgorged of its own ill-gotten gains. That will require the SEC to focus more specifically on the actual entities or individuals involved in any wrongdoing and the profits earned by each. In turn, it should preclude, for example, the SEC from seeking to disgorge from individual defendants trading profits earned by their employers.

Third, the Supreme Court made clear that only “net profits” may be disgorged, as that is the true measure of ill-gotten gains. The Court noted that expenses may not be deductible where the entire profit of the enterprise results from the wrongdoing but held that generally legitimate business expenses must be deducted from any amount to be disgorged. As this has often been a sticking point in negotiations with Staff, the decision will allow defendants to argue that any revenues the SEC seeks to disgorge should be offset by legitimate expenses incurred in connection with such revenues.

It will take some time to see how the *Liu* decision plays out in practice (particularly as to when “legitimate expenses” may be deducted such that a disgorgement amount can be reduced). However, the Supreme Court has now set out clear guidance in terms of what it believes the SEC should be seeking to do when pursuing disgorgement.

The “New News” Standard for Pleading Loss Causation in Securities Fraud Cases

On May 4, 2020, the U.S. Court of Appeals for the Eleventh Circuit partially reversed and partially affirmed the dismissal of a securities class action on the basis that the plaintiffs had failed to adequately plead loss causation. *Luczak v. National Beverage Corp.*, No. 19-14081 (11th Cir. May 4, 2020) (per curiam). Loss causation typically is established through the existence of a corrective disclosure that reveals to the market the pertinent truth that was previously concealed or obscured by the company’s fraud and leads to a stock price decline. Determining whether an alleged corrective disclosure actually provides “new news” or is merely a restatement of previously disclosed information, however, has proven difficult for courts.

In *Luczak*, the plaintiffs alleged that the company (a) made misleading statements regarding two sales metrics the company purportedly touted as an important measure of growth and sales, and (b) failed to disclose that its CEO had engaged in a pattern of sexual misconduct. As to the sales metrics statements, the plaintiffs alleged that the truth was revealed to the market by a March 2018 SEC letter questioning the company’s use of the metrics and a subsequent June 2018 media report discussing the issue. The lower court, however, found that neither of these items were “corrective disclosures” because the SEC letter “merely confirm[ed] the SEC’s already established doubt of the veracity” of the sales metrics and the media report was just a summary of the SEC correspondence. As to the sexual misconduct claims, the plaintiffs argued that a July 2018 *Wall Street Journal* article had revealed the misconduct, but the lower court found that the article only repeated allegations that had been made in publicly filed lawsuits.

On appeal, the Eleventh Circuit rendered a split decision. The Eleventh Circuit found that the lower court had read the March 2018 SEC letter and the June 2018 media report too narrowly. Although the SEC’s interest in the sales metrics was publicly known, the SEC letter and media report arguably provided “new news” that the company was failing to cooperate with the SEC in its inquiry by not providing additional information about the metrics. Moreover, the media report could be read to suggest that this conclusion came from sources beyond the SEC correspondence. As to the sexual misconduct claims, however, the Eleventh Circuit agreed that the July 2018 *Wall Street Journal* article did not provide any additional information that could not be found in the lawsuits.

The *Luczak* decision illustrates that U.S. courts are reluctant to dismiss claims based on the inadequate pleading of loss causation unless the alleged corrective disclosure can be described as entirely duplicative of earlier disclosures (a difficult standard to meet).

Second Circuit Clarifies What is Required to Adequately Plead A Company’s Scienter (Fraudulent Intent) in a Securities Fraud Case

On May 27, 2020, the U.S. Court of Appeals for the Second Circuit addressed what is required for a plaintiff to adequately plead a corporation’s scienter (*i.e.*, fraudulent intent) in a securities fraud case. *Jackson v. Abernathy*, No. 19-1300-cv (2d Cir. May 27, 2020) (per curiam). A corporation’s scienter, under Second Circuit precedent, may be imputed from (a) the scienter of an individual defendant who made the alleged misstatement, (b) the scienter of officers or directors who were involved in the dissemination of the fraud or (c) in rare circumstances, from a statement that is so obviously incorrect that it can be inferred that the makers must have known that it was false.

In *Jackson*, the plaintiffs alleged that the company told investors that its surgical gowns were highly rated for their protectiveness, but in fact the gowns had failed numerous quality control tests. The plaintiffs argued that the company’s scienter could be imputed based on (a) the knowledge of three lower-level employees, who testified in a different litigation that they were aware that the surgical gowns had failed quality control tests, and/or (b) the surgical gowns were a key company product, so senior management must have known about the test failures. The Second Circuit found that these allegations were insufficient to adequately plead the company’s scienter.

First, as to the lower-level employees, the Second Circuit concluded that they did not act with scienter because they took steps to raise warnings about problems with the gowns. Moreover, the complaint failed to plead any facts establishing that these employees were involved with the misstatements or had adequately conveyed their warnings to senior management. The court was therefore left to “only guess what role those employees played in crafting or reviewing the challenged statements and whether it would otherwise be fair to charge the [company] with their knowledge.” Second, as to the allegation that the gowns were a key product, the Second Circuit found that this “naked assertion, without more, is plainly insufficient to raise a strong inference of collective corporate scienter.”

The *Jackson* [decision](#) provides some helpful clarity on the extent to which the scienter of lower-level employees can be imputed to a company in a securities fraud case. The Second Circuit makes it clear that it is not enough for the lower-level employees to have known that the company’s statements were false—they need to have either played a role in crafting or reviewing those statements or adequately conveyed their knowledge to senior management who did play that role.

SDNY Court Holds that Syndicated Loans Are Not “Securities”

On May 23, 2020, Judge Paul Gardephe of the U.S. District Court for the Southern District of New York held that syndicated loans are not “securities” subject to state or federal securities laws. *Kirschner v. J.P. Morgan Chase, et al.*, 17-cv-06334 (S.D.N.Y. May 23, 2020).

In *Kirschner*, Millennium Laboratories LLC (**Millennium**) entered into a \$1.775 billion syndicated loan in 2014. In that transaction, several banks assigned portions of a term loan made to Millennium to institutional investor groups, including approximately 400 mutual funds, hedge funds and other institutions, evidenced by notes. Millennium subsequently lost a significant litigation and reached a settlement with the U.S. Department of Justice with respect to False Claims Act violations. Shortly after Millennium filed for bankruptcy protection, the bankruptcy trustee filed a lawsuit against the banks and broker-dealers of the syndicated loan claiming, among other things, that they violated state securities laws by making misstatements related to the False Claims Act violations.

Judge Gardephe, in deciding whether the syndicated loan constituted a security, applied the “family resemblance” test established by the U.S. Supreme Court in *Reves v. Ernst & Young*. Under that test, a court examines whether the note bears a strong family resemblance to one of the enumerated categories of non-security instruments identified in *Reves*. The four factors of the family resemblance test are: the motivations of seller and buyer, the plan of distribution, the reasonable expectations of the investing public and the existence of another regulatory scheme. The court found that three of those factors favored finding that the structured loan was not a security. In particular, while the motivations of the seller and buyers were mixed, the plan of distribution was narrow (limited to sophisticated institutions with transfer restrictions), the credit agreement and confidential information memorandum distributed to potential lenders strongly suggested that the notes constituted loans and not securities and the specific policy guidelines addressing the sale of loans issued by the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Federal Reserve Board were sufficient to constitute another regulatory scheme. Accordingly, the court held that the structured loan was not a security.

The features of the structured loan at issue in the *Kirschner* decision are common across the industry. Accordingly, it is an important decision because it confirms that structured loans are not subject to federal and state securities laws, which reduces the potential liability for the participants in this large financial market.

Direct Listings May Be Subject to Section 11 Liability

On April 21, 2020, Judge Susan Illston of the U.S. District Court for the Northern District of California denied defendants' motion to dismiss a securities class action complaint brought by a shareholder of Slack Technologies, Inc. following the company's 2019 direct listing. *Pirani v. Slack Technologies, Inc.*, No. 19-cv-05857-SI (N.D. Cal. April 21, 2020). Direct listing is a relatively new process in which a company can enter the public securities market without offering new shares (as in a traditional initial public offering). Insiders can sell their shares, which are exempt from registration under SEC Rule 144, at the same time as others whose shares must be sold under a registration statement. In the Slack direct listing, the company filed a registration statement that applied to approximately 118 million registered shares made available for resale following the listing. However, approximately 165 million additional, unregistered shares were simultaneously made available for resale together with the registered shares.

Section 11 of the Securities Act of 1933 provides for strict liability for a company (and negligence liability for underwriters and certain individuals) if there is a material misstatement in a registration statement. A limitation on Section 11 liability, however, is that the investor must be able to trace his purchased shares to the registration statement. In the Slack listing, as in other direct listings, that arguably was impossible given the mixture of registered and unregistered shares available for purchase at the same time.

In *Pirani*, however, the shareholder brought a Section 11 claim and Judge Illston found that the tracing requirement should not apply to direct listings. The court's reasoning relied on the broad remedial purposes of Section 11, which would be frustrated if the company could escape potential liability by engaging in this particular type of securities offering. Examining the statutory language, the court concluded that the statutory phrase "any person acquiring such security" should be read to include not just any person acquiring securities traceable to a registration statement, but also any person "acquiring a security of the same nature as that issued pursuant to the registration statement."

The *Pirani* decision breaks new ground and is at odds with widely accepted precedent applying a tracing requirement for Section 11 claims. It is reasonable to expect that this issue will continue to be litigated in direct listing cases, pending the Courts of Appeals or the U.S. Supreme Court weighing in.

EU DEVELOPMENTS

Developments Related to COVID-19

COVID-19: Updated ESMA Q&As on Alternative Performance Measures

On April 17, 2020, European Securities and Markets Authority (**ESMA**) published [updated guidelines](#) on alternative performance measures (**APMs**) including a new Q&A on the application of the guidelines following the COVID-19 pandemic. The purpose of the Q&A is to promote common approaches and practices in the application of the update guidelines on APMs.

In the new Q&A, ESMA:

- recommends that issuers apply caution when adjusting APMs, and include new APMs only to depict the impact that COVID-19 may have on performance and cash flows. Issuers should carefully assess whether the adjusted or new APMs would provide transparent and useful information to the market and/or improve comparability, reliability or comprehensibility of information disclosed to the market;
- notes that it may be inappropriate to include new APMs or adjust APMs when the impact of COVID-19 has a widespread effect on the overall financial performance, position or cash flows of an issuer, as they may not provide reliable information to the market and may mislead users' understanding of the fair view of an issuer's assets, liabilities, financial position and profit or loss; and

- encourages issuers to improve their disclosures and include narrative information in their communication documents in order to explain how COVID-19 has impacted and is expected to impact their operations and performance, the level of uncertainty and the measures implemented or expected to be implemented to address the pandemic.

COVID-19: ESMA Statement on Half-Yearly Financial Reporting

On May 20, 2020, ESMA publicly issued a statement on the impact of COVID-19. The statement provides recommendations on listed issuers' half-yearly financial and management reports.

ESMA anticipates that following the pandemic, some issuers may opt to publish their half-yearly financial reports later than usual. However, it provides that reports must still be published within the permitted period and must not be unduly delayed as issuers must comply with their ongoing obligations under the Market Abuse Regulation (**MAR**).

ESMA addresses the application of accounting standard IAS 34 (which sets out the minimum content of an interim financial report) to interim financial statements, highlighting the importance of updating the information included in an issuer's latest annual accounts to ensure that stakeholders are sufficiently informed of the impact of COVID-19.

The statement also provides specific guidance on the preparation of half-yearly financial statements for areas including:

- the impairment of non-financial assets; and
- the presentation of COVID-19-related items in the profit or loss statement.

ESMA also makes recommendations on the entity specific disclosures it expects issuers to include in their interim management reports regarding:

- the impact of the COVID-19 on, among other items, the issuer's strategy and targets;
- measures taken to mitigate these impacts and their development; and
- where available, the expected future impact on the issuer's financial performance, position, cash-flows, the related risks and contingency measures.

In the current circumstances, ESMA encourages audit committees to increase their oversight role and states that ESMA and national competent authorities will monitor and supervise the application of the relevant IFRS requirements and other provisions highlighted in the statement.

COVID-19: Regulation on SE and SCE General Meeting Deadlines Published in Official Journal

On May 27, 2020, the European Council [regulation](#) on temporary measures concerning the general meetings of European companies and of European Cooperative Societies was published in the Official Journal of the European Union (the **Official Journal**).

The draft regulation was formally approved by the European Council before being published in the Official Journal. The regulation extends the deadlines for general meetings to be held in 2020 to within twelve months, rather than six months, of the entity's financial year end, but in any case, no later than December 31, 2020. The regulation has been adopted following social distancing measures associated with the COVID-19 outbreak.

The regulation entered into force on May 28, 2020, the day following its publication in the Official Journal.

EU Consultation on Dealing with Market Distortion Due to Foreign Subsidies

On June 25, 2020, the European Parliament published an [article](#) on foreign takeovers of European companies during the COVID-19 pandemic. In the article, the European Parliament references the European Commission's (the **Commission**) [white paper](#) (adopted on June 17, 2020) which discusses the extent to which foreign subsidies, such as acquisitions of EU targets and public procurement, distort the single market. The white paper includes plans to address these issues.

The Commission has begun a [consultation](#) on the suggested approaches which closes on September 23, 2020. Regarding EU acquisitions, the Commission puts forward plans for a compulsory notification mechanism of proposed acquisitions involving foreign subsidies which could lead into a review of the arrangements and could possibly prohibit the acquisition (as a last resort) if appropriate.

General Developments

Non-Financial Reporting: Council Adoption of Taxonomy Regulation (Corporate Aspects)

On April 15, 2020, the Council of the EU (the **Council**) [adopted](#) its position (at first reading) on the proposed regulation to establish a system to encourage sustainable investment (the **Taxonomy Regulation**.) This establishes an EU-wide classification system intended to provide businesses and investors with a single dialogue to identify the degree to which economic activities are environmentally sustainable.

Following negotiations with the European Parliament in December 2019, the Council's position amends the regulation as adopted by the Parliament on first reading in March 2019. The changes include:

- widening the application of the regulation to include large public interest entities that are subject to the obligation to publish non-financial statements or consolidated non-financial statements under the Accounting Directive;
- incorporating additional transparency obligations applicable to large public interest entities, under which they are required to include in their non-financial statements or consolidated non-financial statements information on how and to what extent their activities are associated with environmentally sustainable activities. In the case of non-financial undertakings, the required information should include the proportion of their turnover derived from products or services associated with environmentally sustainable economic activities, and the proportion of their capital and operating expenditure related to assets or processes associated with environmentally sustainable economic activities. Broadly, an activity will be environmentally sustainable for the purposes of the Regulation if it: (a) contributes substantially to specified environmental objectives; (b) does not significantly harm certain specified environmental objectives; (c) is carried out in compliance with specified minimum safeguards; and (d) meets technical screening criteria established by the Commission; and
- requiring the Commission to adopt an act specifying the information large public interest entities must publish in their non-financial statements under the terms of the regulation and the methodology to be used. The Commission must adopt the act by June 1, 2021.

On June 22, 2020, the Taxonomy Regulation was published in the Official Journal. It came into force on July 12, 2020.

Small and Medium-Sized Growth Markets: ESMA Consultation

On May 6, 2020, ESMA published a [consultation](#) on the functioning of the small and medium-sized (**SME**) growth markets regime under the Markets in Financial Instruments Directive II (**MiFID II**) and on the adjustments to MAR for the promotion of the use of SME growth markets.

MiFID II requires ESMA to submit a report to the Commission about the SME growth markets regime. The consultation assesses the current state and seeks views on possible amendments to the regime, including:

- whether the minimum threshold for at least 50% of issuers whose financial instruments are admitted to trading on a multilateral trading facility (**MTF**) to be SMEs is still appropriate for such MTF to qualify as an SME growth market;
- whether there should be homogeneous admission requirements and consistent accounting standards for issuers admitted to trading on SME growth markets;
- whether a two-tier SME regime with additional reliefs for micro-SMEs would encourage such issuers to seek funding from capital markets; and
- how research coverage for SMEs could be improved.

The consultation sets out the draft technical standards ESMA is required by MAR to develop to draw up a template of a liquidity contract and draft implementing technical standards to determine the format of the insider list.

ESMA notes that the proposed insider list template is for use in EU member states that require SME growth market issuers to include all insiders, not only those with regular access to inside information. ESMA further notes that, although the reduction in the number of fields would be limited, this full insider list for SME growth market issuers should still impose a lower administrative burden than an “ordinary” insider list. The deadline for responses is July 15, 2020.

Money Laundering and Terrorist Financing: Commission Action Plan (Corporate Aspects)

On May 7, 2020, the Commission published for consultation a plan for a comprehensive EU policy on the prevention of money laundering and terrorist financing. The Commission notes that legislation relating to anti-money laundering and countering the financing of terrorism should be more granular, more precise and should not be liable to differing interpretations. The Commission suggests that to limit divergences in interpretation and application of the rules, certain parts of the European money laundering directives, including the provisions on beneficial ownership registers, should be turned into directly applicable provisions set out in a regulation. The anticipated timeframe for a Commission proposal on a single EU rulebook is Q1 of 2021.

The Commission also states that:

- it will monitor the setting up of beneficial ownership registers by member states, in order to ensure that they are populated with high-quality data; and
- it has started interconnecting the beneficial ownership registers and that the interconnection will be complete in 2021.

The Commission was also seeking views on the effectiveness of existing EU tools to enforce the anti-money laundering rules and views on whether other measures could contribute to improving enforcement.

The last date for responding to the consultation is July 29, 2020.

Relatedly, on June 19, 2020, the Commission Delegated Regulation (EU) 2020/855 was published in the Official Journal. The Delegated Regulation updates the list of high-risk third countries listed in Commission Delegated Regulation (EU) 2016/1675 which have been recognized as having strategic deficiencies in their anti-money laundering and counter-terrorist financing frameworks.

Prospectus Regulation: Commission Draft Regulation to Amend Prospectus Delegated Regulation

On June 4, 2020, the Commission published a [draft regulation](#) to amend and correct Commission Delegated Regulation which supplements the regulation (EU) 2017/1129 of the European Parliament and of the Council (**Prospectus Regulation**) in relation to the format, content, analysis and approval of the prospectus.

The draft regulation:

- amends the Articles to apply the less burdensome disclosure requirements to which the issuers of non-equity securities are subject (rather than the requirements that apply to equity securities as is currently the case) to certain types of convertible, exchangeable and derivative securities;
- amends Article 32, Annex 26 and Annex 27 to specify where additional information about underlying shares, derivative securities and the consent given to use the prospectus, where applicable, should be inserted in the EU growth prospectus;
- amends a number of Annexes to state that the requirement, where audit reports on historical financial information have been refused by the statutory auditors or where they contain qualifications, modifications of opinion, disclaimers or an emphasis of matter, that such qualifications, modifications, disclaimers or emphasis be reproduced in full and the reasons given, applies in all cases (not just where the Statutory Audit Directive and the Audit Regulation do not apply);
- makes updates to reflect the amendment made to the Prospectus Regulation by an EU regulation under which disclosure of the working capital statement in the EU Growth prospectus applies to all issuers of equity securities regardless of their market capitalization; and
- inserts clarification that prospectuses approved between July 21, 2019 and the date of entry into force of the regulation will remain valid until the end of their terms.

The draft regulation will take effect on the third day following publication in the Official Journal with the exception of Article 1(1) to (8) (amendments to Articles 2, 4, 12, 13, 24, 25, 28 and 30) and Article 2 (corrections to Article 33 and 42(2)(g)) of the draft regulation which are applicable from July 21, 2019.

Prospectus Regulation: Commission Draft Regulation to Amend Prospectus RTS Regulation

On June 4, 2020, the Commission published a [draft regulation](#) to amend Commission Delegated (EU) 2019/979 Regulation, containing RTS, under the Prospectus Regulation.

The draft regulation is in substantially the same form as the ESMA draft submitted to the Commission in December 2019.

The draft regulation will come into force on the third day after publication in the Official Journal. Its provisions will apply retrospectively, with effect from July 21, 2019. An exception to this is the insertion of a new Article 22a (relating to summaries of prospectuses containing certain financial information that have been approved between July 21, 2019 and the date the draft regulation comes into force) which is to apply from the date the draft-delegated regulation comes into force.

Prospectus Regulation: Draft Regulation on Minimum Information Content for Exemption Document

On June 16, 2020, the Commission published a [draft regulation supplementing](#) the Prospectus Regulation on the minimum content of the document to be published for a prospectus exemption in connection with a takeover by means of an exchange offer, a merger or a division.

The document, defined as an “exemption document,” is required to be made publicly available for the purposes of the exemption from the requirement for a prospectus.

ESMA published its final report on technical advice on the minimum information content in March 2019. The draft supplementing regulation reflects the main elements from ESMA's technical advice with amendments to reflect the changes that were made to the Prospectus Regulation in relation to the promotion of the use of SME growth markets.

Changes to the technical advice include:

- streamlining the minimum content requirements into one annex and making them proportionate to the transaction size;
- the general contents requirement in the draft regulation providing that an exemption document includes the information which is needed to enable investors to understand (as well as the rights attaching to the equity securities and the description of the transaction and its impact on the issuer) the prospects of the issuer, and, depending on the type of transaction, of the offeree company, target company or company being divided, and any significant changes in the business and financial position of each of those companies that have happened since the end of the previous financial year; and
- reducing disclosure requirements where the equity securities offered are to be admitted to trading on a regulated market, are interchangeable with, and represent no more than 10% of equity securities already admitted to trading on the same regulated market. This replaces the simplified disclosure regime.

Capital Markets Union: High Level Forum Final Report (Corporate Aspects)

On June 10, 2020, the High Level Forum on the Capital Markets Union published its final report setting out recommendations aimed at moving the EU's capital markets forward and completing the Capital Markets Union (CMU.)

The key recommendations include:

Setting up a digital platform to operate as a European single access point (**ESAP**)

- The ESAP would require companies to submit all public information through a single reporting channel. Company information is currently spread across the EU. The intention of the ESAP is to improve investors' access to company data and, as a result, expose issuers to a wider set of investors and improve capital allocation across the EU. The recommendation is for ESAP to be introduced in three stages.

Improving the public markets ecosystem

- Companies, SMEs in particular, have recently been electing either to leave the regulated markets or not list at all because of concerns that the expense of the regulatory requirements and of launching an IPO in the regulated market outweigh the benefits of equity finance. Recommendations include revising the prospectus, market abuse and MiFID II regulatory framework to make public listing more attractive. The report considers that improving the ecosystem will increase diversity in financing options and improve financing structures for companies, increase price discovery for all investors, increase investment opportunities for retail investors and enable a well-functioning CMU.

Shareholder identification, exercise of voting rights and corporate actions

- The report concludes that problems relating to the cross-border exercise of ownership rights often prevent investors' cross-border investments. To remedy this, the report suggests introducing a harmonized definition of "shareholder;" amending the Shareholder Rights Directive II and its implementing regulation to clarify and harmonize the interaction between investors, intermediaries and issuers in relation to the exercise of voting rights and corporate action processing; and using technology to enable wider investor engagement and make corporate action processes more efficient.

The Commission is now seeking feedback from stakeholders on the report and intends to publish an action plan on the CMU in the fourth quarter of 2020.

Corporate Reporting: ICGN and ESAs Publish Responses to Commission's Consultation on Non-Financial Reporting Directive EU

On June 11, 2020, the International Corporate Governance Network (**ICGN**) and the European Supervisory Authorities (**ESAs**) each published responses to the Commission's [consultation](#) on the Non-Financial Reporting Directive (**NFRD**). This consultation was launched on February 20, 2020.

The consultation raised some specific issues with the current regime and focused on ways to remedy them. The key issues included:

- inadequate publicly available information about the impact that non-financial issues (especially sustainability issues) have on companies and the environment; and
- companies sustaining excessive and avoidable costs when reporting non-financial information. They face uncertainty and complexity when deciding what non-financial information to report and how and where to report the information.

ICGN Response

The [ICGN response](#) agrees with the Commission's assessment that improvements should be made in relation to NFRD disclosures. A key problem is lack of comparability, which prevents investors from making sufficient practical use of non-financial reporting as a benchmark of company performance. The ICGN also suggests an additional category of disclosure: a company's capital allocation strategy.

The ICGN suggests companies should have to apply a common standard for non-financial reporting to ensure quality, consistency and comparability, with scope for more simplified standards for SMEs that are proportionate to their size.

ESAs Response

Separate responses were issued by each of [ESMA](#), the [European Banking Authority](#) and [The European Insurance and Occupational Pensions Authority](#). The ESAs also issued a joint letter with their responses, emphasizing certain areas which they consider significant for the future of Europe's non-financial reporting regime. These include the following:

- the ESAs suggest that the NFRD should be revised to introduce increased standardization of non-financial disclosure requirements, at European level in the short term, and internationally in the long term;
- the ESAs highlight the importance of detailed disclosure standards in implementing regulatory or technical standards, setting out mandatory rather than voluntary requirements. The lack of these in mandatory reporting requirements, and the divergence between national, regional and global disclosure frameworks, reduces comparability and prevents assurance in relation to the disclosures; and
- the ESAs suggest that the scope of the NFRD should be expanded to cover a larger group of companies. This should be done proportionately to avoid any excessive administrative burdens on smaller companies and to reflect the need for a simplified disclosure standard for SMEs.

U.K. DEVELOPMENTS

Developments Related to COVID-19

BEIS and FRC – Further Q&As on Company Filings, AGMs and Other General Meetings

On March 28, 2020, BEIS announced that it would introduce [a series of measures](#) to assist companies facing difficulties due to COVID-19 in complying with statutory obligations to hold meetings and file documents with the UK Companies Registrar. For further background, please refer to the [Governance & Securities Law Focus, May 2020](#) and Shearman's [prior publication on the proposed measures](#).

The measures are contained in the Corporate Insolvency and Governance Bill (**CIGA**) which was published on May 20, 2020. The CIGA is examined in further detail below.

On June 8, 2020, BEIS and the FRC published their Q&As to include guidance on the best practice for AGMs following publication of the CIGA. The Q&As update those of May 14, 2020, which were released before the CIGA was published and as such are not examined in this newsletter.

The guidance notes that companies have been given flexibility in respect of meetings until the end of September 2020. Not all companies will want or need to exercise the temporary flexibilities in full, and companies should review their positions so as to balance the safety of shareholders with their legitimate expectation to be afforded engagement with the board.

The guidance also notes that companies are expected to consider the rights of members and make reasonable efforts to provide the usual degree of engagement and challenge. Virtual options should be considered where it is difficult to hold meetings in person, and timelines and processes should be designed to allow the broadest engagement and voting from members. In the future, companies may wish to consider a move to a “hybrid” annual general meeting format which allows for attendance in-person and online.

The guidance also sets out the minimum elements of best practice as regards member communications:

- Issuing communications in a timely fashion to ensure that members can consider the matters to be voted on;
- Ensuring that clarity is given on proxy voting;
- Explaining the procedure for both the meeting and any communications prior to the meeting;
- Giving all members the opportunity to both ask questions and receive responses to those questions prior to voting (either at a real time online meeting or via proxy);
- Making answers to any questions raised available to all both in the meeting and in written form following the meeting (including in real-time in the case of virtual meetings); and
- Offering a physical meeting to all shareholders once government restrictions are lifted.

ISS Policy Guidance

On April 8, 2020, Institutional Shareholder Services (**ISS**) published [guidance](#) on the application of its policies in light of COVID-19.

Items addressed included:

- Annual general meeting postponements – ISS understands that where COVID-19 prevents the holding of physical meetings, shareholders are likely to expect companies to keep them abreast of significant developments by use of standard disclosure documents, press releases and website updates. Companies

will be given credit for using webcasts, conference calls and other electronic communications to engage with investors.

- Virtual meetings – In markets where allowed, ISS will not make adverse vote recommendations until safe to have physical meetings. If boards hold virtual-only meetings, they should disclose the reasons and provide shareholders the chance to ask questions of directors and senior management. Boards are encouraged to commit to return to in-person or hybrid meetings (or to put it to shareholders to decide) as soon as possible.
- Director attendance – Attendance may be impacted as a result of COVID-19. Disclosures relating to health should maintain privacy but give sufficient information to allow shareholders to make informed judgments about absenteeism.
- Changes to the board or senior management – ISS notes that boards should have discretion during COVID-19 to adjust the application of its policies where needed to maintain the appropriate boards and management teams.
- Remuneration – Boards should give shareholders timely explanations for changing performance measures, goals or targets used in short-term compensation plans. For long-term remuneration plans, ISS will look for sufficient directors’ discretion and adequate explanation of the reasons. If boards seek shareholder approval/ratification of repricing actions at 2020 meetings, ISS will apply its existing policy.
- Share issuances – ISS’s existing policies will be updated to reflect new guidance.

FCA Statement on Share Issuances

On April 8, 2020, the Financial Conduct Authority (**FCA**) published a [statement of policy](#) providing a series of measures aimed at supporting companies to raise new share capital in response to COVID-19 while maintaining sufficient investor protection. It also published [technical supplements on working capital statements](#) and a [modification of general meeting requirements](#) under the Listing Rules which set out two of the measures included in the statement in more detail.

The guidance applied from April 8, 2020. The measures relating to working capital statements and general meeting requirements will apply until the FCA advises otherwise.

Small share issues

For smaller share issues, the FCA refers to the statement of the Pre-Emption Group (**PEG**). The PEG encourages, for a temporary period, investors to be supportive of “soft pre-emptive” issues of up to 20% rather than the existing 5% + 5% pre-emption disapplication (without shareholder approval). The FCA endorses this.

The FCA will monitor how the new practices are applied and whether any risks to market integrity or consumer protection arise.

Share issues with a prospectus – Shorter form prospectuses

The FCA reminds issuers about the simplified form of prospectus available under the new Prospectus Regulation for secondary issues and encourages issuers to use this form where possible for COVID-19 recapitalization exercises where it is available under the Regulation.

Working capital statements (WCS)

The FCA is allowing issuers to make clean WCS that disclose key assumptions in relation to business disruption during the COVID-19 crisis underpinning the issuer’s “reasonable worst-case scenario.” This departs from the ESMA prospectus recommendations that clean WCS should not contain any assumptions.

The disclosure is justified by the FCA on the basis that since issuers are required to model a “worst-case scenario” when producing their WCS, they may want investors to be aware of specific assumptions they have taken into account in relation to business disruption caused by the crisis. The FCA acknowledges that this additional disclosure may not be appropriate for all issuers and that a qualified WCS may be appropriate for other issuers. This additional disclosure in relation to clean WCS will only be available where the relevant assumptions underpinning the reasonable worst-case scenario are subject to significant uncertainty. The technical supplement on working capital statements emphasizes that apart from this limited additional disclosure, the rest of the WCS must remain “clean” and so lists other disclosures that will not be permitted in such a clean WCS.

Written shareholder support for Class 1/RPT transactions in place of holding a general meeting

To address challenges faced by issuers during the COVID-19 crisis in holding general meetings required under the Listing Rules and to alleviate time constraints imposed by notice period requirements, the FCA is modifying the Listing Rules requirements on a case-by-case basis where the issuer has:

- obtained or confirmed that it will obtain a sufficient number of written undertakings from shareholders that they approve the transaction and would vote in its favor at a general meeting, as would meet the relevant threshold for shareholder approval under the Listing Rules; and
- announced to the market (in the RIS announcement and shareholder circular) that it has obtained these undertakings and that, if allowed by the FCA, a general meeting will not be held.

The transaction can complete:

- When the circular is issued where the required undertakings have already been obtained; or
- Following a further announcement that the required undertakings have now been obtained.

The issuer will not need to send the undertakings to the FCA, but should provide them if requested. All other listing requirements with regards to these transactions remain in force—meaning that a material change to the transaction will require new undertakings to be obtained in lieu of a further shareholder approval at a general meeting. Other key rules also continue, unaffected—including the sponsor’s duties and the operation of MAR.

If an issuer can hold a general meeting virtually, the FCA will support that approach.

Market Abuse Regulation

The FCA reminds market participants that no changes are being made to MAR and that MAR compliance remains critically important in the current environment.

Finally, the FCA welcomes feedback on its Statement that will apply as from today and says that its response to the crisis will continue to evolve as the situation develops and that views on future actions that might be taken are also welcomed.

Companies House: Temporary Changes to Strike-Off Policies and Late Filing Penalties

On April 16, 2020, the U.K.’s Companies House announced temporary changes to its strike-off policy and its approach to penalties for late filings. This is to help enable companies that have been affected by the COVID-19 pandemic to meet their legal requirements. Companies House will continue to review and amend its policies in light of the COVID-19 pandemic.

The strike-off process will be temporarily paused. When a company makes a voluntary application for strike-off, Companies House will still publish a notice in the Gazette as usual. It will not, however, strike off the company in order to give creditors and other interested parties the opportunity to object. Companies House will continue to write

to companies that have failed to file annual accounts or confirmation statements, but it will not publish a notice of its intention to strike off in the Gazette. The changes do not apply to dissolutions under insolvency proceedings.

Companies will still be able to apply for an automatic three-month extension in which to file accounts (please refer to [Governance & Securities Law Focus, May 2020](#) for further background). Companies House has indicated that companies that have been issued a late filing penalty will have their appeals treated sympathetically.

FRC: Modifications of Independent Auditor's Opinions and Reports

On April 21, 2020, the FRC published its guidance on modifications of independent auditor's opinions and reports. The new guidance comes further to the FRC's previous guidance of March 16, 2020, which indicated that auditors may face practical difficulties in carrying out audits in light of the COVID-19 pandemic (please refer to [Governance & Securities Law Focus, May 2020](#) here for further background).

Modified opinions may be required where practical difficulties make certain audit procedures difficult to perform (for instance, physical inventory testing). It may also be difficult for auditors to agree with or support management judgments in respect of asset or liability valuations given the current economic and political uncertainty. Audit opinions may therefore be modified where auditors are unable to obtain sufficient, appropriate evidence to form an opinion on whether the financial statements are free from misstatement or where any errors as to the financial statements are pervasive. The following modifications are possible:

- Qualified Opinion – A qualification may be given to specific balances, transactions or disclosures where there is a lack of evidence or actual or potential misstatements in financial statements. Other than the specific items highlighted, the auditor can conclude that the financial statements are true and fair.
- Adverse Opinion – An adverse opinion may be given where the auditor concludes that on the basis of sufficient, appropriate evidence that material and pervasive misstatements exist that undermine the reliability of the financial statements as a whole.
- Disclaimer of Opinion – An opinion may be “disclaimed” entirely where the auditor has not been able to obtain sufficient, appropriate audit evidence to be able to give an opinion but concludes that potential material and pervasive misstatements may exist.

An independent auditor may also make additional disclosures in their report which are not modifications, for instance, emphases of certain key matters which were significant to the audit or to a user's understanding of the financial statements.

FRC Updated Guidance for Companies on Corporate Governance and Reporting

Interim Reports

On May 12, 2020, the Financial Reporting Council (**FRC**) published an [update](#) to its March 26, 2020 guidance on corporate reporting to cover interim reports (please refer to our [Governance & Securities Law Focus, May 2020](#) for further background).

The FRC notes that directors will need to exercise judgment about the nature and extent of the procedures that they apply to assess the going concern assumption at the half yearly date. In particular, this might include the disclosure of material uncertainties to going concern, assumptions about the future path of COVID-19, the projected impact on business activities, the use of government support and access to financing.

Issues that might trigger a need to re-examine the going concern assumption and going concern and liquidity risk disclosures include:

- A significant adverse variation in operating cash flows;

- A significant reduction in projected revenues for the second half of 2020;
- A failure to obtain the renewal or extension of committed financing facilities; and
- A failure to sell capital assets for their expected amounts or within previously forecast timeframes.

If a going concern has become an issue since the previous annual financial statements, the directors should undertake procedures to identify and consider all relevant issues (as they would for annual financial statements). There is no legal or regulatory requirement to engage auditors to perform an interim review engagement. The FRC notes, however, that investor feedback indicated that such a review provides valuable assurance, and that this may be particularly prudent in the current environment.

Exceptional Items and Alternative Performance Measures

On May 20, 2020, the FRC published a [further update](#) to its March 26, 2020 guidance on corporate reporting (as updated on May 12, 2020, please refer to “*Interim Reports*” above) to include new sections on exceptional (or similar) items and alternative performance measures (**APMs**).

In relation to exceptional items, companies will need to consider whether additional items of income and expenditure arising from the COVID-19 pandemic should be separately disclosed in accordance with their existing policies; the nature and amount of any such items disclosed should be presented in a way which is helpful to readers. Companies should:

- Be even-handed in identifying gains as well as losses;
- Not describe amounts as “non-recurring” or “one-off” if they are expected to arise in the future;
- Not disclose costs as exceptions solely because of a reduction in or elimination of the related revenue stream due to COVID-19; and
- Not identify incremental costs as exceptional if they result in incremental revenue which is also not described as exceptional (e.g. additional staff costs related to managing exceptionally high levels of sales of in-demand items).

Companies often use APMs in interim and annual reports to supplement information provided under IFRS. The FRC expects companies to provide APM disclosures that:

- Have clear and accurate labeling;
- Have an explanation of their relevance and use;
- Are reconciled to the closest IFRS measure; and
- Are not given more prominence than the equivalent IFRS measures.

Although the FRC expects APMs to be presented consistently year-on-year, there may be changes that result from the COVID-19 crisis. Companies should inform readers of any such changes and provide an explanation of why they provide reliable and more relevant information.

There is a risk that APMs which attempt to provide a measure of “normalized” results, excluding the effects of COVID-19, could be regarded as highly subjective and potentially unreliable. The FRC does not expect companies to exclude such “hypothetical” measures in its reports.

AIM Temporary Measures for Publication of Half-Yearly Report

On June 9, 2020, the London Stock Exchange published an [Inside AIM update](#) covering temporary changes to the obligations for companies listing on the Alternative Investment Market (**AIM**) to notify half-yearly reports.

Effective from June 9, 2020, AIM-listed companies needing additional time are given an additional month in which to notify a half-yearly report. A company that wishes to utilize this additional one-month period must notify via an RIS its intention to do so prior to its reporting deadline. The company's nominated adviser must also separately inform AIM Regulation, the team responsible for the compliance by AIM companies.

The extension is a temporary measure and will be kept under review. AIM-listed companies should continue to consider their existing AIM rules disclosure obligations, in conjunction with the advice and guidance of its nominated advisor.

FRC Lab Report on Resources, Action and the Future

On June 15, 2020, the FRC Financial Reporting Lab (**FRC Lab**) published guidance to companies on the information which should be provided to investors. The guidance addresses in detail the areas included in the FRC's COVID-19 infographic of March 2020. The FRC also published a [brief Q&A](#) on the report.

The key areas which are addressed, with reference to real-life examples, are:

- Resources and the availability of cash – Investors want to understand more detail about the availability of cash, particularly in the short term, as well as the availability of debt and other financing facilities. The level and details required will depend on the nature, extent and timing of previous disclosures.
- Actions being taken to manage short-term expenditure and to ensure viability – Investors want to know what the company is doing to manage expenditure and cash outflow, as well as the other actions being taken to ensure viability. The scope and nature of management actions, and in particular the ability of management to adapt, is a key concern in the short term. In the longer term, investors are looking to understand the horizon for expenditure and capital allocation changes.
- The future – Investors are looking to understand how the company is protecting assets and value drivers, and the decisions being taken now to ensure the sustainability of the company. A company should be prepared to disclose how it envisages the future of its business in a range of scenarios, as well as how it is responding to the COVID-19 crisis.

FRC Lab Report on Going Concern, Risk and Viability

On June 15, 2020, the FRC Lab published guidance on going concern, risk and viability during the COVID-19 pandemic. The guidance notes that despite present uncertainty, investors still require and expect disclosure—particularly on key factors and events that impact the level of uncertainty and the prospects for a company over the short, medium and long terms. The FRC also published a [brief Q&A](#) on the report.

The key considerations examined in the report are:

- Going concern – Disruption to business models in the short term means that the going concern assessment is a more complex task, but one which is crucially important. A company can be a going concern despite the existence of material uncertainties. As such, disclosure about any uncertainties and the management's consideration of them is particularly important.
- Risk reporting – Companies should report on their principal risks, as this provides investors with key information about the resilience and adaptability of a company's business model and strategy. This is particularly important at present, as investors want to understand how risk profiles and appetites have changed during the COVID-19 pandemic and how the management has responded to such changes. The most effective risk disclosures are likely to be those that consider issues raised by COVID-19 holistically, with specific reference to the company's circumstances.

- Viability statement – The COVID-19 pandemic is a test of the value of viability statements, which were introduced following the 2008 crisis to provide investors with a better view of the longer-term risks and prospects of a company's future. The viability statement should include realistic scenarios and clear assumptions and are a useful opportunity for boards to communicate about longer-term prospects despite short-term uncertainties.

Companies House: Updated Guidance on Extension for Filing Accounts

On June 18, 2020, Companies House amended its [guidance](#) for companies that have applied for the three-month extension in which to file accounts which was introduced in March (please refer to our [Governance & Securities Law Focus, May 2020](#) for further background).

The guidance has been updated to clarify that the filing period for accounts cannot be more than 12 months. The deadline for filing can only be extended up to 12 months from the end of the accounting reference period. If a company's deadline is already extended to the maximum 12 months, a further extension will not be granted.

Merger Control: New protections for U.K. businesses in areas of national security and public health; amendments to Enterprise Act 2002 regarding new protections for U.K. businesses and BEIS guidance

On June 21, 2020, BEIS published a [press release](#) announcing that new provisions will be introduced into the Enterprise Act 2002 (EA 2002) to safeguard U.K. businesses that are critical to fighting COVID-19 and future public health emergencies. At present, the Government can only intervene in mergers and takeovers on one of three public interest grounds: national security, media plurality and financial stability. The EA 2002 (Specification of Additional Section 58 Consideration) Order 2020 inserts a new subsection into s. 58 which adds public health considerations as a fourth ground. The new power will support the Government to examine certain takeovers where the U.K. target company, for example a vaccine research company, is directly involved in a pandemic response. These measures came into force on June 23, 2020.

Also on June 23, 2020, the draft EA 2002 (Share of Supply Test) (Amendment) Order 2020 was published and the EA 2002 (Turnover Test) (Amendment) Order 2020 was announced. The orders will increase the Government's powers to intervene in mergers in certain sectors which are deemed important to national security (AI, cryptographic authentication technology and advanced materials) by reducing the thresholds required before such scrutiny can take place. This follows the 2018 introduction of powers allowing Government intervention in military products and technologies. The draft orders went before Parliament on June 22, 2020 but will not come into force until the usual parliamentary process has been completed.

The changes to EA 2002 are intended to minimize short-term risks ahead of the introduction of the National Security and Investment Bill.

On June 26, 2020, BEIS published guidance to accompany the changes to the EA 2002 which came into force on June 23, 2020. The guidance aims to provide practical advice to those affected, or potentially affected, by the changes, including explaining the reasons for, the practical effects of, and what is permitted by, the amendment.

Tax Avoidance: New AML reporting duty postponed

On June 29, 2020, the Law Society Gazette published an [article](#) indicating that HMRC has confirmed that the U.K. is taking up the optional six-month deferral provided for in [Council Directive \(EU\) 2020/876](#) and that the Government will update the [International Tax Enforcement \(Disclosable Arrangements\) Regulations 2020](#), which implement [Council Directive \(EU\) 2018/822](#) (DAC 6), to account for this change. While the new regulations were not in force by July 1, 2020, HMRC has confirmed that it will not take any action for non-reporting for the period between July 1, 2020 and the date that the amended regulations come into force.

Corporate Insolvency and Governance Act 2020

On June 26, 2020, the CIGA came into force, introducing some of the biggest changes to U.K. insolvency and restructuring law in a generation. It also has made a number of important temporary changes in the areas of insolvency and company meetings and filings to assist companies and businesses in coping with the severe pressures brought about by the COVID-19 crisis. [See the explanatory notes issued in respect of CIGA.](#)

We have published a detailed analysis of CIGA and the impact that it is likely to have on U.K. insolvency and restructuring practice in our U.K. Corporate Insolvency and Governance Act 2020 [client note](#).

The first mentioned changes were originally consulted on by the Government in 2016, leading to three detailed proposals being announced in August 2018. In March 2020, when announcing some of the temporary COVID-19 measures discussed below, the Government said that it would also be taking the opportunity to bring forward into legislation its August 2018 proposals. These three proposals were: (i) a new standalone moratorium, (ii) a new restructuring plan, and (iii) a new ban on the triggering by insolvency of automatic (or “ipso facto”) termination clauses in supply agreements.

The Standalone Moratorium

Prior to CIGA, U.K. insolvency law provided distressed companies with a moratorium against certain creditor action where the company entered into administration or where a “small company” was proposing a voluntary arrangement with its creditors. CIGA now allows “eligible” companies to take advantage of a creditor moratorium without entering into an insolvency proceeding. While the new moratorium will only be available to an eligible company whose directors confirm that the company is, or is likely to become, unable to pay its debts, it will also be necessary for the “monitor” (who must be appointed to oversee the moratorium) to confirm that it is likely that the moratorium would result in the rescue of the company as a going concern.

The moratorium will be a “debtor-in-possession” process, which leaves the company’s directors in control of the running of the company’s business, subject to a number of restrictions under the Act with respect to disposal of assets, and entering into other transactions, etc. otherwise than in the ordinary course of business and to oversight by the monitor.

The key protection that a moratorium will provide a company is against creditor action—enforcement of security, legal proceedings and the initiation of other insolvency processes. In addition, a company in a moratorium will not have to pay certain “pre-moratorium debts” for which it will be given a payment holiday. However, certain other pre-moratorium debts (as well as moratorium debts) will have to be paid and significantly these will include a wide range of financial services liabilities, including loan facilities and derivatives transactions, etc. as well as the monitor’s remuneration and expenses, wages and salaries and payment for goods and services supplied during the moratorium.

Certain companies are excluded from use of the moratorium process and these include banks, insurance and other financial institutions, as well as parties to certain capital market arrangements and securitization vehicles, etc.

A moratorium may be started by the filing of certain papers with the court or in some cases only by application to the court. It will run for an initial period of 20 business days but may be extended by a further 20 business days or for up to a year with creditor consent (or possibly even longer by a court order).

In addition to expiring, the moratorium can be brought to an end early in certain cases—e.g. where the monitor no longer considers that the company be rescued as a going concern. If a company enters into liquidation within 12 weeks after coming out of a moratorium, certain unpaid debts, including unpaid moratorium and unpaid pre-moratorium debts for which the company did not have a payment holiday (but excluding certain accelerated financial debt), will be given a “super priority” over all other claims in the liquidation.

The New Restructuring Plan

CIGA introduces a new type of scheme of arrangement into the Companies Act 2006 (“CA”) (which will have many of the features of existing creditor schemes of arrangement under the CA but also some important differences).

This new scheme or plan (**Plan**) will only be available for companies seeking to address their “financial difficulties” through the compromise or arrangement of creditors’ or members’ (or shareholders’) rights. As with existing creditor schemes, certain non-U.K. companies with a “sufficient” connection to the U.K. jurisdiction will be able to make use of the Plan.

To implement a Plan, a company will need to apply to the court for meetings to be held of the classes of creditors or members whose rights are to be compromised. The Plan will need to be approved by a 75% vote (in value) of the relevant class present or represented at the meeting, except where the following-mentioned “cross-class cram down” rules apply. This approval requirement differs from that for a creditor scheme for which there are no cross-class cram down rules and for which there is an additional voting requirement that a majority (in number) of the relevant class present or represented vote in favor of the scheme.

The Plan must then be sanctioned or approved by the court, exercising its well-established equitable jurisdiction to approve schemes if it would be just and equitable to do so and if the voting in the various classes was fairly representative of the classes as a whole. Once sanctioned and filed, the Plan will become effective and bind all creditors or members in the affected classes.

The new cross-class cram down rules will allow the court to sanction a Plan which has not been approved by a particular class but has been approved by other classes. This will only be permitted where the court determines that none of the “dissentient” class would be any worse off than they would have been under whatever the court considers to be the most likely scenario for the company if the Plan is not sanctioned (e.g. insolvent liquidation). In addition, the Plan must have been approved by a class that would receive a payment or have a genuine economic interest in the company under that other scenario.

Ban on automatic termination clauses in insolvency

CIGA extends the existing restrictions under the Insolvency Act 1986 (**IA**) on the triggering by an insolvency procedure of so-called “ipso facto” or automatic termination clauses in contracts for certain essential supplies, to all supply of goods or services contracts, subject to two sets of exclusions. The idea is to protect a company entering into administration or the new moratorium or Plan process from being denied access by its creditors to the supplies it may need to allow some form of business activity to continue.

The two sets of exclusions include a wide range of financial services suppliers and financial services companies receiving any supplies and, on a temporary basis until September 30, 2020, “small suppliers,” i.e. suppliers that are subject to the U.K. “small companies” accounting regime.

Suppliers are offered some protection against their forced exposure to potentially insolvent customers under the new ban in two ways. First, a supplier may apply to the court for a ruling allowing its supply contract to be terminated on the grounds of the “hardship” that would otherwise be caused if it continued. Also, the ban does not prevent a supplier from terminating its contract if the customer is unable to pay for supplies delivered during the relevant insolvency period.

Temporary insolvency and other changes

CIGA also makes some changes to the IA to protect companies from winding up proceedings during a temporary period ending on September 30, 2020. In very broad terms, winding up petitions will only be permitted and winding

up orders will only be made where the court is satisfied that the company's financial problems would have existed irrespective of any impact of COVID-19. These provisions are backdated in their application to April 27, 2020.

In addition, where any claim is made against a director under the IA's wrongful trading liability provisions for a contribution to a company that has gone into insolvent liquidation or administration, the court is required to assume that the director had no responsibility for any worsening of the financial position of the company during the period from March 1, 2020 to September 30, 2020.

Finally, CIGA also allows companies to delay holding their AGMs and other meetings until September 30, 2020 (extendable to April 5, 2021) and to hold "virtual meetings" and has authorized the making of regulations to extend various filing periods for companies with Companies House.

COVID-19: FCA Primary Market Bulletin No. 28

On May 27, 2020, the FCA published Primary Market Bulletin No. 28. The publication covers issues resulting from the COVID-19 outbreak. Matters covered include:

Temporary relief for semi-annual financial reports for listed companies

- Temporary relief will be granted to listed companies, which allows them an additional month within which to publish their semi-annual financial reports. Issuers subject to Disclosure Guidance and Transparency Rule (DTR) 4.2 are required to publish their semi-annual reports within three months of the end of the relevant reporting period; however, the FCA currently does not expect issuers to request a suspension of their securities for breaching DTR 4.2.2R if semi-annual reports are published within four months of the end of the relevant reporting period, and will not take unilateral steps to suspend listing for such a breach. Issuers complying with the four-month requirement will not face enforcement action. This is a temporary measure in place while the U.K. faces the disruption of the coronavirus pandemic. The FCA will announce how to end the policy in a fair, orderly and transparent way once the disruption subsides.

Shareholder engagement

- Issuers are encouraged to engage with shareholders to ensure investors are appropriately informed and aware of the issuer's actions with regards to the implications of coronavirus on their business. It is suggested that issuers could communicate through formal disclosures in financial reports and trading updates, while also considering additional ways to engage with and allow shareholders to participate, for example, considering ways for shareholders to ask questions of management and exercise voting rights in non-physical general meetings. Issuers with many smaller shareholders could consider ways to make participation in a capital raising available to those shareholders. Although, the FCA recognizes that this may not be possible due to time pressures or legal risks.

Market practice on going concern assessments

The FCA notes that issuers have concerns about how to address COVID-19-related uncertainties in "going concern" assessments when producing financial statements. It is recognized that issuers may face difficulties where an auditor's review highlights a need for auditors to include remarks in their opinion. The concern is that investors and intermediaries will view such remarks unduly negatively. Given it is vital that investors are properly informed, the FCA urges issuers and auditors to be clear and transparent about COVID-19 impacts in financial statements. Market participants, including intermediaries, should not draw unduly adverse inferences from these disclosures, nor from issuers using extra time as permitted.

General Developments

AQSE: consultation on proposed changes to Aquis Stock Exchange

On May 1, 2020, AQSE (previously NEX Exchange) published for consultation proposed changes to the Aquis Stock Exchange (**AQSE**). The proposals include plans to divide the AQSE Growth Market into two new divisions, titled APX and AXS. The proposals also include plans to allow AIM nominated advisers to be given status as AQSE corporate advisers.

The APX would focus on larger companies with a track record. There would be automatic inclusion for companies already admitted to the AQSE Growth Market with a market capitalization of more than £10 million and with more than 35% of their securities in public hands. It is proposed that for inclusion on APX new applicants must meet the following criteria:

- A trading history of no less than two years;
- 25 shareholders or more;
- 35% or more of their securities in public hands;
- A market capitalization of £10 million or more;
- A minimum of two market makers;
- Comply with either the QCA corporate governance code or the U.K. Corporate Governance Code;
- Publish an EU Growth prospectus prepared in accordance with the Prospectus Regulation and approved by the FCA; and
- Companies on APX will be encouraged to engage an AQSE broker member firm for secondary placings.

The AXS would include companies at an earlier stage in their growth. The eligibility criteria for AXS would be the same as under the old NEX Exchange Growth Market with the exception that:

- In respect of investment vehicles, or companies who do not have a two-year trading history, AQSE would increase the minimum fund raise on admission from £500,000 to £2,000,000;
- The admission document would be in template form; and
- Companies would be automatically promoted to APX once they meet that segment's criteria.

It is suggested in relation to corporate advisers that, on application, AIM Nomads in good standing will automatically obtain status as AQSE corporate advisers. It is also proposed that, on placings, a corporate adviser will be asked to inform AQSE of the procedures their client and its brokers have followed in respect of its fundraising activities, including the pricing and allocation of securities, how the allocation might support secondary market liquidity and details of any other relationships that may have influenced the terms and/or allocation of the placing.

Feedback on the proposed changes, including suggestions on how the costs of preparing an EU Growth prospectus could be reduced to bring it more in line with an admission document, was requested by June 15, 2020.

Risk Committees: revised Chartered Governance Institute guidance on terms of reference

On June 1, 2020 the Chartered Governance Institute published updated guidance on terms of reference for risk committees.

The main updates to the note concern the 2018 U.K. Corporate Governance Code, the FRC's Guidance on Board Effectiveness published in 2018 and the FRC's Guidance on Risk Management, Internal Controls and Related Financial and Business Reporting published in 2014.

Other amendments include:

- Recommendations that all board committees should have a good understanding of the deliberations of the company's other committees. The guidance suggests this could be achieved through reports to the board and, if possible, the appointment of at least one member of a committee to each of the other committees. In relation to the share of duties between the audit and risk committees, duties should not be allocated to more than one committee and there should be no gaps;
- Guidance that the committee should be entirely made up of independent non-executive directors (previously it was only necessary to have a majority of independent non-executive directors). The note also recommends that it include at least one member of the audit committee and/or remuneration committee and/or include one non-executive director specifically responsible for risk; that members have appropriate knowledge, skills and expertise to fully understand risk appetite and strategy/members as a whole have relevant risk expertise; that the committee together have capabilities relevant to the sector in which the company operates; that appointments may only be extended for up to two additional three-year periods; and that the finance director and any Chief Risk Officer be expected to attend meetings on a regular basis (rather than all meetings);
- A recommendation that the committee meet a minimum of four times a year, increased from a minimum of three;
- A recommendation that the committee should seek assurance on the risks the company identifies as those to which the business may be exposed, with examples of likely risks;
- Guidance that the committee provide advice to the remuneration committee on any risk weightings to be applied to performance objectives included in the incentive structure for executive pay and make recommendations to the remuneration committee on clawback provisions; and
- Guidance that the committee be authorized to delegate any matters to another committee or person as it considers appropriate.

ESEF Regulation: BEIS policy paper on directors' sign-off of accounts

On June 1, 2020, the U.K. Department for Business, Energy and Industrial Strategy (**BEIS**) published a policy paper on the government's position on the directors' sign-off of accounts of those companies that are subject to the requirements of the Transparency Directive and the Delegated Regulation on the use of the European Single Electronic Format (**ESEF**).

BEIS considers that:

- When directors review company accounts to decide whether to confirm that they been prepared in accordance with the Companies Act 2006, there is no requirement to consider the tagging of the accounts in ESEF and in particular to consider this as part of whether the accounts are "true and fair." The tagging can be applied later, in a version prepared in XHTML format with iXBRL tagging.
- In terms of process, companies may choose their preferred filing method: single filing, a parallel tagged document, or the creation of a tagged document once the annual report has been completed in paper format. Regardless of the various approaches that companies choose, in all cases, the directors'

confirmation relates to the human-readable version of the annual report and not to consideration of the iXBRL tagged data.

MAR: FCA Primary Market Bulletin No 29

On June 9, 2020, the FCA published Primary Market Bulletin No. 29. The publication includes a note, intended to help government departments, industry regulators and public bodies, on best practice for recognizing, monitoring and disclosing inside information. The note also includes a feedback statement following the consultation on the note (see the draft note, which was published in [Primary Market Bulletin No. 25](#)). The draft has been amended as follows:

- In the section detailing how to publish inside information, the guidance is updated to refer to alternative time zones—if an issuer’s financial instruments are traded on foreign markets or in more than one jurisdiction with different time zones, the timing of announcements should be given additional consideration. It remains the case that, where possible, planned announcements containing inside information should be made outside market hours.
- New guidance has been included which considers requests for inside information, for example under the Freedom of Information Act 2000. It states that the act of disclosing inside information in response to a request is not automatically unlawful under MAR, but the disclosure must still be lawful under Article 10 of MAR. The new guidance also refers to the Freedom of Information Act 2000 containing provisions making information exempt from disclosure in certain circumstances and the need for organizations to take legal advice.
- The definition of inside information is extended to include information received as part of an organization’s regulatory functions.
- Information on how to contact the FCA is added.

Financial Services: Written Statement on the U.K. financial services sector post Brexit

On June 23, 2020, Chancellor of the Exchequer, Rishi Sunak, published a Written Statement on the U.K. financial services sector following Brexit (**WMS**). The WMS considers the U.K.’s approach to regulatory reforms that are currently being implemented at the international and EU level, and which the U.K. needs to address prior to December 31, 2020 (the end of the transition period). It also considers the need to ensure that the relevant regulations remain appropriate for the U.K. financial sector.

In particular, the WMS sets out the Government’s approach to: (a) updating prudential requirements; (b) maintaining sound capital markets (including making amendments to MAR to confirm that both issuers and those acting on their behalf must maintain their own insider lists, and to change the timeline with which issuers have to comply when disclosing certain transactions undertaken by their senior managers); and (c) managing upcoming risks.

Regulation: AIC responds to BEIS Reforming Regulation Initiative consultation

On June 24, 2020, the Association of Investment Companies (**AIC**) published its Response to BEIS’s Reforming Regulation Initiative consultation which was announced in the budget on March 11, 2020. The AIC’s recommendations include:

- removing the obligation for issuers to prepare a prospectus for secondary issues of shares in the same class as others already admitted to trading on a regulated market; and
- the wider review of corporate reporting which, *inter alia*, considers splitting corporate reporting into separate components (Strategic Report, Historic Report, Bespoke Report and Legal and Regulatory Disclosures Document) to make it more effective for shareholders and stakeholders.

TCFD reporting on climate-related financial information by FTSE 350 companies

FTSE 350 companies are increasingly using the Financial Stability Board's (**FSB**) Task Force on Climate-related Financial Disclosures (**TCFD**) recommendations for disclosing climate-related financial information. Of 185 FTSE 350 companies who had published their 2020 annual general meeting notice and annual report at the time of PLC's report, 89 included a statement about voluntary disclosures under the FSB's task force on TCFD recommendations in their annual report. PLC classified 27 of these companies as being in the financial or insurance sectors. Other top-performing sectors included mining, metals and engineering, real estate, construction, and oil, gas and chemicals.

The TCFD recommendations were published in 2017 and have become the leading climate reporting system in many jurisdictions. In the U.K., the TCFD's reporting recommendations are voluntary; however, the government's Green Finance Strategy published in July 2019 set out the government's expectation for all listed companies and large asset owners to disclose in line with the TCFD recommendations by 2022. It is therefore expected to become mandatory for certain organizations in the future.

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