SHEARMAN & STERLING

GOVERNANCE & SECURITIES LAW FOCUS

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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 July 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 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

OCIE Alert for COVID-19-Related Compliance Risks and Considerations

On August 12, 2020, the Securities and Exchange Commission's (the **SEC**) Office of Compliance Inspections and Examinations (the **OCIE**) issued a risk alert (the **Risk Alert**) highlighting COVID-19 compliance risks and considerations for broker-dealers and investment advisers (collectively, **Firms**). The OCIE noted that COVID-19 has required Firms to operate remotely for an extended period, resulting in an increase in fraudulent activity due to heightened market volatility.

As discussed below, the Risk Alert provides observations and recommendations on protection of investors' assets; supervision of personnel; practices relating to fees, expenses and financial transactions; investment fraud; business continuity; and protection of investor and other sensitive information.

Protection of Investors' Assets

The Risk Alert encourages Firms to disclose to investors that checks or assets mailed to a Firm's office location may experience delays in processing. The Risk Alert further states that: "[the] OCIE also encourages Firms to review and make any necessary changes to their policies and procedures around disbursements to investors, including where investors are taking unusual or unscheduled withdrawals from their accounts, particularly COVID-19 related distributions from their retirement accounts." Additionally, the OCIE encourages Firms to "[i]mplement[] additional steps to validate the identity of the investor and the authenticity of disbursement instructions, including whether the person is authorized to make the request and bank account names and numbers are accurate," and to "[r]ecommend[] that each investor has a trusted contact person in place, particularly for seniors and other vulnerable investors."

Supervision of Personnel

Firms must reasonably supervise their personnel, regardless of whether employees work in the office or remotely. The OCIE suggests that Firms implement changes to their policies and procedures to address the changes related to COVID-19, including in relation to:

- supervisors not having the same level of oversight and interaction with supervised persons when they are working remotely;
- supervised persons making securities recommendations in market sectors that have experienced greater volatility or may have heightened risks for fraud;

- the impact of limited on-site due-diligence reviews and other resource constraints associated with reviewing third-party managers, investments and portfolio holding companies; and
- communications or transactions occurring outside of the Firms' systems due to personnel working from remote locations and using personal devices.

Fees, Expenses and Financial Transactions

The Risk Alert states that the recent market volatility and the resulting impact on investor assets and fees collected by Firms may have increased financial pressures on Firms and their personnel, thereby increasing the potential for misconduct regarding financial conflicts of interest as well as fees and expenses charged to investors.

The OCIE suggests that Firms address these risks by reviewing their fees and expenses policies and procedures and enhancing their compliance monitoring, including (i) validating the accuracy of their disclosures, fees and expenses calculations and the investment valuations used, (ii) identifying and monitoring transactions that resulted in high fees and expenses to investors and evaluating whether those transactions were in the best interest of investors, and (iii) evaluating the risks associated with borrowing or taking loans from investors, clients and other parties that create conflicts of interest.

Investment Fraud

The Risk Alert notes that times of financial uncertainty can lead to a higher risk of fraud and/or fraudulent offerings, and cautioned Firms that they should be mindful of these risks, particularly when conducting due diligence on investments.

Business Continuity

The OCIE observed that the shift to remote work during the pandemic may raise compliance issues and other risks, including:

- Firms' supervisory and compliance policies and procedures utilized under "normal operating conditions" may need to be modified or enhanced to address some of the unique risks and conflicts of interest present in remote operations. For example, supervised persons may need to take on new or expanded roles in order to maintain business operations. These and other changes in operations may create new risks that are not typically present.
- Firms' security and support for facilities and remote sites may need to be modified or enhanced. Relevant issues that Firms should consider include, for example, whether (i) additional resources and/or measures for securing servers and systems are needed; (ii) the integrity of vacated facilities is maintained; (iii) relocation infrastructure and support for personnel operating from remote sites is provided; and (iv) remote location data is protected.

Protection of Investor and Other Sensitive Information

The Risk Alert highlights that personally identifiable information and other sensitive information may be compromised by the increase in videoconferencing and other electronic communications, thereby increasing opportunities for third-party actors to access clients' information. To mitigate these risks, OCIE recommends that Firms consider enhanced identity protection practices; conducting heightened reviews of personnel access rights and controls as personnel assume new or expanded roles; providing Firm personnel with additional trainings and reminders; use of validated encryption technologies; ensuring security of remote access servers; enhancing system access security; and addressing cyber-related issues related to third parties that may be accessing Firms' systems remotely.

SEC Resources

Firms are encouraged to remain informed on fraudulent activities that may affect investors' assets, and when fraud is observed, to report such activities. For example, Firms may submit a tip or ask a question using the SEC's tips, complaints and referral system.

Division of Corporation Finance Issues Statement Regarding Submission of Supplemental Materials and Information in Light of COVID-19 Concerns

On August 4, 2020, in light of ongoing health and safety concerns resulting from COVID-19, the SEC's Division of Corporate Finance (the **Division**) issued guidance related to the submission of supplemental materials and information subject to Rule 83 confidential treatment requests.

Supplemental Materials. Under Rule 418 and Rule 12b-4, the SEC may request the submission of supplemental materials, which are not deemed to be filed with the SEC and are typically returned to the company upon request. The Division is providing a temporary secure file transfer process for the submission of such supplemental materials, including supplemental materials subject to a Rule 83 confidential treatment request.

Rule 83 Confidential Treatment Requests. Under Rule 83, persons submitting information may request confidential treatment for portions of that information where no other confidential treatment process applies. Under the temporary secure file transfer process, Rule 83 confidential treatment requests and related confidential information may be submitted electronically. A copy of the request for confidential treatment must also be submitted to the Commission's Office of FOIA Services (the **OFS**). The OFS is currently accepting confidential treatment requests via email at Rule83CTRs@sec.gov. The OFS has provided guidance on submitting required copies of Rule 83 confidential treatment requests to that office.

Although information received through the secure file transfer process will be retained by the Division in accordance with the appropriate records retention schedules, supplemental information subject to Rule 418 or Rule 12b-4 received through the secure file transfer process will not be retained after the materials have been reviewed. Furthermore, although supplemental materials and information may be sent subject to a Rule 83 confidential treatment request to the SEC mailroom, there will be delays in the processing of such documents.

Developments Related to U.S. Securities Regulation

SEC Adopts Rule Amendments to Business Description, Legal Proceedings and Risk Factors Disclosure Requirements

On August 26, 2020, the SEC adopted amendments to modernize certain specific disclosure requirements applicable to public companies. The amendments are part of a series of SEC rulemakings aimed at modernizing the disclosure regime for public companies by eliminating or updating disclosure requirements that have been long considered outdated and by formally adopting best practices and existing SEC interpretative guidance. The amendments address the following disclosures required by Regulation S-K: description of business (Item 101); legal proceedings (Item 103); and risk factor disclosure (Item 105).

The key changes introduced by the amendments include two new specific requirements: (i) a summary of risk factors where the risk factor section itself is longer than 15 pages; and (ii) a description of the company's human capital resources, measures and objectives.

The amendments are designed to provide public companies with more flexibility in describing their business, legal proceedings and risk factors by shifting to principles-based disclosure. This allows public companies to focus on describing material aspects of their particular business whilst avoiding prescriptive disclosure topics not meant for investors.

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

The amendments address the following disclosures required by Regulation S-K:

General Development of the Business (Item 101(a)). Description of the general development of the business of the company as amended shifts to a principles-based approach, requiring disclosure of information material to an understanding of the general development of the business irrespective of a specific time frame, with the elimination of the previously prescribed five-year time frame in Item 101(a) (and three-year time frame for smaller companies in Item 101(h)). Pursuant to the amendments, companies need to disclose only information material to an understanding of the general development of the business and no longer need to address all topics listed in Item 101(a). Such topics have been replaced with examples instead, including: any material changes to a company's previously disclosed business strategy; the nature and effects of any material bankruptcy, receivership, or any similar proceeding with respect to the company or any of its significant subsidiaries; the nature and effects of any material reclassification, merger or consolidation of the registrant or any of its significant subsidiaries; and the acquisition or disposition of any material amount of assets otherwise than in the ordinary course of business.

Narrative Description of the Business (Item 101(c)). The revisions of the rule replaced the required twelve disclosure topics with a non-exclusive list of seven disclosure topic examples (drawn from the prior list of twelve). As amended, Item 101(c) removes references to disclosures regarding new segments, the dollar amount of backlog orders and working capital practices. It also introduced a new disclosure topic regarding the company's human capital resources, including a discussion about the attraction, development and retention of personnel, to the extent such disclosures would be material to an understanding of the registrant's business. Further, the prior regulatory compliance disclosure requirement in Item 101(c) has been expanded by including as a topic all material government regulations, not just environmental laws.

Legal Proceedings (Item 103). The specified dollar threshold under the rules requiring the disclosure of legal proceedings to which a governmental authority is a party and that seeks monetary sanctions under certain environmental laws is increased from $100,000 to $300,000. However, the revised rule allows a company to elect to apply a different threshold that it determines is reasonably designed to result in disclosure of material environmental proceedings, *provided that* the threshold does not exceed the lesser of $1 million or 1 percent of the company's current assets. The amended rule also permits hyperlinks or cross-references to legal proceedings disclosure elsewhere in the document (such as in the MD&A, risk factors or notes to the financial statements) to avoid duplication.

Risk Factor Disclosure (Item 105). As amended, the rule requires summary risk factor disclosure of no more than two pages if the risk factor section exceeds 15 pages, and which is required to be in concise, bulleted or numbered statements summarizing the principal factors that make an investment in the company or offering speculative or risky. Additionally, it refines the principles-based approach by requiring disclosure of "material" risk factors over the previous standard of "most significant" and requires companies to organize risk factors under relevant headings (in addition to the subcaptions currently mandated), with any risk factors that may generally apply to an investment in securities disclosed at the end of the risk factor section under a separate heading.

The rule changes to Item 101 (Business Description) and Item 103 (Legal Proceedings) of Regulation S-K will not apply to foreign private issuers, unless they have chosen to register securities on a domestic form, such as Form S-1. However, the changes to Item 105 (Risk Factors) will apply to foreign private issuers (**FPIs**) because Forms F-1, F-3 and F-4 all refer to Item 105. To the extent that an FPI's annual report on Form 20-F is incorporated into its Form F-3 for purposes of updating the registration statement, the rule changes for Item 105 would apply as well.

SEC Revised Definitions of Accredited Investor and Qualified Institutional Buyer

On August 26, 2020, the SEC adopted amendments to broaden and update the definitions of "accredited investors" under Regulation D and of "qualified institutional buyers" under Rule 144A in order to identify more effectively institutional and individual investors that have the knowledge and expertise to participate in private capital markets. The changes are part of the SEC's effort to "simplify, harmonize and improve" the private offering framework.

The amendments will become effective 60 days after publication in the Federal Register, and as of the date of this memorandum, the final rule has not yet been published in the Federal Register.

Rule 506(b) of Regulation D provides a non-exclusive safe harbor under Section 4(a)(2) of the Securities Act of 1933, as amended (the **Securities Act**), which exempts transactions by an issuer "not involving any public offering" from Securities Act registration requirements. Pursuant to this safe harbor, an issuer may offer and sell an unlimited amount of securities, *provided that* offers are made without the use of general solicitation or general advertising and sales are made only to accredited investors and up to 35 non-accredited investors who meet an investment sophistication standard. The accredited investor definition, set forth in Rule 501(a) of Regulation D, includes (i) natural persons whose net worth or income exceeds specific thresholds, (ii) certain types of entities with total assets in excess of $5 million, (iii) specific types of institutional investors, such as banks and insurance companies, and (iv) any entity in which all of the equity owners are accredited investors. As amended, the accredited investor definition now includes the following categories:

- *Natural persons*. The amended rule adds two new non-financial categories for natural person accredited investors which are based on professional knowledge and experience in addition to the historical use of net worth and income levels, and includes natural persons who:
  - hold certain professional certifications or designations or other credentials designated from time to time by order of the SEC and held in good standing—the SEC has initially designated Series 7, 65 and 82 licenses required for broker-dealer representatives or certain investment adviser representatives dealing with retail investors; and
  - meet "knowledgeable employee" status (*i.e.*, a high-level executive or qualifying investment personnel) for a private fund and investing in such private fund.
- *Entities*. The amended rule also adds new categories of entity accredited investors, including:
  - SEC- and state-registered investment advisers, as well as venture capital or mid-sized private fund exempt reporting advisers under the Investment Advisers Act of 1940 (the **Advisers Act**);
  - rural business investment companies (**RBICs**);
  - limited liability companies with total assets in excess of $5 million that are not formed for the specific purpose of acquiring the securities being offered;
  - any form of entity not covered under the current rule (*e.g.*, Native American tribal entities, non-U.S. pension plans or sovereign wealth funds) owning "investments" in excess of $5 million that is not formed for the specific purpose of acquiring the securities being offered;
  - "family offices" (as defined in the family office rule under the Advisers Act) with at least $5 million in assets under management that are not formed for the specific purpose of acquiring the securities offered—whose prospective investment is directed by a person who has knowledge and experience in financial and business matters—and that such family offices are capable of evaluating the merits and risks of the prospective investment; and

- "family clients" of a "family office" qualifying as an accredited investor, whose prospective investment is directed by such family office.

Rule 144A under the Securities Act allows the private resale of securities offered in a private placement to large "qualified institutional buyers" (**QIBs**) without registration. QIBs generally are certain classes of institutional investors that own and invest on a discretionary basis at least $100 million in securities of non-affiliated issuers. Many institutional private placements (*e.g.*, debt or asset-backed securities) are structured to comply with Rule 144A, and many buyers of such securities (*e.g.*, private funds) seek to meet the QIB definition. The SEC expanded the definition of QIB in order to avoid inconsistencies between the entity types that are eligible for accredited investor status and QIB status. The final rules expand the definition of QIB to include the following types of institutional investors meeting the $100 million of securities test:

- limited-liability companies and RBICs; and
- any entity not covered under the current accredited investor rule (as described above), such as sovereign wealth funds, Native American tribal entities and non-U.S. plans.

In practice, this change will have limited impact, as many capital markets participants have always presumed that such entities are QIBs.

SEC Adopts Amendments to Modernize Shareholder Proposal Rule 14a-8

On September 23, 2020, the SEC adopted amendments to modernize certain requirements for the submission of shareholder proposals under the Securities Exchange Act of 1934 (the **Exchange Act**) Rule 14a-8. The amendments most notably revise the initial submission and resubmission thresholds that shareholders must satisfy to submit shareholder proposals and apply the one-proposal rule to "each person," rather than to "each shareholder," meaning that an individual may submit only one shareholder proposal to a company for a particular shareholders' meeting, whether the shareholder proposal is submitted by a person as a shareholder or as a representative of a shareholder.

These amendments are designed to strengthen the requirement that shareholder-proponents demonstrate a meaningful economic stake or investment interest in the company for which they are seeking to present a matter before shareholders. The updates introduced by these amendments are a welcome modernization of the shareholder proposal rule, which has not been amended with respect to initial submission eligibility thresholds since 1998, nor amended with respect to resubmission thresholds since 1954. The amendments were adopted substantially as proposed by the SEC on November 5, 2019.

Below is a brief summary of these amendments. For a more complete review of these amendments, please refer to our client publication.

Initial Submission Threshold (Rule 14a-8(b))

Rule 14a-8(b) currently requires a shareholder-proponent to demonstrate that he or she has continuously held for at least one year either $2,000 in market value or 1 percent of the company's securities entitled to be voted on the proposal at the meeting in order to submit a proposal. Under Rule 14a-8(b), as amended, this threshold is replaced with three tiered thresholds, requiring a shareholder to demonstrate minimum continuous ownership with one of the following thresholds:

- $2,000 of the company's securities for at least three years;
- $15,000 of the company's securities for at least two years; or
- $25,000 of the company's securities for at least one year.

To satisfy the new tiered thresholds, shareholder-proponents are no longer permitted to aggregate holdings to be eligible to submit or co-file a proposal. Whilst aggregation is no longer permitted under the amendment, shareholders continue to be permitted to co-file proposals as a group, provided that each shareholder-proponent is independently eligible to submit a proposal. Further, a shareholder that uses a representative to submit a proposal must provide documentation that, among other things, includes a statement from that shareholder authorizing the representative to act on the shareholder's behalf and a shareholder's statement supporting the proposal. The purpose of this requirement is to provide a meaningful degree of assurance as to the shareholder's identity, role and interest in the proposal.

Under the amendment's transition provision, shareholders who are currently eligible to submit a proposal under the existing eligibility criteria will remain eligible without any additional investment for proposals submitted for an annual or special meeting to be held prior to January 1, 2023, so long as they provide the company with a written statement that they intend to continue to hold at least $2,000 of such securities through the date of the shareholders' meeting for which the proposal is submitted, as is already required. The transition provision is not applicable to the prohibition on aggregation of holdings.

Resubmission Threshold (Rule 14a-8(i)(12))

Rule 14a-8(i)(12) currently permits a company to exclude from its proxy materials a shareholder proposal dealing with substantially the same subject matter as another proposal or proposals that had been submitted once, twice or three or more times in the preceding five calendar years and received less than 3 percent, 6 percent and 10 percent of shareholder votes, respectively. Such proposal would be excludable for any meeting held within three calendar years after the last meeting for which the proposal was included.

Under Rule 14a-8(i)(12), as amended, the thresholds are increased to 5 percent, 15 percent and 25 percent, respectively. Thus, for example, a proposal would need to achieve support by at least 5 percent of the voting shareholders in its first submission to be eligible for resubmission in the following three years, and proposals submitted two and three times in the prior five calendar years would need to achieve 15 percent and 25 percent support, respectively, in their most recent vote to be eligible for resubmission in the following three years after such most recent vote. These updates are intended to reduce the costs to the company related to repeated consideration of proposals that have not been widely supported by shareholders, whilst continuing to maintain shareholders' ability to submit proposals and engage with companies.

One-Proposal Limit (Rule 14a-8(c))

Rule 14a-8(c) currently allows "each shareholder" to submit no more than one proposal to a company for a particular shareholders' meeting, but someone serving as a representative for more than one shareholder can submit multiple proposals to the same company on behalf of different shareholders. In order to more effectively apply the one-proposal limit, Rule 14a-8(c), as amended, revises the rule to apply the one-proposal limit to "each person" rather than "each shareholder," and the amendment further states that a person cannot rely on the securities holdings of another person for purposes of meeting the eligibility requirements and thereby submit multiple proposals for a particular shareholders' meeting. As a result, the new rule prevents representatives from having the ability to submit multiple proposals to the same company for the same shareholders' meeting, and it also prevents a shareholder-proponent from submitting one proposal in his or her own name and simultaneously serving as a representative to submit a different proposal on another shareholder's behalf.

Effectiveness

The amendments will be effective 60 days after publication in the Federal Register, and the final amendments will apply to any proposal submitted for an annual or special meeting to be held on or after January 1, 2022, subject to

the transition provision related to initial submissions described above. We expect the amendments to be effective for the 2021 proxy season.

SEC Modernizes Guide 3 Disclosures for Banking Registrants

Since the 1960s, the SEC has had various so-called “Guides” for business disclosure by SEC registrants engaged in banking, oil and gas, real estate, insurance and mining activities. Guide 3, applicable to bank holding companies and other registrants with material lending and deposit activities (including savings and loan holding companies), has required various tabular and qualitative disclosures on these entities’ assets, liabilities and stockholders’ equity, interest rates and interest rate differentials, investment portfolios, loan portfolios, summaries of loan loss experience, deposits, return on equity and assets and short-term borrowings. The requirements have changed little since the 1960s, even though U.S. GAAP and IFRS, the two principal accounting standards used by SEC registrants, have changed significantly.

For a more complete review of the new rules, please refer to our client publication.

On September 11, 2020, after a comment process, which commenced in 2019, the SEC announced that it has adopted rules to update and expand the statistical disclosures that institutions covered by Guide 3 must provide to investors, considering changes in this sector over the past 30 years. The new rules also eliminate certain disclosure items that are duplicative of other SEC rules and/or are required to be disclosed in financial statements using U.S. GAAP or IFRS.

Per the final rule, Guide 3 will be rescinded effective January 1, 2023, and replaced by a new set of rules, which are to be codified in a new subpart 1400 of Regulation S-K (the general regulation setting forth the disclosure requirements for various SEC filings used by SEC registrants, including annual reports on Form 10-K and periodic reports on Form 8-K). Whilst the existing Guide 3 rescission date is not until January 1, 2023, SEC registrants will be required to apply the new rules beginning with fiscal years ending on or after December 15, 2021, unless such registrants voluntarily choose to early adopt the new rules. Until then, registrants will be required to continue to apply the existing Guide 3 requirements. As has been the practice over the last decade or more, we expect that issuers engaged in Rule 144A transactions will also continue to seek to comply with Guide 3 until it has been replaced with the new rules.

The new rules will apply to domestic and foreign bank holding companies, banks, savings and loan holding companies and savings and loan associations, as well as foreign registrants. However, those foreign registrants that use IFRS will be exempt from certain disclosure requirements that are not applicable under IFRS. Whilst the new rules will not codify the undue burden or expense accommodation for foreign registrants in existing Guide 3, the SEC noted that all registrants, including foreign registrants, can always use the “unknown and not reasonably available to the registrant” accommodation under Rule 409 of the Securities Act and Rule 12b-21 promulgated under the Exchange Act, as amended.

The new rules are intended to eliminate inconsistencies and overlap with applicable requirements under U.S. GAAP and IFRS, the two accounting standards available to SEC registrants. Commentators noted that this had increasingly become a source of confusion for registrants and investors as both U.S. GAAP and IFRS had been modified significantly and Guide 3 had remained unchanged. In some instances, this had led to different disclosure requirements in a registrant’s SEC reporting documents and its financial statements, and in other instances, there was a significant amount of overlap between the reporting standards, which the new rules are intended to eliminate. We do expect that SEC registrants and 144A issuers (and underwriters of their securities) will nonetheless look to their independent accountants to help validate and provide customary comfort on the various tabular and other disclosures required by the new rules. We therefore recommend that issuers consult with their independent accountants as early as possible on the timing and nature of presentation to be certain that there is clarity on how the new rules are to be addressed.

Further, the disclosures required by the new rules are not required to be presented in the notes to the financial statements. As such, the disclosures will not have to be audited, and they will not be subject to the SEC's XBRL (eXtensible Business Reporting Language) requirements.

Amendments to Proxy Solicitation Rules Relating to Proxy Voting Advice

On July 22, 2020, the SEC adopted final amendments to its rules governing proxy solicitations with a view to ensure that clients of proxy voting advice businesses are provided with reasonable and timely access to more transparent, accurate and complete information to form the basis of their voting decisions. Introducing the amendments, Chairman Jay Clayton stated that, "Today's actions ensure that those who take on the responsibility of investing and voting on behalf of our Main Street investors have the accurate and decision-useful information necessary to make an informed voting decision for the benefit of those investors."

Generally, most proxy advisory firms rely upon exemptions from the rules to avoid the various applicable disclosure requirements mandated by the law. The amendments to the rules now condition the availability of the exemptions on compliance with tailored and comprehensive conflicts of interest disclosure requirements. Further, the exemptions are also conditioned on two principles-based requirements to ensure that all advice is made available in a timely manner, and that clients of proxy advisory firms are provided with efficient and timely means of becoming aware of any written statements made in relation to the proxy voting advice by the subject company. The amendments also provide that proxy advisory firms are not required to comply with the conditions in order to rely upon the exemptions if the proxy voting advice is based on a custom policy proprietary to the firm's client, or if the proxy voting advice is provided regarding certain specified or contested matters.

Further, the amendment codifies the definition of "solicitation" under Section 14(a) of the Exchange Act and Rule 14a-1(1) to include "any proxy voting advice that makes a recommendation to a shareholder as to its vote, consent, or authorization on a specific matter for which shareholder approval is solicited, and that is furnished by a person who markets its expertise as a provider of such advice, separately from other forms of investment advice, and sells such advice for a fee." However, this definition excludes proxy voting advice provided by a person in response to an unprompted request.

Along with the amendments, the SEC also issued supplemental guidance on how investment advisers could responsibly manage the additional information that may become more readily available as a result of the rule amendments. The supplement also states that an investment adviser should consider whether its policies and procedures are reasonably designed to ensure that the adviser exercises voting authority in its client's best interests.

SEC Stays NYSE Rules of Primary Direct Listings

On August 26, 2020, SEC approved a proposal from the New York Stock Exchange (the **NYSE**) allowing companies to raise capital by issue and selling shares on their behalf through a direct listing. However, on August 31, 2020, the approval was stayed by the SEC due to objections received from the Council of Institutional Investors (the **CII**) following its intention to petition for a review of this rule. A petition for review of the SEC approval order was filed by CII on September 8, 2020, requesting review of the proposals and a determination as to whether adequate investor protection mechanisms were in place. Opposing the stay, the NYSE contends that CII's concerns were raised and considered in the comment process.

Once effective, the proposal by the NYSE would presumably lead to an increase in the number of companies going public by way of direct listing, as compared to traditional initial public offerings (**IPOs**). The benefits of this approach typically include lower costs to the issuer and fewer regulatory restrictions due to the elimination of lockup periods imposed by the underwriters. Prior to the proposal, direct listings were only available to issuers seeking to conduct a

secondary offering. However, once approved, the proposal would permit issuers to raise capital directly, subject to compliance with higher market valuation requirements, as well as the initial listing requirements of the NYSE.

Similarly, on August 24, 2020, NASDAQ filed a similar proposal with the SEC, seeking to allow companies to raise capital by selling shares on their own behalf through direct listings. This would include the creation of a new order, the Company Direct Listing Order. However, after the notice by CII, the NASDAQ proposal was removed from the SEC's website.

DOJ and SEC Publish New FCPA Resource Guide

On July 3, 2020, the Criminal Division of the Department of Justice (the **DOJ**) and the Enforcement Division of the SEC published the Second Edition of the Resource Guide (the **Guide**) on the U.S. Foreign Corrupt Practices Act (**FCPA**).

Originally published in November 2012 to provide guidance on the requirements of the FCPA and insight into DOJ and SEC enforcement practices, the Guide includes details on the DOJ's corporate enforcement policy, located in the "Guiding Principles of Enforcement" section, along with other case law developments and clarifications. The Guide explains that whilst a company's internal accounting controls may contain a number of overlaps with its compliance program, it is critical that robust internal accounting controls are in place and co-exist with a company's compliance program.

Below is a brief summary of changes included in the Guide. For a more complete review, please refer to our detailed publication.

Conspiracy and Aiding and Abetting Liability

The Guide contains updates based on the decision in *United States v. Hoskins*, 902 F.3d 69 (2d Cir. 2018) (**Hoskins**), where the Second Circuit held that the government could not expand the scope of the statute beyond the categories set out in the statute by charging the defendant with conspiracy to violate the FCPA or aiding and abetting a violation. However, the government could pursue a theory that the defendant had acted as an agent for a U.S. domestic concern.

The Guide reflects the trial court's decision that "at least in the Second Circuit, an individual can be criminally prosecuted for conspiracy to violate the FCPA anti-bribery provisions or aiding and abetting an FCPA anti-bribery violation only if that individual's conduct and role fall into one of the specifically enumerated categories expressly listed in the FCPA's anti-bribery provisions." However, the Guide notes that the Hoskins case does not limit conspiracy or aiding and abetting liability for the FCPA's accounting provisions, which apply to "any person" rather than the specific categories of covered persons and activities enumerated in the FCPA's anti-bribery provisions. Thus, the government may effectively continue to pursue cases against foreign nationals for conspiring to violate or aiding and abetting the violation of the FCPA's accounting provisions.

Local Law Defense

The FCPA provides an affirmative defense in cases where a bribe paid to a foreign government official would violate the FCPA but is "lawful under the written laws and regulations of the foreign official's… country." This defense was taken up by the defendant in the *United States v. Ng Lap Seng*, No. 18-1725 (2d Cir. 2019) case, where the district court denied the defendant's request for a jury instruction that his payments to local government officials did not violate the FCPA so long as the conduct was not expressly prohibited by written local laws or regulations. The Guide discusses the ruling of the district court that such defense would be inconsistent with the statutory language of the FCPA and would lead to impractical results, if granted.

Limitation Period

The Guide clarifies the applicable limitation period for various violations of the FCPA, with a five-year limitation period for substantive violations of the anti-bribery provisions, with a six-year period for violations of the accounting provisions of the FCPA. The Guide also discusses situations where such applicable limitation periods can be extended.

Disgorgement

The Guide includes brief updates on disgorgement guidance provided by the SEC and primarily derived from the decision of the Supreme Court of the United States (the **Supreme Court**) in *Kokesh v. SEC*, 137 S. Ct. 1635 (2017), which held that the SEC's disgorgement remedy constitutes a "penalty" and is thus subject to the five-year statute of limitations.

DOJ Policy of Coordination of Corporate Resolution Penalties

The Guide includes a discussion on the DOJ's 2018 Policy on Coordination of Corporate Resolution Penalties, laying down the following factors that prosecutors should consider in imposing penalties:

- the egregiousness of the company's misconduct;
- the statutory mandates regarding penalties, fines and/or forfeitures;
- the risk of unwarranted delay in achieving a final resolution; and
- the adequacy and timeliness of a company's disclosures and its cooperation with the DOJ, separate from any such disclosures and cooperation with other relevant enforcement authorities.

SEC Proposes to Increase Form 13F Reporting Threshold

On July 10, 2020, the SEC issued a proposed rule (the **Proposal**) that would raise the Form 13F reporting threshold for investment managers (including non-U.S. investment managers and investment advisers) to $3.5 billion in Section 13(f) securities, up from the $100 million threshold that has been in effect since the Form 13F filing obligations were adopted in 1978.

Whilst the SEC considered three different approaches to increasing the reporting threshold, it ultimately chose to propose an increase in the reporting threshold to $3.5 billion. The SEC determined that a "Stock Market Growth" model, which adjusts the reporting thresholds based on growth in the stock markets from the time of the adoption of the reporting requirements, better reflects the original intent of the 13(f) disclosure program, as it would only apply to managers whose holdings of section 13(f) securities are relatively large compared to the overall size of the U.S. equities market. The SEC also noted that the legislative history indicates that the 13(f) reporting threshold was designed to focus on larger managers.

The SEC estimates that the increased threshold would eliminate Form 13F filing requirements for approximately 90 percent of managers, whilst retaining disclosure for over 90 percent of the dollar value of the holdings data currently reported. The increased threshold is designed to reflect proportionally the increase in the market value of publicly-traded U.S. equities since 1975.

The Proposal would also eliminate the omission threshold that permits the exclusion of certain small holdings, namely holdings of fewer than 10,000 shares (or less than $200,000 principal amount of convertible debt securities) and less than $200,000 aggregate fair market value. The original rationale for the omission threshold was to allow the SEC to collect meaningful holdings data whilst minimizing the Form 13F's reporting burdens. The SEC viewed a reporting requirement for holdings under the omission threshold as *de minimis*, potentially burdensome (especially on comparatively smaller managers) and unlikely to have the potential to materially impact the market.

The Proposal would also amend the instructions for requesting confidential treatment, as well as direct SEC staff to review the Form 13F reporting threshold every five years and recommend to the SEC an appropriate adjustment, if any.

The Proposal was subject to a 60-day public comment period.

Please refer to our related client publication for additional information.

Noteworthy U.S. Securities Litigation and Enforcement

Goldman Seeks Supreme Court Review of Class Certification Standard for Securities Class Actions

On August 21, 2020, Goldman Sachs Group, Inc. (**Goldman**) filed a petition for a writ of *certiorari* from the Supreme Court seeking to overturn a lower court's granting of class certification in a securities class action brought against the company. Goldman is asking the Supreme Court to review whether (i) a defendant in a securities class action may rebut the presumption of class-wide reliance by pointing to the generic nature of the alleged misstatements; and (ii) a defendant seeking to rebut this presumption has only a burden of production or also the ultimate burden of persuasion.

The case is based on alleged misstatements relating to conflicts of interest in four collateralized debt obligations that Goldman structured and sold around 2006. In most securities class actions, plaintiffs allege that misstatements increased the price of the company's stock, leading to a stock price decline when the truth was revealed. In this case, however, Goldman's stock price did not increase when the generic alleged misstatements, such as "we have extensive procedures and controls designed to identify and address conflicts of interest," were made. As a result, plaintiffs' case rests on an ambitious use of the "inflation maintenance theory"—a theory recognized by certain appellate courts, but never by the Supreme Court.

The price impact of the alleged misstatements is a key component of the fraud-on-the-market presumption of reliance that plaintiffs use to establish reliance on a class-wide basis in securities fraud cases. Under the inflation maintenance theory, however, the presumption may be established by alleging that the misstatements maintained pre-existing inflation in the stock price (*i.e.*, the "price impact" is the prevention of any change in the price). Arguably, a defendant then can rebut the presumption only by showing that the "correction" of the alleged inflation-maintaining misstatement did not cause a subsequent drop in the stock price.

In the lower courts, Goldman opposed class certification by arguing that the alleged misstatements were so generic that they could not have impacted its stock price. The district court, however, rejected this argument and certified the class because it found that there was a sufficient link between the alleged corrective disclosures about Goldman's conflicts and stock price declines. The U.S. Court of Appeals for the Second Circuit (which hears appeals from New York, Connecticut and Vermont) affirmed, finding that arguments about whether the statements were too generic were an improper attempt to argue the materiality of the statements, a merits issue that the Supreme Court has held should not be addressed at the class certification stage. In a strong dissent, however, one of the judges concluded that Goldman had offered "uncontradicted evidence" that "severed the link" between the alleged misstatements and their impact on Goldman's stock price, and that it would not be possible, or advisable, to ignore the content of the statements when assessing their price impact.

Goldman's petition argues that the Second Circuit's ruling conflicts with the Supreme Court's decision in *Halliburton Co. v. Erica P. John Fund, Inc.*, 573 U.S. 258 (2014) (***Halliburton II***) because it erroneously bars defendants from relying on the nature of the alleged misstatement to show the absence of price impact at the class certification stage. In particular, in *Halliburton II*, the Supreme Court held that courts should not "artificially limit" the evidence a defendant may use to show the absence of price impact "even though such proof is also highly relevant at the merits stage." Goldman's petition argues that showing that the alleged misstatements are merely generic and aspirational

can suffice to sever the link between the statements and the stock price, and therefore should be considered by courts at the class certification stage. Goldman's petition also asks the court to review whether the Second Circuit correctly held that defendants "bear the burden of persuasion" to rebut the presumption of price impact at class certification, or if, consistent with Federal Rule of Evidence 301, the ultimate burden of persuasion remains with the plaintiffs.

If the Supreme Court decides to take this closely-watched case, its decision could have broad ramifications for securities class actions. Indeed, six *amici* have filed briefs in support of Goldman's petition, raising other issues that the court may consider as well. For example, the Washington Legal Foundation, in a brief co-authored by Shearman & Sterling, asserted that the Second Circuit wrongly applied the inflation maintenance theory by refusing to consider all relevant evidence related to price impact.

Seventh Circuit Vacates Decision Certifying Class, Holding That District Court Must Consider Sufficiency of Defendants' Evidence Rebutting Presumption of Reliance

On July 16, 2020, the United States Court of Appeals for the Seventh Circuit unanimously vacated the Northern District of Illinois' decision to grant class certification in a securities class action brought against Allstate Corporation. The Seventh Circuit (which hears appeals from Illinois, Wisconsin and Indiana) held that the decision to exclude certain evidence at the class certification stage was based in part on a legal error and remanded to the district court for further proceedings.

In *Carpenters Pension Trust Fund v. Allstate Corp*., the plaintiffs brought securities fraud claims against Allstate Corp. (**Allstate**) alleging that it failed to adequately disclose that the increase it experienced in auto insurance claims was related to a new "growth strategy" it implemented, which involved "'softening' its underwriting standards." The plaintiffs alleged that the company misled the market by falsely attributing the increases in auto claims to other factors such as higher-than-usual precipitation and miles driven rather than the higher risk involved with the new strategy. The defendants countered that "the market understood the risks" involved when the strategy was announced.

The plaintiffs sought class certification relying on the fraud-on-the-market presumption of reliance. The defendants offered evidence to rebut the presumption—namely, an expert report opining that the alleged misstatements had no impact on the price of Allstate's stock. The district court declined to consider the defendants' evidence out of concern that it would "essentially and improperly [require the court] to decide" merit issues—which is prohibited at the class certification stage—and instead granted plaintiffs' motion for class certification.

In its decision, the Seventh Circuit provided a detailed overview of Supreme Court precedent establishing that courts must evaluate all of the evidence proffered by the defense in an attempt to rebut the presumption of reliance, even though the elements of reliance, materiality and loss causation often overlap and may require analysis of the same evidence. The district court properly admitted the defendants' expert evidence, but it did not evaluate its sufficiency in rebutting reliance. Instead, the district court "concluded that the issue was tied so closely to the merits that [it] should not decide it on class certification." Whilst the Seventh Circuit noted that it "underst[ood] that view[,]" it ruled that the district court must still "decide at the class stage the price impact issue . . . and may not defer that question for the merits." The court instructed that the district court should evaluate whether defendants have met their burden of persuasion, which shifted to them after the fraud-on-the-market presumption was sufficiently invoked by plaintiffs.

According to the Seventh Circuit, Allstate's position was that reliance had not been established because the market had the correct information "at all times" and the statements plaintiffs pointed to "could not have caused any concurrent price reactions." To support this, Allstate's expert concluded that because there was no stock price reaction to the alleged misstatements, no price impact could be established. The plaintiffs' position was that the evidence furnished by the defendants was a "truth-on-the-market defense," which is "premature" at the class

certification stage. The plaintiffs alleged that the misstatements were fraudulent under an "inflation maintenance" theory—that defendants' false statements maintained inflation in the stock price even if the price itself did not change. The court observed that the analysis of "price reaction . . . is quite different from the legal concept of price impact" and held that the expert report's finding "does not actually resolve the legal issue of price impact." The court then turned to a "second core dispute over the [expert] report's findings . . . that [in essence] because nothing came down after the alleged corrective disclosures, nothing could have gone up in the first place." The court was unconvinced, observing that it is "hard to square" this with the alleged ten percent price drop after the "truth" about the auto claims was revealed, and further held that the district court "may take into account expert findings with regard to '[w]hether the stock price responds when the [alleged] fraud is revealed to the market,' only as backward-looking, indirect evidence of . . . 'whether stock price [is] distorted at the time that the plaintiff trades.'"

In combination with the Goldman case discussed above, Allstate further emphasizes the difficulty that lower courts are having in assessing how defendants can rebut the fraud-on-the-market presumption of reliance in securities fraud cases (especially when plaintiffs invoke an inflation maintenance theory to support their claims). It seems likely that the Supreme Court will need to step in and bring further clarity to this area of the law.

Second Circuit Affirms in Part Dismissal of Securities Claims Against Cancer Drug Developer, Holding Certain Alleged Misstatements Inactionable as Corporate Puffery

On July 13, 2020, the U.S. Court of Appeals for the Second Circuit affirmed in part and vacated in part the dismissal of securities fraud claims against NewLink Genetics Corp., a pharmaceutical company (**NewLink**), and certain individual defendants in connection with alleged misstatements regarding the efficacy of NewLink's pancreatic cancer drug, the design of the drug's clinical trial and the scientific literature concerning pancreatic cancer. The Second Circuit (which hears appeals from Connecticut, New York and Vermont) held that whilst some alleged misstatements were inactionable puffery, others were statements of opinion as to which, under the Supreme Court's decision in *Omnicare v. Laborers District Council Construction Industry Pension Fund*, 135 S. Ct. 1318 (2015) (**Omnicare**), plaintiffs adequately pled falsity. The Second Circuit also held that the plaintiffs sufficiently pled loss causation.

By way of background, the plaintiffs in *Nguyen v. NewLink Genetics Corp.* had alleged that the defendants made material misstatements regarding the efficacy and trial design of NewLink's pancreatic cancer treatment, leading to a stock drop when the Phase 3 clinical trial of the drug failed. The drug had a successful Phase 2 trial, which studied the survival rate or median life expectancy of patients with Stage I or Stage II pancreatic cancer who received the drug as treatment after undergoing a resection to remove pancreatic tumors. NewLink followed up with patients for at least 24 months before ending the Phase 2 trial and concluded that those treated with its drug had a survival rate of 24.1 months. In September 2013, when NewLink was in the process of enrolling patients in its Phase 3 trial of the drug, the Chief Medical Officer (the **CMO**) allegedly made statements (the **September Statement**) at an industry conference referring to the Phase 2 results showing a 24.1-month survival rate as "remarkable." The CMO further allegedly reported that scientific literature indicated resected pancreatic cancer patients "live 15 months, 19 months," and that the major U.S.-based studies within the last 30 years indicate that survival rates were "between 15 to 19, 20 months. That's it." The plaintiffs alleged that the paper the CMO referenced had also presented survival rates of 24.1 months and 20.6 months.

The plaintiffs further claimed that the defendants made statements during the following three years "that expressed confidence in the Phase 2 trial results," noting that the data was "encouraging" and that the Phase 2 results "really exceeded any expectation that experts in the field had" and further showed a "very strong efficacy signal" (the **2013–2016 Assessments**).

The plaintiffs also alleged that the defendants made misstatements during the Phase 3 clinical trial in responding to the interim publication of negative results that failed to meet the threshold for approval from the U.S. Food and Drug

Administration (the **FDA**). In particular, the CMO stated that NewLink believed that the control arm of its Phase 3 study would not have a median survival rate of "more than low 20s," adding that, although the survival rate expectations were 18 or 19 months, the study was designed based on an assumed survival rate for the control group in the low 20s (the **March Statement**). Newlink's stock price rebounded after this statement and certain individual defendants sold millions of dollars worth of Newlink stock. Additional study results were released in March 2015, which again did not satisfy the FDA approval threshold, showing a median survival rate of 28.5 months for both the control and test groups blended together. In a July 2015 earnings call, the CMO allegedly reiterated NewLink's belief that the control arm's survival rate was in the low 20s. Prior to the release of the third wave of interim results, NewLink disclosed that a clinical site had not been compliant with Good Clinical Practice requirements in enrollment of patients, but noted that it was a minor issue involving only one clinician (the **Enrollment Statement**).

The last of the Phase 3 clinical trial results were released in March 2016, and NewLink announced that the trial had failed because it showed "a median survival rate of 27.3 months for the test group, which was *below* the 30.4-month survival rate for the control group." The plaintiffs then filed a securities class action.

On appeal, the Second Circuit first considered the plaintiffs' claims that falsity was adequately alleged with respect to the alleged misstatements, including the 2013–2016 Assessments, the September Statement, the March Statement and the Enrollment Statement. The court agreed with the lower court's holding that falsity was inadequately pled with respect to the 2013–2016 Assessments, finding that the plaintiffs' theory was "untenable." The court noted that such statements constituted "puffery" and as such are "actionable only when the speaker 'knew that the contrary was true,'" which the plaintiffs here failed to sufficiently plead. Furthermore, the court observed that the fact that the individual defendants sold their company stock during this time period "reasonably could have been . . . to hedge against the risk of the Phase 3 trial failing, despite their belief that [the drug] showed promise."

The Second Circuit next considered the September Statement. In doing so, the court discussed its understanding of *Omnicare* at some length, noting that it established "two principal ways of challenging statements of opinion that do not require plaintiffs to show that the speaker subjectively disbelieved the statement," including: (i) "plaintiffs can allege that a statement of opinion contained one or more embedded factual statements that can be proven false" or (ii) "plaintiffs can allege that a statement of opinion, without providing critical context, implied facts that can be proven false," such that "when a statement of opinion implies facts or the absence of contrary facts, and the speaker knows or reasonably should know of different material facts that were omitted, liability under Rule 10b-5 may follow." The court added that "*Omnicare* held that the appropriate perspective for identifying whether a statement of opinion implies facts is that of the reasonable investor."

Applying these principles to the September Statement, the Second Circuit noted that it need not "decide whether the district court's classification" of that statement as opinion, rather than fact, "ran afoul of" the *Omnicare* decision, because the result would be the same either way. The court determined that a jury could find that the CMO's statement, "whether characterized as one of fact or opinion, would, absent clarification, lead a reasonable investor to the falsifiable conclusion that no study any knowledgeable person would find credible has shown the median survival rates of resected pancreatic cancer patients to be longer than 20 months." The court further held that the plaintiffs plausibly alleged falsity based on the major U.S. studies published before the September Statement submitted by plaintiffs that showed survival rates ranging from 25 months to 43 months for resected pancreatic cancer patients. The court concluded that the plaintiffs sufficiently pled that contrary facts omitted by defendants substantially undermined the conclusion that a reasonable investor would reach from the September Statement.

Next, the Second Circuit considered the March Statement and similarly concluded that the plaintiffs plausibly pled falsity as to part of the statement. The court found that the statement regarding NewLink's beliefs as to the median survival rate of the control arm was a statement of opinion, whereas the statement regarding trial design was a statement of fact. As to the statement of opinion, the court held that a "jury could find that, by saying [NewLink] did

not have ‘any reason’ to believe that the control group could be living” at greater than 20 months, the CMO “implied that there were no competing facts on survival rates.” The court further noted that a reasonable jury could have concluded that “the sheer volume of competing facts required [the CMO] to either speak less confidently about the control group’s survival rate or to disclose the existence of studies showing survival rates above 20 months.” However, with respect to the statement of fact regarding the trial design, the court held that it was not actionable as the plaintiffs’ allegations did not “rebut” the statement that NewLink “designed the Phase 3 trial in anticipation of the trial’s control group living ‘in the low 20s,’” adding that the plaintiffs’ disagreement with the defendants’ methodology for the trial “does not mean the methodology was not in fact selected” as disclosed.

Turning finally to the Enrollment Statement, the Second Circuit held that the plaintiffs adequately pled both falsity and loss causation. The plaintiffs relied on a confidential witness—a researcher with NewLink—who “claimed to have witnessed the enrollment of ineligible individuals and to have raised concerns about the ‘design’ of the Phase 3 trial with [the CMO].” The witness further allegedly stated that the CMO dismissed these concerns and was more focused on meeting enrollment numbers. The court held that these allegations were “sufficiently particular and plausible” to proceed past the pleading stage. The court disagreed with the lower court’s conclusion that loss causation was not sufficiently pled, finding persuasive plaintiffs’ theory that the Phase 3 failure was attributable to the concealed improper design of the trial and that the failure of the trial therefore constructively disclosed the fraud, leading to a stock drop. The court also agreed with the plaintiffs that loss causation was sufficiently pled because “a sufficient number of improper enrollments would naturally and predictably affect a trial’s statistical integrity.”

Accordingly, the Second Circuit affirmed the dismissal of the plaintiffs’ claims regarding the 2013–2016 Assessments, vacated the dismissal of claims regarding the remaining statements and remanded for further proceedings. The Newlink decision highlights that even mischaracterizing public, non-company information (in this case, the results of published scientific studies on the survival rates of resected pancreatic cancer patients) can lead to securities fraud liability if a court determines that the impact was to mislead investors about NewLink’s prospects.

First Circuit Affirms Dismissal of Securities Fraud Class Action Alleging Company Lied Before IPO

On August 25, 2020, the U.S. Court of Appeals for the First Circuit affirmed the dismissal of a securities class action against ReWalk Robotics Ltd., a medical robotics company (the **Company**), as well as certain of its officers. The class action alleged both Securities Act and Exchange Act claims.

In *Yan v. ReWalk Robotics Ltd.*, the plaintiffs had alleged that the Company made false or misleading statements and omissions in its IPO registration statement (the **Registration Statement**) and subsequent quarterly and annual disclosures concerning its dealings with the FDA regarding one of the Company’s devices. The First Circuit (which covers appeals from Maine, Massachusetts, New Hampshire, Puerto Rico and Rhode Island) affirmed the lower court’s dismissal of the Securities Act claims, finding that plaintiffs failed to allege a material misstatement or omission. Although it disagreed with the lower court’s reasoning in dismissing the Exchange Act claims for lack of standing, the First Circuit nevertheless found that the Exchange Act claims were properly dismissed because plaintiffs failed to sufficiently allege a material misstatement or scienter.

By way of background, the Company designs and manufactures robotic exoskeletons that offer greater mobility to individuals with spinal cord injuries, including an exoskeleton that is intended for use in a home or general community setting (the **device**). The device is subject to regulation by the FDA, which approved the device, so long as the Company conducted a post-market surveillance study of the safety of the device outside institutional settings. Although the safety of the device had been demonstrated in institutional settings, such as hospitals and rehabilitation centers, there was limited data on its safety in the home or community settings—the intended environment for the device. The FDA ordered the Company to submit the proposed study plan for approval and begin the study within a specific time frame.

Upon submitting the proposed study plan for approval, but before receiving FDA approval of that plan, the Company issued its Registration Statement and a month later went public. The Registration Statement allegedly touted the device as, among other things, a "breakthrough product" with "compelling clinical data," but noted that the FDA had ordered the performance of a post-market surveillance study and failure to comply could result in the device's removal from the market.

According to the plaintiffs, the Company missed certain deadlines for submitting plans for its post-market surveillance study, and when it did submit such plans, the FDA deemed them inadequate. As a result, one year after its IPO, the FDA issued a warning letter to the Company, stating that (i) the Company had not made satisfactory progress towards commencing an approved post-market surveillance study; (ii) the device was "misbranded;" and (iii) the Company would be sanctioned if it did not take corrective action. In the year between the IPO and its receipt of the warning letter, the Company allegedly did not disclose that the FDA was dissatisfied with the Company's progress towards commencing the study. And in subsequent quarterly and annual disclosures, the Company allegedly continued to tout the device and assure investors it was making progress in commencing the post-market study. Plaintiffs alleged that the Company waited six months after receiving the warning letter to disclose it to the public, doing so just days before the FDA was scheduled to make the letter public.

In January 2017, the plaintiffs filed the proposed class action complaint focusing only on alleged misrepresentations in the Registration Statement. In August 2017, plaintiffs amended the complaint to include claims under Section 10b and Rule 10b-5 of the Exchange Act, further alleging that the Company failed to disclose the FDA's dissatisfaction with its progress towards commencing its study.

The lower court dismissed the Securities Act claims, holding that the plaintiffs failed to allege any false or misleading statements or omissions. It similarly dismissed the Exchange Act claims, holding that (i) lead plaintiff purchased his securities well before the Company made the alleged misstatements or omissions; and (ii) lead plaintiff, after the supplemental briefing, had not plausibly alleged that a common fraudulent scheme united the alleged misrepresentations in the Registration Statement and those made in public filings and on investor calls after the Company's IPO. The lower court further held that, because lead plaintiff's Exchange Act claims failed, he lacked standing to move to amend the complaint to add another lead plaintiff to pursue these claims.

The First Circuit initially considered the alleged misrepresentations in the Registration Statement and affirmed the lower court's decision that the lead plaintiff failed to allege any actionable misstatement or omission. According to the lead plaintiff's principal theory of liability, the Company's description of the FDA's evaluation of the device's safety was misleading because "the FDA specifically determined . . . that the device's failure to prevent a fall would be reasonably likely to cause serious injury or death;" thus, any "boilerplate recitation of the potential adverse regulatory consequences was rendered meaningless." The First Circuit disagreed, finding the cautionary language sufficient. The court noted that no reasonable investor would conclude that the FDA was concerned with "mere bumps and bruises" when the Registration Statement disclosed that a "user could experience death or serious injury" if the device were to malfunction and that, as a result, the Company needed to "demonstrate reasonable assurance of safety" to the FDA in the device's post-market study. The court similarly held that other alleged misstatements, such as the Company touting its "compelling clinical data" or "breakthrough device," were inactionable statements of mere puffery. Further, the court affirmed the lower court's dismissal of any potential claims under Regulation S-K, holding that regardless of whether these claims were adequately pleaded, they failed for the same reason that plaintiffs' other Securities Act claims failed—the Registration Statement's risk disclosures were adequate.

Finally, the First Circuit rejected the plaintiffs' procedural objection that the district court had improperly dismissed some of the alleged misstatements "*sua sponte*" relying on the statutory safe harbor for forward-looking statements. The court held that whilst "it is sometimes inappropriate for a district court to advance on its own a reason to dismiss a claim," the issue the lower court addressed posed a "pure issue of law," the plaintiffs "lost no chance to marshal any

supporting arguments" on appeal and the plaintiffs failed to point to anything that they would have added to the appellate record had the Company raised the argument itself.

Turning to the Exchange Act claims and the alleged misrepresentations on investor calls after the IPO, the First Circuit held that the lead plaintiff lacked standing to challenge the alleged misstatements because they occurred months after his purchases of the Company's stock. Agreeing with the lower court, the court held that the lead plaintiff had not sufficiently alleged that the Company had "engaged in a 'common scheme' that tied together claimants who purchased in the IPO with claimants who purchased after the IPO." According to the court, the lead plaintiff failed to adequately allege any misstatement or omission in the Registration Statement and, therefore, the Company's repetition of the same alleged misstatements on investor calls after the Company's IPO cannot establish a "common scheme." Accordingly, "even if fraud occurred after the IPO, there is no basis for claiming that it commenced *before* the IPO." As such, the court found that the Exchange Act claims "rise or fall . . . on consideration of [the Company's] decision not to disclose the difficulties it was having after the IPO in seeking approval by the FDA for its study plan"—which occurred after lead plaintiff purchased the Company's stock. The court therefore concluded that "it would hardly serve the interests of class members who may have valid claims based on their facts to be represented by a person whose facts dictate he or she will lose the case even if the class members might have won."

The First Circuit did, however, disagree with the lower court's reasoning in dismissing the Exchange Act claims, which the district court dismissed because the lead plaintiff "had no standing to ask the court to do anything at all, including adding a party." Whilst the court acknowledged that certain cases support this "formalistic approach," it noted that the First Circuit "matter-of-factly" follows the Supreme Court's approach in *Sierra Club v. Morton*, where the Supreme Court held that although Sierra Club lacked standing, it could amend its complaint to plead new facts that would support standing. Citing to cases in the First Circuit "reversing the denial of a motion to amend where the amended pleading established Article III standing by adding facts not contained in prior complaints" and Congress' endorsement of this approach, the First Circuit determined that it "[saw] no reason why this permissiveness does not extend to motions seeking to add a named party asserting the exact same claims that is already pleaded in the complaint."

Although the First Circuit disagreed with the lower court's standing analysis as it pertained to the Exchange Act claims, the court nevertheless held that such claims were properly dismissed. In so holding, the court noted that it has the discretion to affirm the lower court's decision on alternative grounds and that the parties had anticipated such a possibility in their briefing. In particular, the court held that the amended complaint had not adequately pled scienter because (i) the majority of the alleged misstatements or omissions concern "run-of-the-mill regulatory back-and-forths;" (ii) the Company has no affirmative obligation to disclose "each detail of every communication with the FDA;" and (iii) as the court previously had made clear, the Company's risk disclosures were adequate.

The First Circuit noted that whilst the Company's receipt of the FDA warning letter might be the exception to the Company's "run-of-the-mill" exchanges with the FDA, the FDA took no action against the Company at the time it issued the warning letter and merely stated that the failure to take corrective action "may" result in sanctions. The court further held that even if the Company failed to demonstrate a "sense of urgency" after receiving the FDA warning letter, such "lack of urgency might amount to poor management, [but] such a failing does not amount to securities fraud."

Having found that plaintiffs failed to adequately plead a material misstatement or scienter, the First Circuit affirmed the lower court's dismissal of the amended complaint. The ReWalk decision highlights the focus of the plaintiffs' bar on bringing securities fraud cases in the wake of negative regulatory actions and the need for companies to provide robust warnings to investors as to the scope and potential consequences of their dealings with regulators.

Fifth Circuit Affirms Decision to Dismiss Putative Securities Class Action in Nabors-Tesco Merger

On August 19, 2020, the U.S. Court of Appeals for the Fifth Circuit upheld the trial court's decision to dismiss a putative securities class action that stemmed from a merger between Tesco Corporation (**Tesco**) and Nabors Industries Ltd. (**Nabors**). Nabors, a company that provides drilling and drilling-related services for oil and gas wells, proposed an all-stock acquisition to combine with Tesco, an Alberta-incorporated company that provides technologies related to the drilling, servicing and completion of wells for the upstream energy industry.

The proposed merger was approved by Tesco's shareholders and received preliminary and final approval from an Alberta court. Shareholder plaintiffs, however, filed suit in the U.S. District Court for the Southern District of Texas alleging that Tesco misleadingly omitted or misstated material information in the Schedule 14A proxy statement in violation of the Exchange Act. Specifically, the plaintiffs argued that the proxy was materially misleading because it (i) described the premium that Tesco shareholders would receive as "significant;" (ii) omitted projections for Tesco's revenue and EBITDA for 2019 and beyond; (iii) omitted unlevered cash flow projections; (iv) failed to disclose projections based on the growth potential of implied per share equity value ranges; and (v) omitted details of the analyses performed by J.P. Morgan Securities LLC, which was retained to analyze the proposed merger. The lower court dismissed all of the claims with prejudice.

In *Heinze v. Tesco*, the Fifth Circuit (which hears appeals from Texas, Louisiana and Mississippi) agreed with the lower court's holding that none of the omissions rendered any of the proxy's statements materially misleading. First, the court held that a reasonable investor would not have relied on the characterization of the premium as "significant" in light of the fact that the actual amount, 19 percent, had been disclosed in the proxy. Second, the court found that the plaintiffs failed to identify how any of the alleged omissions were materially misleading beyond the "rank speculation" that oil prices would increase from 2019 through 2022. The court found that the defendants' failure to disclose this bullish forecast of oil prices did not come close to rendering the proxy's statements misleading. Thus, the plaintiffs alleged an incognizable "pure-omission theory that is untethered to any specific false or misleading representation in the proxy statement." Finally, even if the statements were linked to a specific representation in the proxy, the revenue and EBITDA projections were prefaced as "forecasts" and "projections" and accompanied by meaningful, cautionary language. As a result, they "fall comfortably within the safe harbor" of the Private Securities Litigation Reform Act.

In recent years, merger-related suits have made up a growing share of all federal securities class actions. At a minimum, Heinze clarifies that plaintiffs must plead more than pure omission allegations to get past a motion to dismiss in these cases.

Dismissal for Altice in a Putative Securities Class Action in New York State Court

On June 26, 2020, a court in New York Supreme Court, Queens County dismissed a securities class action brought against Altice USA, its board of directors and Altice Europe, alleging Securities Act claims based on supposed misstatements in Altice USA's initial offering prospectus. Shearman & Sterling represented the defendants in the case.

The case, which is a consolidation of seven different state court actions, arose from alleged misstatements and omissions about the strength and application of an Altice business strategy called the "Altice Way." The plaintiffs asserted that, contrary to the optimistic statements in the prospectus, one component of the "Altice Way" strategy had not been fully implemented by Altice Europe in France. Moreover, the plaintiffs argued that the poor financial performance of the French and Portuguese subsidiaries of Altice Europe cast doubt on the viability of the "Altice Way" strategy and that the performance of these subsidiaries was a trend that should have been disclosed to Altice USA investors.

In granting defendants' motion to dismiss, the court ruled that:

- the challenged statements describing the "Altice Way" as a successful business model were non-actionable expressions of general corporate optimism;
- the prospectus contained extensive risk factors regarding Altice USA's commercial prospects;
- the allegation that one component of the "Altice Way" was not yet fully implemented in France could not support a cognizable claim against Altice USA because the prospectus did not claim the Altice Way had been perfectly executed in all countries and it was not a material omission as to Altice USA; and
- plaintiffs' "trend" allegations—based on Items 303 and 503 of Regulation S-K—were defective because the plaintiffs failed to allege that the poor financial performance in France and Portugal was occurring or known at the time of Altice USA's IPO. In addition, the court held that alleged trends at Altice USA's foreign counterparts in France and Portugal did not directly impact Altice USA, and that the prospectus did not contain any information or statements regarding Altice Europe's financial performance.

In the wake of the Supreme Court's decision in *Cyan, Inc. v. Beaver County Employees Retirement Fund*, which confirmed that securities class actions alleging Securities Act claims can be brought in state court, it is likely that companies will face an increasing number of similar suits in New York state court. The Altice decision provides a helpful precedent for companies seeking a potential dismissal of this type of case.

DOJ Releases First FCPA Opinion in Six Years, Approving Legitimate Payments to Government Instrumentalities

On August 14, 2020, the DOJ released its first FCPA opinion (the **August 14 Opinion**) in six years, in response to a request from a multinational company headquartered in the U.S. (the **Requestor**). The Requestor sought to clarify whether contemplated payments to a majority government-owned foreign investment bank would result in an FCPA enforcement action against it. The DOJ found that the facts and circumstances as presented by the Requestor evidenced a payment to a foreign government instrumentality, and not a "foreign official," and were in any event supported by a proper business justification. As a result, the payment would not violate the anti-bribery provisions of the FCPA.

The release of the August 14 Opinion is significant in large part because it represents a revival of a dormant practice. The opinion procedure was established to allow companies to make specific inquiries and help them comply with the FCPA, but the last FCPA opinion was released by the DOJ in late 2014. Notably, in 2018, then-Deputy Assistant Attorney General Matthew Miner stated that not enough companies were "taking advantage" of the opinion procedure which the DOJ views as a "tremendous resource" to companies in complying with the FCPA.

As evidenced by the August 14 Opinion, the process of obtaining an opinion can be lengthy, because the DOJ may seek additional details after a requesting company submits its initial request. In this case, the Requestor submitted its initial request in November 2019, and even though the issue presented appears relatively straightforward (a payment to a foreign government-owned company is clearly different from a payment to a "foreign official"), the Requestor apparently was asked to provide supplemental information on several different occasions.

As outlined in the August 14 Opinion, the Requestor presented the following prospective—not hypothetical—conduct for the DOJ's consideration: the Requestor sought to purchase a portfolio of assets in Country A from the foreign subsidiary of a foreign investment bank, which was indirectly majority-owned by a foreign government. In connection with the same purchase, the Requestor sought and received assistance in Country B from a different foreign subsidiary of the same investment bank. The Requestor also sought the assistance of a local partner with respect to the purchase of assets from the foreign subsidiary in Country A.

Following the successful purchase of assets, the subsidiary in Country B sought a fee of $237,500 (equaling approximately 0.5 percent of the face value of the assets in question) from the Requestor for the work that the subsidiary in Country B had done. The Requestor represented to the DOJ that this contemplated fee was "justified

and commercially reasonable" because the subsidiary in Country B did provide legitimate services during the relevant period.

In determining that it did not presently intend to take any enforcement action against the Requestor, the DOJ found, based on the facts and circumstances presented, that there was "no information evincing a corrupt intent to offer, promise, or pay anything of value to a 'foreign official' in connection with the contemplated payment."

First, the DOJ found that the contemplated payment was to a commercial entity and not to an individual. The DOJ noted that the FCPA does not prohibit the payment to foreign governments or foreign government instrumentalities, although payments to "foreign officials" are prohibited.

Second, the DOJ found that there were no indications that the Requestor intended or believed that the money would be diverted to an individual. Notably, the Chief Compliance Officer of the subsidiary in Country B certified to the Requestor that the payment was for corporate purposes and would not be diverted to an individual. And even though the company was a wholly-owned subsidiary of a foreign investment bank that was indirectly owned by a foreign government, there were no other indicators that the contemplated payment to the subsidiary in Country B would be used to corruptly influence a "foreign official."

Finally, the DOJ found that the Requestor represented that it sought and received specific and legitimate services from the subsidiary in Country B, with the Requestor representing, and the Chief Compliance Officer of the foreign subsidiary certifying, that the intended payment was "commensurate with the services . . . provided and is commercially reasonable."

The key takeaway from the August 14 Opinion is that justified and commercially reasonable payments to foreign government agencies or instrumentalities will not be considered a violation of the anti-bribery provisions of the FCPA, as long as there are no indicia that the entity is, in fact, acting as a conduit for improper payments to a foreign official. Whilst the opinion may have no precedential value for companies other than the Requestor, it provides an important marker on a critical delineation in the FCPA that can sometimes be overlooked, causing companies to avoid dealing with government agencies and government-owned or -controlled entities for entirely legitimate purposes. That said, companies should, of course, continue to employ heightened diligence and controls when dealing with a government-affiliated entity.

FCPA Settlements

There were a number of significant FCPA settlements announced in the third quarter of 2020.

Alexion Pharmaceuticals to Pay More Than $21 Million

On July 2, 2020, the SEC announced that Alexion Pharmaceuticals Inc. agreed to pay more than $21 million to resolve charges that it had violated the books and records and internal accounting controls provisions of the FCPA. The SEC order stated that two of the company's subsidiaries had made payments to foreign government officials in order to secure favorable treatment of Alexion's primary drug, Soliris. The company neither admitted nor denied the SEC's findings.

World Acceptance Corp. to Pay $21.7 million

On August 6, 2020, the SEC announced a settlement with World Acceptance Corporation, a South-Carolina based consumer loan company, which agreed to pay $21.7 million to resolve charges that it had violated the anti-bribery, books and records and internal accounting controls of the FCPA. The SEC order found that a Mexican subsidiary of the company had, over more than six years, paid more than $4 million in bribes to Mexican government officials and union officials to secure the ability to make loans to government employees and to ensure those loans were timely repaid. The SEC found that those bribes were inaccurately recorded as legitimate business expenses. The SEC further

found that the company lacked internal accounting controls sufficient to detect or prevent the payment of such bribes, and that management lacked the appropriate tone at the top regarding internal audit and compliance. The company neither admitted nor denied the SEC's findings.

Herbalife to Pay More Than $123 Million

On August 28, 2020, the SEC announced that Herbalife Nutrition Ltd. agreed to pay more than $67 million to settle charges that it violated the books and records and internal accounting controls provisions of the FCPA. In a parallel action, the DOJ and the U.S. Attorney's Office for the Southern District of New York announced the company would pay a criminal fine of more than $55 million. The SEC order found that Chinese subsidiaries of Herbalife made payments and provided meals, gifts and other benefits to Chinese government officials in connection with curtailing government investigations of Herbalife China, obtaining sales licenses and removing negative coverage of Herbalife China in state-run media.

S.D.N.Y. Grants Summary Judgment for SEC on Issue of Whether Issuance of Digital Assets Was a Securities Offering

On September 30, 2020, a court in the U.S. District Court for the Southern District of New York granted summary judgment for the SEC in the closely-watched matter of *SEC v. Kik Interactive Inc*. The court found that Kik Interactive Inc's (**Kik**) offering of "Kin," its native digital asset, constituted an unregistered securities offering in violation of Section 5 of the Securities Act of 1933. Paired with a similar ruling for the SEC in the *SEC v. Telegram* matter, the Kik ruling is a second win for the SEC in finding that digital assets are securities.

Kik was founded in 2009 and it launched a messaging application in 2010. Kik subsequently developed "Kin," a cryptocurrency stored, transferred and recorded on the Ethereum blockchain, which it envisioned as a means of buying and selling digital products and services in various digital applications. Kik publicly announced its plans for Kin in a May 25, 2017 white paper, and internally set a fundraising goal of $100 million. In addition, the court noted that Kik embarked on a multi-city "roadshow" to promote Kin, and Kik's CEO publicly stated that buyers of Kin "could make a lot of money."

Kik structured its sale of Kin in two phases: a private offering (the **Pre-Sale**) and a public offering (the Token Distribution Event or **TDE**). Kik intended that the Pre-Sale would be an exempt securities offering to accredited investors pursuant to Rule 506(c), and that the subsequent TDE would not qualify as a securities offering because the Kin would be sold for consumptive use. As part of the Pre-Sale, Kik entered into agreements with 50 accredited investors and conveyed to these Pre-Sale investors the right to buy Kin at a discount of the public offering price. The agreements explicitly acknowledged that securities were being sold, and that the proceeds would go towards developing the "Kin Ecosystem." Kik raised $50 million from the Pre-Sale and claimed exemption under Rule 506(c).

The day after the private sale ended, Kik began its public offering, or TDE. As of the end date of the TDE, no goods or services were available for sale to holders of Kin; the court noted that the only accessible product was a digital wallet that showed the holder's balance and "digital stickers of undefined use or purpose." Despite this, the agreement governing the TDE described Kin as "intended to be used for [the purchase or sale] of digital services." Kik sold nearly $50 million worth of Kin in the TDE, but it retained 30 percent of the issued tokens for itself and distributed 60 percent of the issued tokens to the Kin Foundation, an affiliated non-profit entity.

Based on these facts, the SEC filed suit in June 2019, seeking injunctive relief enjoining Kik's unregistered sale of Kin, disgorgement of ill-gotten gains and monetary penalties. After extensive fact discovery, both parties cross-moved for summary judgment.

The court held that the TDE constituted an unregistered securities offering in violation of Section 5, and rejected Kik's argument that the TDE did not meet the definition of an investment contract. The court analyzed whether the sale

constituted an investment contract based on the three-prong test articulated by the Supreme Court in *SEC v. W. J. Howey Co*., and noted that there was no "direct precedent in relation to cryptocurrencies" on this issue. Because Kik conceded the first prong of the *Howey* test, that the TDE involved an investment of money, the court analyzed only the second and third prongs of the Howey test.

As to whether the TDE reflected a "common enterprise," the court found that this can be shown by "horizontal commonality: the tying of each individual investor's fortunes to the fortunes of the other investors by the pooling of assets." The court found that this prong was satisfied by Kik's pooling of the raised funds into a single bank account that it used to build the digital ecosystem, the success of which "drove demand for Kin and thus dictated investor's profits." The court rejected the argument that a "contractual obligation" between investors and Kik was required, focusing instead on the "economic reality" that the value of Kin was dependent on Kik's efforts to grow the Kin ecosystem.

As to the "expectation of profits based on the efforts of others" prong, the court found that investor's expectation of profit in Kin outweighed any potential consumptive use. In support of this finding, the court again quoted the CEO's statement that investors "could make a lot of money" from buying Kin, and also focused on the structure of the offering, which limited the supply of Kin "so as demand increased, the value of Kin would increase, and early purchasers would have the opportunity to earn a profit." The court concluded that none of the potential consumptive use was available at the time of the TDE and it "would materialize only if the enterprise advertised by Kik turned out to be successful." The court further distinguished case law from the real estate context, because unlike real estate, Kin has "no inherent value and will generate no profit absent an ecosystem" to drive demand, the creation of which was heavily reliant on Kik's entrepreneurial and managerial efforts.

The court also held that the Pre-Sale was integrated with the unregistered TDE, and thus did not qualify under the claimed exemption. Focusing on the five factors set forth in the SEC rules, the court found that the Pre-Sale and TDE were structurally "intertwined" and thus were "a single plan of financing . . . made for the same general purpose." Although the court noted that Kik received different forms of consideration in the two sales, this did not outweigh the finding that the two offerings were "interdependent" and thus did not qualify for exemption under Rule 506(c). The court also rejected Kik's argument that the investment contract standard was unconstitutionally vague, finding that *Howey* and its progeny provided sufficiently objective guidance so as not to encourage arbitrary or discriminatory enforcement. Having ruled in favor of the SEC, the court set a schedule for the ordering of the requested injunctive and monetary relief in the coming weeks.

The *Kik* ruling is one of the most definitive opinions yet on the application of the *Howey* test to the sale of digital assets. Although it is limited to its facts, and it remains to be seen if the U.S. Court of Appeals for the Second Circuit will have an opportunity to review it, *Kik* will serve as a guardrail to potential offerors of digital tokens as to offering structures that are unlikely to pass muster under this evolving area of law.

EU DEVELOPMENTS

Developments Related to the Prospectus Regulation

Prospectus Regulation: ESMA Revises Guidelines on Disclosure Requirements

On July 15, 2020, the European Securities and Markets Authority (**ESMA**) announced that it had published a final report incorporating a revised version of its guidelines on disclosure requirements (the **Guidelines**) under the Prospectus Regulation (EU) 2017/1129 (the **Prospectus Regulation**) and a summary of the responses to its related consultation.

The Guidelines are primarily based on the recommendations of ESMA's predecessor, the Committee of European Securities Regulators (the **CESR**), first issued in 2005 and then reissued by ESMA in 2011 and updated in 2013.

The purpose of the Guidelines is to promote a uniform understanding among market participants of the disclosure requirements laid out in the annexes of the Commission Delegated Regulation (EU) 2019/980.

The Guidelines cover a variety of financial and non-financial topics, including pro forma information; working capital statements; capitalization and indebtedness; profit forecasts and estimates; historical financial information; operating and financial review; options agreements; and collective investment undertakings.

In general, respondents to the consultation, including ESMA's Securities and Markets Stakeholder Group, were satisfied with the proposed Guidelines.

Although the Guidelines broadly replicate the content of the CESR recommendations, there are a number of alterations and additions to the effect that:

- the operating and financial review should include the extent to which the issuer's earnings and cash flow are likely to be impacted by the issuer's financial and nonfinancial objectives and strategy;
- the restrictions concerning the use of capital resources has been upgraded from explanatory text to a guideline;
- the principles for preparing profit forecasts and estimates apply to profit forecasts and estimates in supplements or amendments;
- those responsible for the prospectus should ensure comparability between the restated financial statements and the previous financial statements;
- those responsible for the prospectus should explain to the competent authority why they consider the inclusion of pro forma financial information to be disproportionately burdensome if they wish to exclude it;
- all amounts which are reasonably expected to be received or fall due within a minimum of 12 months from the date of approval of the prospectus should be included in an issuer's working capital statement; and
- trade payables and trade receivables do not need to be included in an indebtedness statement.

The Guidelines will become effective two months after being published on ESMA's website in all official European Union (the **EU**) languages.

COVID-19: Commission Temporarily Adopts Simplified Prospectus Regime

On July 24, 2020, the European Commission (the **Commission**) adopted a draft amending regulation to amend the Prospectus Regulation with a view to facilitating the recapitalization of companies affected by the economic impact of COVID-19.

The proposed amendments include the introduction of a simplified prospectus (the **EU Recovery Prospectus**) in relation to secondary issuances of shares by issuers that are already admitted to trading on a regulated market or a small and medium enterprise (**SME**) growth market for a continuous period of at least 18 months. Under the new regime, the EU Recovery Prospectus:

- must be limited to a single document of 30 pages, focusing only on the essential information required to make an informed investment decision, and should include, as a minimum, the name of the issuer, a responsibility statement, financial statements, the final offer price, reasons for the offer and use of proceeds, a working capital statement, any conflicts of interest and the shareholding after issuance;

- should include a summary of no more than two sides of A4 paper including: (i) an introduction containing a warning that the investor could lose all or part of the invested capital, that the investor may have to bear certain legal costs should a claim relating to the prospectus be brought before a court and that any decision to invest in the securities should be based on a consideration of the prospectus as a whole by the investor; (ii) key information on the issuer; (iii) key information on the securities; and (iv) key information on the offer of securities to the public or the admission to trading on a regulated market or both; and
- will benefit from a fast-track approval process of no more than five working days.

The new regime is intended to be temporary and will expire after an 18-month period of application.

The proposed amendments also relate to supplementary prospectus and credit unions.

In relation to supplementary prospectuses, the amendment to Article 23(3) of the Prospectus Regulation:

- clarifies that financial intermediaries only need to inform investors of the possibility of the publication of a supplement if they subscribed and purchased securities through a financial intermediary between the time of the approval of the prospectus and the closing of the offer period or the time when trading on a regulated market begins, whichever occurs later; and
- extends the deadline for (i) financial intermediaries to contact investors who subscribed and purchased securities in the circumstances outlined above and (ii) the right of an investor to withdraw their acceptance of an offer under Article 23(2) of the Prospectus Regulation to one working day from the publication of the supplement.

In relation to credit unions, the addition of new Article 1(4)(k) makes it easier for credit unions to raise additional funds on a regular basis without the need to issue a new prospectus each time as the amendment increases the prospectus exemption threshold in relation to certain non-equity securities from EUR 75 million to EUR 150 million calculated over a period of 12 months. The increased threshold is intended to be temporary and will expire after an 18-month period of application.

The draft amending regulation will be sent to the European Parliament and the Council of the EU for discussion and adoption and will enter into force on the 20th day following its publication in the Official Journal of the European Union (the **Official Journal**).

Commission Publishes Amending Prospectus Delegated Regulation

On September 14, 2020, Commission Delegated Regulation (EU) 2020/1273 amending and correcting various aspects of Commission Delegated Regulation (EU) 2019/980 was published in the Official Journal. The regulation relates to the format, content, scrutiny and approval of the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market.

For further details on the draft regulation, please refer to our Governance & Securities Law Focus, July 2020. The regulation is in substantially the same form as the draft regulation published by the Commission in June 2020.

The regulation came into force on September 17, 2020.

Commission Publishes Amending Prospectus Regulatory Technical Standards Regulation

On September 14, 2020, the Commission Delegated Regulation (EU) 2020/1272 amending and correcting the Prospectus Regulatory Technical Standards Regulation was published in the Official Journal. The regulation relates to regulatory technical standards on key financial information in the summary of a prospectus, the publication and classification of prospectuses, advertisements for securities, supplements to a prospectus and the notification portal.

For further details on the draft regulation, please refer to our Governance & Securities Law Focus, July 2020. The regulation is in substantially the same form as the draft regulation published by the Commission in June 2020.

The regulation came into force on September 17, 2020. Its provisions apply retrospectively, with effect from July 21, 2019, apart from the insertion of a new Article 22a (relating to summaries of prospectuses approved between July 21, 2019 and September 16, 2020 for non-financial entities issuing equity securities) which has been applicable from September 17, 2020.

Prospectus Regulation: ESMA Issues Statement on Prospectus Directive Q&As and CESR Recommendations

On September 30, 2020, ESMA issued a public statement on the Q&As that have been previously issued in relation to the Prospectus Directive (2003/71/EC) (the **Prospectus Directive**) and on the applicability of the CESR recommendations relating to property, mineral, scientific research-based, start-up and shipping companies (**Specialist Issuers**).

With respect to the Prospectus Directive Q&As, ESMA announced that they will be, as applicable:

- deleted as no longer being relevant under the Prospectus Regulation;
- updated by ESMA in the coming months;
- transferred to the Commission for potential update; and
- continue to be applicable to the Prospectus Regulation, having already been updated.

With respect to the CESR recommendations for Specialist Issuers, ESMA stressed that the recommendations have not been abolished even though they have not been covered in the guidelines on prospectus disclosure. ESMA stated that it plans to address such recommendations in the future and that issuers should, in the meantime, continue to comply with them in accordance with Prospectus Regulation Q&A 2.1.

Developments Related to Environmental Regulation

Commission Publishes Roadmap on Taxonomy-Related Disclosures

On July 28, 2020, the Commission published a roadmap on a delegated act, to be adopted by June 2021, supplementing the Taxonomy Regulation (EU) 2020/852 (the **Taxonomy Regulation**).

The Taxonomy Regulation requires large banks and insurance companies, and listed companies with more than 500 employees, to publish information under the Non-Financial Reporting Directive 2014/95/EU (the **NFRD**) on how, and to what extent, their activities are environmentally sustainable. More specifically, the NFRD obliges such undertakings to disclose the proportion of their turnover, investments and expenditures that is related to environmentally sustainable activities.

The Commission intends to consider whether these indicators should be further specified in the delegated act and whether different indicators for financial undertakings under the NFRD should be developed for that purpose.

Commission Publishes Initiative to Tackle "Greenwashing"

On July 22, 2020, the Commission published feedback on an initiative requiring companies to substantiate claims relating to the environmental impact of their products and services. The intention of the initiative is to reduce "greenwashing"—the process of giving a false impression that a company's products and/or services are more environmentally sustainable than they are—and to make a company's environmental claims more reliable, comparable and verifiable across the EU.

Commission Adopts Delegated Regulations on Benchmarks Regulation

On July 17, 2020, the Commission adopted three delegated regulations which supplement the Benchmarks Regulation (EU) 2016/1011 (the **Benchmarks Regulation**) in relation to the minimum technical requirements for the methodology of EU climate benchmarks, and environmental, social and governance (**ESG**) disclosure requirements for benchmark administrators. The Benchmarks Regulation introduces a common framework to prevent manipulation of benchmarks referenced in financial instruments, financial contracts or investment funds in the EU.

The delegated regulations supplement the Benchmarks Regulation by setting out:

- an explanation in the benchmark statement (which outlines what a given benchmark intends to measure) of how benchmark ESG factors are reflected in each benchmark, or where applicable, a family of benchmarks provided and published;
- the minimum content of the explanation outlining how key elements of the benchmark methodology reflect ESG factors for each benchmark (with the exception of interest rate and foreign exchange benchmarks); and
- minimum standards for EU climate benchmarks and EU Paris-aligned benchmarks, and an explanation of the transparency requirements on the methodology for both benchmarks.

Developments Related to Brexit

Brexit: U.K. Publishes Equivalence Determinations for Financial Services (Amendment etc.) (EU Exit) Regulations

On September 29, 2020, the U.K. government (the **Government**) published the Equivalence Determinations for Financial Services (Amendment etc.) (EU Exit) Regulations 2020 (the **Regulations**). The purpose of the Regulations is to ensure a coherent and functioning financial services equivalence framework in the United Kingdom during and at the end of the transition period.

The Regulations provide that:

- equivalence determinations made before the end of the transition period will have effect as if made under the relevant provisions of retained EU law and, therefore, the other provisions of retained EU law will apply to them; and
- where such provisions determine that the information requirements imposed by the national law of a third country are equivalent to the requirements under the Prospectus Regulation, those provisions have effect as if made during the transition period.

The Regulations came into force on September 30, 2020.

Brexit: Commission Publishes Updated Notice to Stakeholders on EU Company Law

On July 3, 2020, the Commission published an updated notice to stakeholders on the implications of Brexit for EU rules on company law (the **Notice**).

The Notice states that after the transition period:

- national rules for mergers with companies established in third countries will apply to cross border mergers involving a U.K. incorporated company;
- EU rules on shareholder rights and engagement (the **Shareholder Rights Directive II**) will no longer apply to companies with U.K. registered offices or which are only listed on a U.K. stock exchange;
- the Takeovers Directive will no longer apply to securities traded in the U.K. and national rules for takeover bids will apply instead; and

- European Companies (**SE**s) with U.K.-registered offices no longer have the status of an SE, European Economic Interest Groupings (**EEIG**s) registered in the U.K. will no longer have the status of an EEIG and European Cooperative Societies (**SCE**s) registered in the U.K. will no longer have the status of an SCE.

Brexit: AFME Paper Calls for Cooperation on Future EU-U.K. Financial Services Relationship

On July 6, 2020, the Association for Financial Markets in Europe (the **AFME**) published a paper stressing the risks that uncertainty over Brexit in conjunction with the economic impact of COVID-19 pose to U.K. and European markets. In order to mitigate these risks, the AFME urges the EU and the U.K. to agree to:

- equivalency determinations and ensure that these are in place before the end of the transition period;
- a formalized framework for regulatory cooperation to build trust and ensure as much transparency as possible over equivalence processes; and
- close supervisory cooperation to ensure effective and efficient oversight of firms and cross-border activities.

The AFME proposes that an "EU-U.K. Regulatory forum" should be established to enhance regulatory cooperation and coordination between EU and U.K. regulators whilst preserving each other's autonomy over policy making.

Other Developments

Commission Sets Out Capital Markets Union Action Plan

On September 24, 2020, the Commission published a communication (the **Communication**) to EU bodies on its Capital Markets Union (**CMU**) action plan. The CMU is an EU initiative which aims to enhance and further integrate the capital markets of EU Member States. An action plan to develop the initiative was first adopted in 2015 and has been commented upon and updated since then. The Commission's Communication sets out the latest action plan and is accompanied by a Q&A. It follows the recommendations of the High-Level Forum on the CMU, which proposed 17 key recommendations for the CMU, and the Commission's roadmap on the CMU which set out details of the Commission's proposed action plan for comments by interested parties.

There are three key pillars to the Commission's latest CMU action plan, together with 16 proposed measures to help achieve those key objectives:

- Pillar 1 – Support a green, digital, inclusive and resilient economic recovery by making financing more accessible to European companies. Measures to achieve this include making companies more visible to cross-border investors, supporting access to public markets, supporting vehicles for long-term investment and encouraging more long-term and equity financing from institutional investors.
- Pillar 2 – Make the EU a safer place for individuals to save and invest long term. Measures to achieve this include improving EU citizens' financial literacy, building retail investors' trust in capital markets and supporting EU citizens in their retirement.
- Pillar 3 – Integrate national capital markets into a genuine single market. Measures to achieve this include alleviating the tax-associated burden in cross-border investment, making the outcome of cross-border investment more predictable with respect to insolvency proceedings, facilitating shareholder engagement and developing cross-border settlement services.

The Commission also notes that the coronavirus pandemic has made the consolidation of the CMU even more urgent, given the role banks will play in providing financing to sustain the recovery of the EU economy.

The Commission has simultaneously published Communications on its digital finance strategy and retail payments strategy for the coming years.

AML & CTF: Commission Extends Deadline for Feedback on AML and CTF Action Plan

On July 9, 2020, the Commission updated its webpage on its AML and CTF action plan to state that it has extended the deadline for feedback on the action plan to August 26, 2020 (the original deadline was July 29, 2020).

In its action plan of May 7, 2020, the Commission set out its views on the steps to be taken to establish a comprehensive EU-wide policy on preventing money laundering and terrorist financing. The public consultation provides an opportunity for interested parties to give feedback on each of the proposals in the action plan.

EU Securities Authority Recommends Changes to EU Market Abuse Regulation

On September 24, 2020, ESMA published a final report on the review of the Market Abuse Regulation (**MAR**). MAR requires the Commission to report on certain aspects of the operation of MAR, including where appropriate, making recommendations for legislative change. ESMA's final report and recommendations will support the work of the Commission on producing that report. The proposals will mostly affect issuers of financial instruments admitted to trading, as well as trading on a trading venue, and investment firms and asset management firms.

In its final report, ESMA makes several recommendations, including:

- that further consideration be given as to how the provisions of the Benchmark Regulation interact with MAR provisions and to establishing new powers for national regulators to impose administrative sanctions for breach of MAR on benchmark administrators and supervised contributors, such as withdrawal of authorization and prohibiting senior managers from exercising managerial functions;
- for issuers making use of the exemption for buy-back programs, proposing that MAR should be amended so that an issuer would only need to report information on buy-back program transactions to the national regulator of the trading venue that is most relevant in terms of liquidity of the shares. The information would need to cover all buy-back program transactions on all trading venues. To facilitate this, investment firms would need to provide the issuer with the name of the relevant national regulator. ESMA is also recommending that the information reported to a regulator be reduced to that which is relevant for the purpose;
- leaving the definition of "inside information" unchanged, except with respect to an issue of "front running," where ESMA recommends amending the definition of inside information to also cover the information on orders conveyed by persons other than clients, including managers of a proprietary account or a fund. No other recommendations are made to the definition (or any changes recommended to the conditions to delaying disclosure of inside information), but ESMA commits to providing further guidance on the application of the definition, delays to disclosure of inside information and pre-hedging;
- despite the vast majority of respondents to the consultation that ESMA carried out prior to issuing its final report objecting to this, ESMA recommends clarifying the market-sounding requirements under MAR to make it clear that they are mandatory for all disclosing market participants and not merely optional for the purposes of relying on the protection against unlawful disclosure that MAR provides when the requirements are followed. It also recommends the introduction of a specific sanction for violations of the market-sounding requirements and clarifying the position regarding market soundings where inside information is passed and those where it is not;
- clarifying the obligations of issuers to maintain insider lists, including allowing the issuer to include only one contact of a natural person for each legal person acting on its behalf or on its account and having access to inside information, making it clear that it is not just persons acting on behalf of an issuer who must maintain an insider list, but also others, such as external service providers (*e.g.*, auditors, financial intermediaries and

other advisers), performing tasks for the issuer through which they have access to inside information and requiring issuers to inform all such persons when they identify any information as inside information;

- not changing the current €5,000 and optional €20,000 notification thresholds for managers' transactions and not extending the prohibition on dealings during the closed periods of 30 days prior to the announcements of financial reports to issuers or "persons closely associated" with "persons discharging managerial responsibilities" (**PDMRs**). However, ESMA does recommend making certain limited extensions to the list of transactions that are exempted from the prohibition on dealings during the closed periods of 30 days prior to the announcements of financial reports;
- in relation to collective investment undertakings (**CIUs**), not extending the PDMR notification obligations to managers of management companies of CIUs and therefore, in the interests of consistency, excluding self-managed CIUs from the obligations in the regime for PDMRs and making certain clarifications to MAR with respect to the application of the disclosure of inside information and maintenance of insider lists to CIUs; and
- introducing a reinforced cooperation framework to facilitate the exchange of order book data between national competent authorities (**NCAs**) with standardization requirements for messages and validation of data and removing the legal limitations for national regulators to exchange information obtained through intra-EU cooperation and information exchange mechanisms with tax authorities. ESMA published a full report on the issue of dividend arbitrage schemes alongside its MAR Review Report.

ESMA does not recommend amending MAR to expand the remit of national securities regulators to investigate and sanction unfair behaviors carried out by regulated entities, beyond insider dealing and market manipulation, though it does recommend that the Commission consider changes to the current legal framework on cross-border enforcement of financial penalties issued under MAR. It also recommends deleting the five-year maximum retention period for personal data collected by NCAs in the course of carrying out their tasks under MAR.

ESMA also analyzed whether the scope of MAR should be extended to include foreign exchange spot contracts. ESMA refrains from making any recommendations on this point, stating that further work is needed, in particular in view of the current revisions being made to the FX Global Code and to ensure engagement with global stakeholders.

Non-Financial Reporting: International Financial Reporting Standards Foundation Publishes Paper on Sustainability Reporting

On September 30, 2020, the International Financial Reporting Standards (**IFRS**) Foundation published a consultation paper on sustainability reporting.

In its consultation paper, the IFRS Foundation seeks views on:

- whether it is necessary to have a global set of internationally recognized sustainability reporting standards, and if so, whether the IFRS Foundation should play a role in setting those standards;
- whether a sustainability standards board (**SSB**) operating under the IFRS Foundation would be a good way of achieving further consistency and global comparability in sustainability reporting;
- whether the IFRS Foundation, if it were to establish an SSB, should initially limit its focus to developing climate-related financial disclosures before potentially broadening its remit into other areas;
- whether an SSB should focus initially on sustainability information most relevant to investors, and subsequently consider how to provide a more comprehensive assessment of the risks and opportunities for a reporting entity; and

- whether sustainability information disclosed should be auditable or subject to external assurance.

Responses to the consultation must be received by the deadline of December 31, 2020.

U.K. DEVELOPMENTS

Developments Related to the Publication of the Corporate Insolvency and Governance Act 2020

The Corporate Insolvency and Governance (Coronavirus) (Extension of the Relevant Period) Regulations 2020

On September 24, 2020, regulations were laid before Parliament to extend the relevant periods during which certain requirements or conditions with respect to certain insolvency measures, including some of those introduced under the Corporate Insolvency and Governance Act 2020 (**CIGA 2020**) are relaxed (the **Extension Regulations**). The periods are extended beyond their original expiry date of September 30, 2020. The explanatory memorandum advises that the requirements affected consist of modifications to aspects of corporate insolvency law and company law so as to mitigate effects of coronavirus. They have been extended to the following dates:

- December 31, 2020 (for restrictions on winding-up petitions);
- December 30, 2020 (for provisions relating to company meetings); and
- March 30, 2021 (for the exclusion of "small suppliers" from the new "ipso facto" termination clauses ban and the temporary relaxation of certain moratorium requirements).

CIGA 2020 Provisions Extended to December 2020

The following measures are extended:

- The prohibition on presenting winding-up petitions based on statutory demands (until December 31, 2020).
- The prohibition on presenting winding-up petitions or making winding-up orders based on any other definition of the debtor's inability to pay its debts, unless coronavirus can be discounted as a reason for that inability (until December 31, 2020).
- The relaxation of the conditions for annual general and other meetings of "qualifying bodies" in Schedule 14 to CIGA 2020 (until December 30, 2020).

The Schedule 14 relaxation of conditions under CIGA 2020 are of particular relevance. The Schedule provides that company general meetings (and other specified meetings) do not have to be held in a particular place, can be held electronically or with participants in different places. It also provides that members do not have a right to attend, participate or vote in person. Effectively, the Schedule facilitates the use of online meetings during the coronavirus pandemic.

The U.K. Court of Appeal has also held that Schedule 14 provisions apply to shareholder meetings convened by the court to consider and approve schemes of arrangements under Part 26 of the Companies Act 2006, such as schemes in takeover situations.

CIGA 2020 Provisions Extended to March 2021

The following measures are extended until March 30, 2021:

- The temporary insolvency rules on procedural aspects of the part A1 moratorium (the **Part A1 Moratorium**), contained in Schedule 4 to CIGA 2020.
- The waiver of the requirement that a U.K. company seeking a Part A1 Moratorium must use a court application if they are subject to a winding-up petition.

- The relaxation of the requirement that a company seeking a Part A1 Moratorium has not been in an insolvency procedure or Part A1 Moratorium in the previous 12 months.
- The temporary exclusion of small suppliers from the effect of the restrictions on terminating supply contracts for insolvency.
- The prohibition on entities authorized to hold client money from obtaining a Part A1 Moratorium.
- The relaxation of the requirement that a company seeking a Part A1 Moratorium (or seeking to extend a moratorium as being required to bring it to an end) is likely to be rescued as a going concern as a result of the moratorium, where its potential failure is due to coronavirus.

CIGA 2020 includes a power for the Secretary of State for Business, Energy and Industrial Strategy (**BEIS**) to extend the relevant insolvency measures provided they deem it reasonable to mitigate an effect of coronavirus. Therefore, there is a possibility some of the measures might be extended beyond the revised end dates.

Corporate Insolvency and Governance (Coronavirus) (Early Termination of Certain Temporary Provisions) Regulations 2020

On September 25, 2020, a separate set of regulations (the **Early Termination Regulations**) were laid before Parliament, terminating certain provisions under CIGA 2020 that would otherwise have been extended to March 30, 2021 under the above Extension Regulations. The explanatory memorandum advises that the Early Termination Regulations are effectively a carve-out from the Extension Regulations and provide that certain provisions—*i.e.*, those mentioned in the last two bullet points above—in relation to moratoriums would terminate on October 1, 2020, rather than be extended.

Therefore, in effect, certain aspects of the Extension Regulations would be terminated by the Early Termination Regulations.

These provisions relax the conditions for obtaining a moratorium as well as modifying how a moratorium is to be monitored and extended.

CIGA 2020—Insolvency Practice Direction

On July 3, 2020, the Lord Chancellor approved and signed a new Insolvency Practice Direction (the **Practice Direction**) and an amendment to the Insolvency Proceedings Practice Direction 2018, which primarily take account of changes to insolvency practice pursuant to CIGA 2020.

The new Practice Direction contains provisions ensuring that a winding-up petition will remain private unless and until a judge has decided that the inability to pay the debt on which the statutory demand is based is not as a result of the coronavirus pandemic.

The provisions are backdated to June 26, 2020, when CIGA 2020 came into force.

This provides businesses with some relief from publication of winding-up petitions, provided they can demonstrate the inability to pay their debts is a result of the coronavirus pandemic.

CIGA 2020 was covered in detail in our Q2 2020 issue of this newsletter.

Other Developments

Enterprise Act 2002 Changes

On July 21, 2020, two orders made under the Enterprise Act 2020 (the **EA 2020**) came into force, together with the publication of Government guidance.

The two orders expand the Government's power to scrutinize and intervene in mergers which involve companies which have a bearing on national security in the fields of artificial intelligence, advanced materials and cryptographic authentication. The orders amend the jurisdictional thresholds for intervention under the EA 2020.

The jurisdictional threshold for the military sector, and companies designing or manufacturing items subject to export controls, was lowered in 2018 from £70 million to £1 million, whilst the share of supply test was amended to apply in any merger where a target had a share of supply of 25 percent or greater. These new 2020 orders expand the industries covered by these new threshold tests.

EA 2002 (Share of Supply Test) (Amendment) Order 2020

The order (the **2020 Order**) expands the circumstances in which the Secretary of State may make an intervention notice to the Competition and Markets Authority (the **CMA**) where there is a public interest consideration relevant to a merger situation.

In most cases, a relevant merger situation occurs where the value of the U.K. turnover of the target exceeds £70 million and the merger would result in a U.K. market share of at least 25 percent. The 2018 Share of Supply Order (the **2018 Order**) amended the normal share of supply test so that, in cases where the enterprise being taken over is a "relevant enterprise," that test is additionally met if the relevant enterprise has a 25 percent share of supply of goods or services in the U.K. before the merger.

The 2018 Order applied to certain "relevant enterprises," including military or dual-use goods that are subject to export control, computer processing units and quantum technology. The 2020 Order expands these "relevant enterprises" to include artificial intelligence, cryptographic authentication technology and advanced materials.

EA 2002 (Turnover Test) (Amendment) Order 2020

Similarly, the "Turnover Test Order" expands the same category of relevant enterprises to encompass the same additional sectors, building on a 2018 order which had reduced the "turnover threshold test" for CMA intervention from £70 million to £1 million for certain sectors.

The effect for business will be that much smaller companies might have to consider the regulatory and competition implications of a merger, if that merger would result in a change of ownership of a company operating in one of the additional sectors.

Guidance

The non-statutory guidance published alongside the two orders provides further information on their rationale and how businesses can operate under them. The guidance explains that the provisions have been introduced due to the considerable technological developments since 2018 and the changing nature of the threats to U.K. security. The guidance also clarifies what is not changed by the new orders.

Businesses involved in these sectors should review whether their operations fall within the definitions contained in the relevant orders. Mergers or acquisitions affected by the orders may become subject to statutory interventions from the CMA or Secretary of State, though companies can also voluntarily notify BEIS of any transactions.

Interventions by the Secretary of State can continue to be challenged by judicial review when parties are served (or not served) with a public interest notice, or by any decisions following Phase 1 or Phase 2 reports. Companies who believe they might be subject to the new orders would benefit from early and expert advice on their scope and the applicability to their circumstances.

Companies (Shareholders' Rights to Voting Confirmations) Regulations 2020

On July 9, 2020, the Companies (Shareholders' Rights to Voting Confirmations) Regulations 2020 were brought into force, implementing requirements of the Shareholder Rights Directive II. These regulations provide that traded companies (*i.e.*, companies whose voting shares are admitted to trading on an EEA-regulated market) must provide confirmation of a receipt of the votes cast on a poll electronically, and that shareholders have a right to request information from the company to enable them to determine that their vote has been validly recorded and counted.

In practice, this means that publicly-traded companies must take steps to ensure that they confirm receipt of all shareholders' votes cast during online polls, and put measures in place to ensure that votes are recorded, counted and accessible to the shareholder who cast them.

Government Response to BEIS Committee on Thomas Cook and Preventing Corporate Collapse

On July 14, 2020, BEIS published the Government's response to the BEIS Committee's recommendations concerning, among other things, corporate governance, audit reform and executive pay and bonuses following its inquiry examining the collapse of Thomas Cook.

The Government's response principally endorses the creation of a new statutory regulator, as recommended by the Kingman Review of the Financial Reporting Council (the **FRC**) in its 2018 report, and indicates the Government will respond with proposals for reform of company audit and legislation.

The response indicates that:

- The Government will proceed with the creation of a new regulator and give it stronger powers to scrutinize and enforce compliance with reporting requirements, especially on pay and corporate governance.
- The Government expects that executive-level pension contribution policies will match those that are available to the wider workforce, and that companies should have a plan to show how they are achieving this.
- The Government endorses the recommendations for clawback provisions in directors' contracts, allowing companies to withhold remuneration, which are also provided for in the U.K. Corporate Governance Code.
- The Government endorses a range of proposals in relation to tackling late payment of suppliers, including fines, binding payment plans and reviewing supply chain finance. The Government declined, however, to endorse a 30-day statutory limit for payment of suppliers.

Government Response to BEIS Consultation on Corporate Transparency and Register Reform

On September 18, 2020, BEIS published its response to the consultation on corporate transparency and Companies House register reform. BEIS had launched its consultation on a range of proposals to enhance the role of Companies House, increase the transparency of U.K. corporate entities and help combat economic crime.

The reforms cover four distinct areas:

- knowledge of who is setting up, managing and controlling corporate entities;
- improving the accuracy and usability of data on the companies register;
- protecting personal information; and
- ensuring compliance, sharing intelligence and other measures to deter abuse of corporate entities.

The response considers each of these areas.

Setting Up, Managing and Controlling Corporate Entities

The Government has stated its intention to introduce compulsory ID verification for all directors and "Persons with Significant Control" (**PSCs**) of U.K.-registered companies. Therefore, all company directors and PSCs will be required to create accounts on Companies House and undergo ID verification.

Improving the Accuracy and Usability of Data on the Companies Register

The registrar of companies will be given a statutory discretion to query and check information that is submitted to Companies House before it is placed on the register.

In relation to company accounts, the Government intends to:

- consult on proposals to introduce full Inline eXtensible Business Reporting Language, (or iXBRL) tagging for the submission of accounts to Companies House;
- tighten regulation regarding amendments to accounting reference periods to reduce the potential for abuse (*e.g.*, companies would only be able to shorten their accounting reference period once in five years); and
- review certain aspects of accounts filing, including the exemptions that allow companies to submit micro or dormant accounts.

Companies House will continue to retain company records for 20 years from the date of dissolution. Currently, six years of historic information is freely available online via the Companies House service. The Government intends to make all dissolved records since 2010 freely available early in 2021. Whilst there is an intention for all 20 years' worth of dissolved company records to be made available, the Government will only action this once legislation is introduced to provide individuals with a simple process for requesting that personal information is protected (where appropriate).

Protecting Personal Information

To protect personal information, directors will no longer be required to list their occupation on the register and a process will be set up for individuals to suppress this information where it is currently displayed on the register. A process will also be introduced to enable individuals to have signatures, date of birth and residential addresses suppressed from the register.

Ensuring Compliance, Sharing Intelligence and Other Measures to Deter Abuse of Corporate Entities

To enable better information sharing, the Government will introduce an obligation on bodies that fall under the remit of the Money Laundering and Terrorist Financing (Amendment) Regulations 2019 to report to the registrar discrepancies between the information held on the public register and the information that they hold.

Companies House will be given the power to query, and possibly reject, company names before registration.

The Government intends to publish a comprehensive and detailed set of proposals that will set out how the Government believes that these reforms should be implemented.

Treasury Consults on Proposed Reforms to Regulatory Framework for Financial Promotion Approvals and Unregulated Crypto Assets

Financial Promotion Approvals Consultation

On July 20, 2020, the Treasury announced proposals to amend the U.K.'s financial promotion rules to provide increased consumer protection from misleading advertisements and a lack of suitable information.

The U.K. financial promotion rules provide that a person may not communicate a financial promotion—an invitation or inducement to engage in an investment activity—unless the communication is exempt, the firm is authorized to carry on a regulated activity or the communication is approved by an authorized firm. Only financial promotions that are not

real-time may be approved by an authorized person, and any approval must comply with the Financial Conduct Authority's (**FCA**) financial promotion rules. Any communication must be fair, clear and not misleading.

The Government is proposing to amend the financial promotion rules for promotions by unauthorized firms which are approved by authorized firms. Responses to the consultation could be submitted until October 25, 2020. It has been identified that the current regime can lead to consumers losing money, investors being re-directed away from more appropriate products and result in loss of consumer confidence. These situations may arise because the firms approving financial promotions do not have the relevant expertise for the product or service being promoted and the authorized firm does not conduct the appropriate due diligence. In the Treasury's view, this results in a reduced ability for the FCA to appropriately regulate all financial promotions.

The Government is therefore proposing to limit the ability to approve financial promotions of unauthorized firms to authorized firms that obtain the specific consent of the FCA to do so. Consent would not be required for the approval of promotions of unauthorized entities within the same group of an authorized firm or to the approval by an authorized firm of its own financial promotions. The intention of the proposal is to provide the FCA with the information it needs to supervise these financial promotions, giving the regulator the ability to assess a firm's suitability and competence to approve financial promotions as well as remove its consent for a firm to do so. It is also envisaged that the FCA's consent could be tailored to limit the types of products for which a firm could provide approval.

The Government is also seeking feedback on whether to implement the changes through FCA rules or by making "approval of financial promotions" a regulated activity in the Regulated Activities Order. It proposes adopting the former option.

Promotion of Unregulated Crypto-Assets Consultation

Alongside its proposals on misleading advertisements, the Treasury also released proposals to amend the U.K.'s financial promotion rules to subject unregulated crypto-assets to the financial promotions regime. The government proposals aim to enhance consumer protection, ensure market integrity and fight against financial crime. Responses to the consultation could be submitted until October 25, 2020.

In line with the FCA's guidance on which crypto-assets fall within the U.K. regulatory perimeter, certain securities tokens and e-money tokens are subject to regulation and subject to the financial promotion regime. However, the promotion of unregulated crypto-assets does not need to comply with the financial promotion requirements. The Government is therefore proposing to amend the Financial Promotion Order (**FPO**) to add unregulated crypto-assets to the list of controlled investments. The change would capture within the financial promotion rules all stablecoins not currently classed as a regulated security or e-money token. However, only crypto-assets that are both fungible and transferable would be within scope of the regime. In addition, a new exemption to the FPO would exempt vendors offering to accept crypto-assets in exchange for goods or services and buyers offering crypto-assets to pay for goods or services.

FCA Statement on Listings of Cannabis-Related Businesses

On September 18, 2020, the FCA published a statement on the listing of cannabis-related businesses, pending a guidance consultation, stating it will not be admitting securities of recreational cannabis companies to the FCA's Official List; however, medicinal cannabis companies may be listed provided that they have appropriate licenses for their activities.

Further, the statement confirmed that proceeds of investment in recreational cannabis companies would be treated as proceeds of crime, subject to the Proceeds of Crime Act 2002 (**POCA**), even in instances where the company is located in a jurisdiction that has legalized recreational use of cannabis. This is because POCA captures proceeds not

only from an offence in any part of the U.K., but also any conduct outside of the U.K. which would be criminal in the U.K. if carried out here.

Overseas-licensed medicinal cannabis companies and cannabis oil companies may be admitted to the Official List, provided the FCA is satisfied that POCA does not apply and they otherwise satisfy the criteria for listing.

FCA 30th Primary Market Bulletin

On August 19, 2020, the FCA published its 30th Primary Market Bulletin, including the outcome of guidance consultations and a new consultation on when prospectuses are required where securities are issued pursuant to schemes of arrangement under the U.K. Companies Act 2020.

The Bulletin consults on a new FCA technical note, “When a prospectus is required where securities are issued pursuant to Schemes of Arrangement” (Primary Market/TN/606.1). The note acknowledges the longstanding and common view among practitioners that an issuance of securities pursuant to a scheme of arrangement should not trigger the requirement for a prospectus as the issuance does not fall within the definition of public offer, on the basis that that there is no offer which enables investors to buy or subscribe for securities; instead, there is a court procedure under which members/creditors are asked to vote on and approve an arrangement which results in the allotment of securities to shareholders.

The Bulletin gives the FCA’s view that where a scheme of arrangement has the result that no individual shareholder is asked to make a decision to buy or subscribe for securities, but all shareholders are allotted securities automatically if the scheme is approved, an issuer may reasonably conclude that there is no public offer of those securities and therefore no prospectus is required.

On the other hand, if schemes include mix and match facilities, which offer shareholders a choice between shares and cash, a prospectus should be produced.

The deadline for responses passed on September 30, 2020.

The Bulletin also reminded PDMRs of their duties in relation to reporting requirements, and notifications to the FCA of acquisitions, disposals and exercises of options in shares.

Elsewhere, the Bulletin gave an update on the EU’s publication of the Commission Delegated Regulation on June 4, which amended Delegated Regulation (EU) 2019/980 on the format, content and approval of prospectuses, which made some principal changes to the annexes of the Prospectus Regulation.

Finally, the Bulletin also covered changes to exemptions from the requirement to prepare a prospectus. The new regulation, which came into force on December 31, 2019 (the **SME Regulation**), amended both the Prospectus Regulation and the Market Abuse Regulation, providing a number of exemptions to the requirement to prepare a prospectus with regards to SMEs.

Corporate Crime: Government Publishes Consultation on Economic Crime Levy

On July 21, 2020, the Government published a consultation on its proposed economic crime levy, which it believes could raise up to £100 million per year to fund the Government’s AML initiatives.

The levy would likely target private sector businesses such as financial and credit institutions, legal services providers, accountants, trust or company service providers, money services businesses, estate agents, letting agents, casinos, dealers of high value goods, art market participants and crypto asset providers.

It would then pay for initiatives such as the National Economic Crime Centre and Suspicious Activity Reports reform. It would also pay for an uplift in current functions—mainly more human resources in the U.K. Financial Intelligence Unit and more financial investigators.

The consultation refers to the private sector as the "first line of defense" against economic crime and notes that financial institutions in particular hold significant data and information that enables law enforcement to prevent and detect economic crime. It stresses that firms which "contribute towards the risks within the U.K. economy should pay towards the costs of addressing those risks."

There are eight separate funding models set out in the consultation paper, ranging from charging the levy through existing supervisor fee structures, a fixed charge per business or a charge proportionate to the business's U.K. revenue or profitability. Small businesses would be exempt by a threshold.

The consultation closed on October 14, 2020 (although the consultation document states October 13, 2020).

Brexit/Corporate Crime: Regulations Expanding Trust Registration Service Laid Before Parliament

On September 15, 2020, the Money Laundering and Terrorist Financing (Amendment) (EU Exit) Regulations 2020 were laid before Parliament.

These Regulations amend the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017.

The main changes are made in order to transpose provisions introduced by EU Directive 2018/843 (the **Amending Directive**) to EU Directive 2015/849 (the **Fourth Anti-Money Laundering Directive**) concerning the U.K.'s register of express trusts, in particular expanding the scope of the register and requiring that information on the register is made available, from March 10, in certain circumstances to those with a legitimate interest.

The Fourth Anti-Money Laundering Directive and the Amending Directive set out the rules to ensure businesses properly assess money laundering and terrorist financing risks and carry out appropriate checks on their customers. They also stipulate beneficial ownership information that the U.K. must collect and hold on bodies corporate and express trusts.

U.K. express trusts with taxable consequences are already required to collect information on beneficial ownership and register with HMRC's Trust Registration Service. New Regulations widen the scope of trusts required to register to include all U.K. express trusts, including those with no tax consequences, with explicit exemptions for some categories of trusts, such as where the trust results from a legislative requirement rather than from the intention of the settlor or is merely incidental to a legitimate wider commercial transaction.

Stewardship: Government Launches Consultation on Improving Climate Change Reporting by Occupational Pension Schemes

On August 26, 2020, the Government launched a consultation on policy proposals to require trustees of larger occupational pension schemes and authorized schemes to address climate change risks and opportunities through effective governance and risk management measures.

It is proposed that among the activities required would be calculating the "carbon footprint" of pension schemes and assessing how the value of the schemes' assets or liabilities would be affected by different temperature rise scenarios, including the ambitions on limiting the global average temperature rise set out in the Paris Agreement. Larger occupational pension schemes will be required to maintain accompanying metrics and targets for the assessment and management of climate risks and opportunities.

The Consultation invites responses on proposals to disclose the above information in line with the recommendations of the international industry-led Task Force on Climate-related Financial Disclosures.

Pre-Emption Group Statement on Issuances During COVID-19

On September 4, 2020, the Pre-Emption Group (the **PEG**) stated that it is extending, to November 30, 2020, its April recommendation that investors, on a case-by-case basis, consider supporting non-pre-emptive placings by companies of up to 20 percent of their issued share capital over a 12-month period.

The PEG notes that of the £23.7 billion raised in the U.K. market since the start of the year, over 125 of the issuances have been accessing emergency funds, generally at a small discount to the prevailing market price. Investors have responded pragmatically to the extenuating circumstances by extending the usual thresholds for pre-emptive issuances.

Their recommendation is in place until November 30, 2020 and at that stage it is the PEG's stated expectation that companies should revert to seeking approvals for a maximum of 10 percent as set out in the Statement of Principles (5 percent for general corporate purposes with an additional 5 percent for specified acquisitions or investments).

This issue was previously covered in our Q2 2020 newsletter, which considered companies raising new share capital in response to COVID-19. We noted in that newsletter that the FCA endorsed the PEG's April recommendation, and that the FCA would continue to monitor how these practices are applied.

Chartered Governance Institute Guidance on Directors' Duties

On August 25, 2020, the Chartered Governance Institute published updated guidance on directors' general duties under the Companies Act 2006, which includes a section on the section 172 reporting requirement introduced by the Companies (Miscellaneous Reporting) Regulations 2018.

The guidance covers, among other issues, in relation to the section 172 reporting requirement:

- Considerations for when to make a disclosure, including a workforce description; methods of workforce engagement and how views are communicated to the board and considered; how the workforce contributes to the success of the business model and strategy and creates value; how workforce contribution is measured; how the company invests in its workforce; risks associated with its workforce; and corporate culture.
- The company's methods to identify and engage with suppliers, customers and others to obtain their views and the effect on board decisions, as well as information on customer relations, prompt payment to suppliers, supply chain sustainability and resilience and responsible sourcing.
- With respect to the need to act fairly between members of the company, how the company has achieved a balance between major investors and minority shareholders. It should also discuss other relevant key stakeholders.

Chartered Governance Institute Guidance on General Meetings Under CIGA 2020

On July 9, 2020, the Chartered Governance Institute published guidance to assist companies holding shareholder meetings under CIGA 2020.

CIGA 2020 has relaxed certain requirements for the holding of shareholder meetings during the coronavirus pandemic. Now, a company may hold a partial or fully virtual meeting by telephone or video conference, regardless of whether this is permitted by a company's articles of association.

The guidance notes that companies are likely to provide facilities for members to appoint the chair of the meeting as their proxy. Some companies may also choose to allow shareholders to vote via an online facility or application, but this is not required by CIGA 2020.

The guidance notes, crucially, that the temporary measures in CIGA 2020 flexibly override any contrary provisions in a company's articles of association.

LSE Disciplinary Notice for Yü Group Plc for Breaches of AIM Rules for Companies

On August 10, 2020, the London Stock Exchange (the **LSE**) announced that Yü Group plc had been publicly censured and fined £300,000 for breaches of Rules 10 (principles of disclosure) and 31 (Alternative Investment Market (**AIM**) company and directors' responsibility for compliance) of the AIM rules (the **AIM Rules**) for Companies.

According to the Notice, Yü Group plc identified that there were errors in its previous management information concerning recognized accrued income, receivables and potential recoveries. These material errors impacted the company's profitability. Rather than meeting market expectations of predicted profit before tax for its full 2018 financial year of between £5.2–£5.4 million, the Company identified that it was likely to make a significant loss.

The LSE determined that, in breach of its AIM Rule 31 obligations, the Company failed to ensure that it had in place sufficient procedures, resources and controls to comply with the AIM Rules.

The Notice contains important warnings and guidance for AIM-listed companies in relation to their AIM Rule 31 obligations.

It notes that these obligations go beyond an AIM company merely ensuring that it has in place documented procedures and protocols. Companies should ensure that these are appropriately reviewed and developed so that they are effective in practice and are adapted to adequately address changes to the business, planned growth or other operational needs. Boards should also be appropriately engaged in respect of evaluating the effectiveness of a company's financial control environment and the framework for assuring the integrity of internal management information upon which it relies for making its disclosure judgments.

Cryptoassets/Smart Contracts: Law Commission Launches Smart Contracts and Cryptoassets Projects

On September 21, 2020, the Law Commission launched two projects on smart contracts and digital assets to consider reforms to English law in relation to these developing technologies.

Smart Contracts

The Law Commission intends to analyze the current law on smart contracts, highlight uncertainties and identify any potential reforms that may be required.

Digital Assets

Similarly, the Law Commission intends to explore questions about the legal status of intangible assets such as Bitcoin or other "distributed ledger entries" which are tied to physical assets, following a request from Government. The Commission intends to publish a consultation addressing this issue early in the next year.

Corporate Reporting: Government Publishes Response to Consultation on Strengthening Transparency in Supply Chains

On September 22, 2020, the Government published its response to its consultation on transparency in supply chains.

The consultation included proposals on:

- modern slavery statements;
- how the Government could improve transparency and enforcement of non-compliance; and
- the extension of the modern slavery reporting requirements to the public sector.

In the response, the Government stated that the Home Office is currently developing an online registry for modern slavery statements, which will encourage organizations to publish their statements on this platform once launched.

Similarly, a single reporting deadline will be introduced where organizations will publish their statements each year.

The Government will also clarify in legislation that organizations must demonstrate compliance by stating the date of board approval and director sign off and by providing the names of entities covered in group modern slavery statements.

Stewardship: International Corporate Governance Network Approves Revised Global Stewardship Principles

The International Corporate Governance Network (**ICGN**) has approved a revised version of the ICGN Global Stewardship Principles at its annual general meeting.

Major changes include:

- greater emphasis on fiduciary duty, culture and values by institutional investors;
- the use of environmental, social and governance factors in investment decision-making, as well as stewardship;
- more focus on systemic risks relevant to institutional investors;
- greater emphasis on the application of stewardship to asset classes beyond listed equities;
- establishing capital allocation as a topic for engagement for both creditors and shareholders;
- protecting against the dilution of voting rights due to dual class shares and other forms of differential ownership; and
- encouraging investors to disclose more information about stewardship activities and outcomes.

Stewardship: FRC Publishes Review of Early Reporting Against Stewardship Code 2020

On September 30, 2020, the FRC published a review of the early reporting that it has seen against the U.K. Stewardship Code 2020, which took effect on January 1, 2020 and replaced the U.K. Stewardship Code 2012.

The U.K. Stewardship Code 2020 is a set of twelve principles for asset owners and asset managers and a separate set of six principles for service providers.

These principles are, in turn, supported by a set of reporting expectations which indicate the information that organizations should include in their stewardship report and are the basis on which the FRC assesses the quality of the reporting.

Asset managers who wish to be included as signatories to the U.K. Stewardship Code 2020 must apply by March 31, 2021; for asset owners, the deadline is April 30, 2021.

The FRC review stated it found good examples of case studies evidencing stewardship activity, that reporting needs to improve by reflecting on effectiveness of approach, that statements should be supported with specific evidence from the reporting period and that reporting should address all asset classes and geographies.

THIS NEWSLETTER IS INTENDED ONLY AS A GENERAL DISCUSSION OF THESE ISSUES. IT SHOULD NOT BE REGARDED AS LEGAL ADVICE. WE WOULD BE PLEASED TO PROVIDE ADDITIONAL DETAILS OR ADVICE ABOUT SPECIFIC SITUATIONS IF DESIRED. IF YOU WISH TO RECEIVE MORE INFORMATION ON THE TOPICS COVERED IN THIS PUBLICATION, YOU MAY CONTACT YOUR USUAL SHEARMAN & STERLING REPRESENTATIVE OR ANY OF THE FOLLOWING:

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

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