SHEARMAN & STERLING

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GOVERNANCE & SECURITIES LAW FOCUS

Below is a summary of the main developments in US, EU, and UK corporate governance and securities law since our last update in February 2020.

Financial regulatory developments are available here.

IN THIS ISSUE

COVID-19: GENERAL INFORMATION AND RESOURCES

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

Shearman has additionally been hosting a series of partner-led calls to answer your COVID-19 questions, including industry trends and the legal and business implications to the pandemic. These calls began on March 31, 2020, and have been taking place Tuesday to Thursday of each week. The previous sessions can be accessed on-demand by visiting the resource hub and selecting from the list of previously covered topics. As the situation evolves, further calls, if any, will be announced and linked on the resource hub. Our COVID-19 task force is available at COVID_19_Task_Force@Shearman.com to discuss any questions or concerns you may have relating to this pandemic.

US DEVELOPMENTS

Developments Related To COVID-19

CARES Act

In response to the impact the COVID-19 pandemic has had on the global and U.S. economy in recent weeks, Congress passed the Coronavirus Aid, Relief and Economic Security Act (**CARES Act**), which was enacted into law on March 27, 2020. The CARES Act is a nearly $2 trillion stimulus package aimed at delivering critical aid to the U.S. economy, including by way of $500 billion in loans and loan guarantees to support a broad range of borrowers, including specific aid directed at certain hard-hit industries. The CARES Act also includes unemployment and other labor-related assistance to businesses and workers, more than $377 billion in federally guaranteed loans to small businesses, and tax provisions aimed at providing much-needed liquidity to businesses as the world seeks to address the COVID-19 pandemic. For more details on the CARES Act generally, including a breakdown of the various components thereof, you may wish to refer to Shearman's related client publication. If you wish to read a more detailed analysis of the key provisions Paycheck Protection Program specifically (an allocation of $349 billion under the CARES Act for the U.S. Small Business Association to guarantee loans to small businesses), Shearman's client publication on the topic, available here, may be of interest.

Jay Clayton, Chairman of the U.S. Securities and Exchange Commission (**SEC**), recently shared his thoughts on the disclosure duties of companies seeking bailouts under the CARES Act, stating that such companies should share with investors their current status and their plans going forward, and in particular, any plans around the payment of dividends, share buybacks and capital preservation. Amidst worries of insider trading relating to the CARES Act stimulus package (spurred on in part by a recent study indicating that instances of insider trading appeared to rise dramatically during the 2008 bailout), Chairman Clayton reiterated earlier SEC warnings to executives to guard against this possibility. He noted that companies should follow good corporate hygiene and announce information as soon as they can but that, until that time, they should keep the information as tight as possible.

SEC Operations and Areas of Focus in Response to COVID-19

On March 24, 2020, Chairman Clayton released a statement sharing his perspective on the SEC's ongoing efforts to navigate the COVID-19 pandemic. He noted that the efforts of the SEC and other financial regulators are focused on two related issues: (a) the health and safety crisis and the changes and sacrifices that all Americans are having to make in response, and (b) the recognition that the continued operation of our markets is an essential component of our national response to, and recovery from, COVID-19. Chairman Clayton stressed the interrelationship between these issues. Private sector industries (such as health care, pharmaceutical, transportation, manufacturing and telecommunications) are critical to combatting COVID-19, and these industries rely on the provision of credit from the banks and capital markets to make and receive the necessary payments to continue to fulfil their respective duties. This reliance on the capital markets in combatting COVID-19 extends to the public sector as well; many state and local governments, who play pivotal roles in the provision of health care, transportation, and public services, including supplying health care professionals, depend on continued access to financing through the banking system and the municipal finance markets.

Chairman Clayton went on to acknowledge the impacts that COVID-19 has had on certain "non-essential" sectors such as air transportation, restaurants and lodging. He noted that the administration's efforts to provide funds to workers and businesses in these sectors to bridge any funding gaps, and doing so while keeping as many workers connected to their employers as is practicable, will enhance U.S. efforts to fight and recover from COVID-19. Chairman Clayton asserted that markets and policies should support a tailored, multi-faceted, time-limited approach that allows certain essential sectors to operate full-throttle and other sectors to stand down. In conclusion, he reiterated that preserving the flows of credit and capital in the U.S. economy to both businesses and individuals will help the U.S. better fight COVID-19 and speed and strengthen the recovery therefrom.

On April 3, 2020, the SEC released further statements on the regulatory priorities of the SEC and the importance of maintaining high-quality financial reporting, respectively, each in light of COVID-19. With respect to regulatory priorities, Commissioner Allison Herren Lee highlighted two considerations that she believes should inform the regulatory approach of the SEC in the current climate. First, she asserted that the SEC should extend current and recently closed comment periods to ensure that the public has an adequate opportunity to provide comments to the SEC's proposed regulatory actions. Second, she noted that the SEC should proceed with great caution in considering whether to take any non-critical regulatory action, and what ramifications any such action would have for the public, investors, markets, and the economy. She also stated that regulatory action in the near term unrelated to the exigencies created by COVID-19 would seem to rarely be warranted.

In the second statement, SEC Chief Accountant Sagar Teotia stressed to reporting companies the importance of continuing to provide investors and other stakeholders with high-quality financial information. Teotia reiterated that the SEC's Office of the Chief Accountant (**OCA**) remains committed to assisting market participants, and is available for consultation with respect to any questions that market participants may encounter as a result of COVID-19. Teotia addressed several areas of the OCA's work in light of the COVID-19 pandemic, including the following:

- **Accounting**: The OCA remains actively engaged with the Financial Accounting Standards Board to address the impact of COVID-19. Teotia acknowledged that the impact of COVID-19 may require significant judgments and estimates with respect to certain accounting areas (fair value and impairment, leases, restructurings, and going concern, to name a few), and that such judgments can be challenging for reporting companies to make in times of continued uncertainty. In this context, he stressed the importance of including required disclosures on the nature of judgments and estimates in these and other areas.

- **Auditing**: The OCA remains actively engaged with the Public Company Accounting Oversight Board (**PCAOB**) to address emerging issues related to COVID-19. For instance, the OCA supports the PCAOB's approach in providing audit firms conditional relief from inspections, suspending international travel with respect to inspections and in providing timely updates on the status of their operations. The OCA remains focused on auditor independence, stressing that this is a shared responsibility between audit committees, management and auditors, and that OCA is available for consultation in this respect as needed.
- **International Engagement**: The OCA remains engaged with the International Accounting Standards Board and other international securities regulators on the impact of COVID-19. The OCA participates in efforts to reform the international audit-related standard-setting system through its participation in The Monitoring Group, a global organization composed of regulators and others dedicated to serving the public interest in areas related to international audit standard setting and audit quality.

For details on how to initiate a dialogue with the OCA, visit https://www.sec.gov/page/communicating-oca.

The SEC has reassured market participants that while its efforts are centered on the health and safety of its employees and all Americans, it is also focused on maintaining the continuity of operations. This includes monitoring market functions and system risks, providing prompt, targeted regulatory relief and guidance to issuers, investment advisers and other registrants impacted by COVID-19 and maintaining enforcement and investor protection efforts.

Against this backdrop, a majority of the SEC's staff have transitioned to remote work, but have remained fully operational throughout the transition. The SEC encourages market participants to continue to engage with them during this time, and has noted that they will continue to provide operational updates, as necessary. In order to facilitate continued engagement, the SEC has expanded its ongoing outreach efforts with and monitoring of various market participants. Key areas that the SEC will continue to monitor include the functioning and resiliency of securities markets, the activities and operations of large financial firms, the asset management industry, corporate filings and disclosures, and the impact of COVID-19 on securities markets generally. The SEC will also continue to engage and coordinate with other members of the U.S. and global financial regulatory community.

In the enforcement space, the SEC's Division of Enforcement and the Office of Compliance Inspections and Examinations has confirmed that it also remains fully operational, and continues to actively monitor for fraud, illicit schemes and other misconduct affecting U.S. investors relating to COVID-19.

The SEC has created and is continually updating a page detailing these and other facets of its response to COVID-19, which can be found here.

SEC Extends Reporting Deadlines and Relaxes Proxy Rules

On March 25, 2020, the SEC issued an order (superseding its earlier order from March 4, 2020) providing companies with additional time to make regulatory filings otherwise due between March 1 and July 1, 2020, (an extension from the April 30, 2020, deadline initially set forth in the March 4, 2020, order). This extension is subject to certain conditions, including filing a current report on Form 8-K (or Form 6-K for foreign private issuers (**FPIs**)) by the report's original filing deadline with a statement as to why the delayed report could not be timely filed, an estimated filing date and any company specific risk factors explaining the impact, if material, of COVID-19 on the company's business. A separate Form 8-K (or Form 6-K) must be furnished for each delayed filing. This is an evolving process, and the SEC has indicated that further extensions may be necessary.

However, the SEC confirmed that relief under the order will not apply to filing of a Schedule 13D or related amendments. The SEC also confirmed that companies relying on well-known seasoned issuer (**WKSI**) status exemptions will remain eligible and preserve their WKSI status if timely filings have been made as of the first day of the relief period and the subsequent report due is filed within 45 days of the filing deadline.

The SEC's order further exempts, as did its earlier order, companies from requirements under the U.S. Securities Exchange Act of 1934, as amended (**Exchange Act**), to furnish proxy materials, annual reports and other soliciting materials by mail where delivery is not possible as a result of COVID-19. Specifically, a company is exempt from the requirements with respect to a shareholder that has a mailing address in an area where, as a result of COVID-19, a common carrier has suspended delivery service of the type or class that the company customarily uses to make the solicitation and the company has made a good faith effort to furnish the soliciting materials to the shareholder as required by the rules.

If you wish you receive further information on the SEC's order of March 25, 2020, you may wish to refer to our prior publication on the subject, available here.

On March 31, 2020, and April 6, 2020, the SEC released guidance clarifying certain logistical aspects following from the above order, particularly with respect to how the order interfaces with the standard Form 12b-25 notice for late filings and the provision of Part III information. If you have questions on timing applicable to your specific reporting obligations in light of the foregoing or otherwise, your contacts at Shearman or the Shearman COVID-19 task force are happy to assist.

SEC Staff Recommends Relief from Certain Execution, Document Retention and Notarization Requirements in Light of COVID-19

On March 24, 2020, the SEC staff released a staff statement recognizing the potential difficulty in light of COVID-19 for reporting companies to comply with the authentication document retention requirements of Rule 302(b) of Regulation S-T (which requires that signatories to documents electronically filed with the SEC under the federal securities laws manually sign and retain said documents), noting that SEC staff will recommend no enforcement action be taken in cases of noncompliance if:

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

The SEC announced similar relief regarding the notarization requirements of Form ID by way of a temporary final rule on March 26, 2020, which provides conditional relief from these requirements from March 26 to July 1, 2020.

SEC Issues Statement on Maintaining Market Integrity During the COVID-19 Pandemic

On March 23, 2020, two co-directors of the SEC's Division of Enforcement released a statement emphasizing the importance of maintaining market integrity and following corporate controls and procedures in light of COVID-19. The statement reminds corporate insiders that the material non-public information that comes to their attention may hold an even greater value now than it would under usual circumstances, particularly if earnings reports or required SEC disclosure filings are delayed due to COVID-19. They asserted that insiders should be mindful of their obligations to keep this information confidential and comply with the prohibitions on illegal securities trading.

The statement encouraged public companies to be mindful of their established disclosure controls and procedures, insider trading prohibitions, and codes of ethics, and to ensure that they protect against the improper dissemination and use of material non-public information. Similarly, broker-dealers and investment advisers were reminded to comply with policies and procedures designed to prevent misuse of material, non-public information.

COVID-19 Disclosure Considerations

As part of its response to COVID-19, and further to initial guidance issued on March 4, 2020, the SEC issued additional guidance on March 25, 2020, regarding public company disclosure requirements relating to COVID-19.

The guidance makes clear that the SEC is conscious of the rapidly evolving nature of the pandemic, and that disclosure will need to be tailored to each company based on a facts and circumstances analysis, but goes on to set out generally applicable guidelines for all companies. For instance, companies should disclose the effects COVID-19 has already had on the company, what management expects the future impact will be, how management is responding to evolving events, and how the company is planning for COVID-19-related uncertainties material to investment and voting decisions. The guidance notes that the existing disclosure framework for each of Management's Discussion and Analysis of Financial Conditions and Results of Operations (**MD&A**), business and operations disclosures, risk factors, legal proceedings, disclosure controls and procedures, internal controls over financial reporting and financial statements may require consideration of COVID-19 impacts, and that it may be appropriate to provide additional disclosure on COVID-19's effects even when there is no specific line-item requirement within the current disclosure framework.

The guidance highlights certain specific considerations that companies should take into account in crafting disclosure, including the following:

- impact on financial condition and results of operations, including future operating results and near- and long-term financial condition;
- impact on capital and financial resources, including overall liquidity position and outlook, cost of or access to capital and funding sources (such as revolving credit facilities), sources or uses of cash, ongoing ability to meet debt covenants and actions taken to remedy any deficiency;
- effects on balance sheet assets and timely accounting for those assets, including significant changes in judgments in determining fair values;
- anticipated material impairments (e.g., with respect to goodwill, intangible assets, long-lived assets, right of use assets, investment securities), increases in allowances for credit losses, restructuring charges, other expenses or changes in accounting judgments;
- impact of remote work arrangements on operations, including financial reporting systems, internal controls over financial reporting and disclosure controls and procedures and anticipated challenges in this area;
- challenges in implementing business continuity plans and related expenditures and resource constraints; and
- impact on demand for products or services, supply chain or distribution and changes in the relationship between costs and revenues (margins), human capital resources and productivity, travel restrictions and border closures.

The guidance encourages companies to proactively revise and update disclosure as facts and circumstances change. Depending on the particular circumstances, updating prior disclosure that has become inaccurate may be required. The guidance also notes that disclosure of COVID-19-related information must be broadly disseminated and selective disclosure must be avoided.

To the extent a company presents a non-GAAP financial measure to adjust for or explain the impact of COVID-19, the guidance indicates that it would be appropriate for management to highlight why it finds the measure useful and how the measure helps investors assess the impact of COVID-19. The SEC sets forth specific considerations in that regard, including the following:

- when a GAAP financial measure is not available at the time of the earnings or other release because the measure may be impacted by COVID-19-related adjustments that are not yet final, companies can reconcile non-GAAP measures to preliminary GAAP results that either include any provisional amount(s) based on a reasonable estimate, or a range of reasonably estimable GAAP results (any provisional GAAP amount or range should reflect a reasonable estimate of COVID-19-related charges not yet finalized, such as impairment charges);
- any non-GAAP financial measure should not be disclosed more prominently than the most directly comparable GAAP financial measure or range of GAAP financial measures;
- if a company presents non-GAAP financial measures that are reconciled to provisional amount(s) or an estimated range of GAAP financial measures, it should limit the measures in its presentation to those non-GAAP financial measures it is using to report financial results to the board of directors; and
- if a company presents non-GAAP financial measures that are reconciled to provisional amount(s) or an estimated range of GAAP financial measures, it should explain, to the extent practicable, why the line item(s) or accounting is incomplete, and what additional information or analysis may be needed to complete the accounting.

As COVID-19 has impacted, and will continue to impact, many aspects of a company's operations, the SEC clearly expects companies to review and revise COVID-19-related disclosures as the crisis evolves to reflect the changing impact on the company. It is therefore important that companies stay abreast of developments in this area. An important takeaway from this guidance is that the staff of the Division of Corporation Finance of the SEC will be reviewing the timing, quality and transparency of a company's disclosures related to the impact of COVID-19 on its operations.

If you wish to read a further analysis of SEC guidance related to COVID-19, Shearman's related March 16, 2020, and March 27, 2020, client publications may be of interest.

On April 8, 2020, Chairman Clayton and William Hinman, Director of the SEC's Division of Corporate Finance, released a rare statement building upon the previous guidance and addressing the importance of quality disclosure, particularly in light of upcoming Q1 earnings reports and the related investor and analyst calls. In particular, the statement highlighted that historical information is likely to be relatively less significant in these reports and on these calls, and that a company's disclosure should instead focus on: (a) where the company stands today, operationally and financially, (b) how the company's COVID-19 response, including its efforts to protect the health and well-being of its workforce and its customers, is progressing, and (c) how its operations and financial condition may change as all our efforts to fight COVID-19 progress.

Chairman Clayton and Director Hinman asserted that substantive forward-looking disclosure (as opposed to generic boilerplate) is critical, not only for investors and the markets generally, but also for the nation as a whole as public and private entities and individuals seek to fight and recover from COVID-19. They urged companies to provide as much information as possible around their current status and their plans going forward, even amidst this time of great uncertainty and even though subsequent changes to forward-looking disclosure may be likely. In this context, they encouraged companies to avail themselves of the various safe-harbors for forward-looking statements, and indicated that they we would not expect the SEC to second guess good faith attempts by companies to provide appropriately framed forward-looking information.

Market Disruption and US Exchange Developments

The COVID-19 outbreak and the breakdown of negotiations between oil producers each contributed to a fall in the stock market, ending the longest bull market in history and bringing about a period of volatility. As of March 23, 2020, movements in the stock market had led to four 7% declines in the S&P 500 index in 2020, each triggering cross-market circuit breakers and bringing trade to a halt across exchanges (**trading halt**). The SEC relies on various mechanisms and discretionary powers capable of pausing or stopping the trade of individual securities or general market activity. Fifteen-minute trading halts, for instance, occur automatically when the S&P 500 index declines by 7% and 13% from the prior day's close, and day-long trading halts occur automatically when the S&P 500 index declines by 20% from the prior day's close. There are also automatic mechanisms to limit trading of specific securities during particularly volatile periods, and to prohibit short sales of securities that have decreased by more than 10% from the prior day's closing price.

The SEC and the Financial Industry Regulatory Authority (**FINRA**) also have certain discretionary powers to restrict trading. The SEC, upon notifying the President of the United States and unless the President disapproves, may suspend all trading on any national securities exchange for up to 90 days if they believe that it is in the public interest. Both the SEC and FINRA may effect the suspension of particular securities for up to 10 business days, and the SEC also has the authority to act to halt short selling. As markets continue to react to rapidly changing current events, it will be important for companies to stay abreast of new guidance and prepare for the contingencies outlined above. If you are interested in a more detailed analysis of this topic, you may wish to refer to Shearman's related client publication.

Notably, on March 23, 2020, the New York Stock Exchange (**NYSE**) took the unprecedented step of closing its trading floors and moving exclusively to electronic trading. For more details on this development, see the NYSE's public release on the topic here.

IRS Extends Deadlines and Offers Immediate Relief to Employers via Tax Credits

On March 20, 2020, the Internal Revenue Service (**IRS**) released Notice 2020–18, extending the deadline for payment and filing of federal income taxes for the 2019 taxable year as well as any estimated income tax payments for the 2020 taxable year to July 15, 2020. This extension applies to any individual, trust, estate, partnership, association, company, or corporation with a federal income tax return or payment due April 15, 2020. The notice also confirmed that interest will not accrue on taxes owed and penalties will not apply for the postponement period beginning April 15, 2020, and ending July 15, 2020. However, these changes do not apply to any federal payment other than income tax payments, nor do they apply to state filings or payments, unless a taxpayer's state independently implements similar changes.

Relatedly, on March 31, 2020, the IRS issued Notice 2020–22, which permits employers to immediately receive the benefits of certain employment tax credits available under the Families First Coronavirus Response Act and CARES Act by reducing employment tax deposits that such employers would otherwise be required to submit to the IRS (including any deposits attributable to income and employment taxes withheld from amounts paid to an employee) without penalty. Additionally, on the same date, the IRS released Form 7200 (and instructions to the Form 7200) allowing for advance payment of the available employment tax credits to employers. If you would like further details on IRS extensions and other relief measures, Shearman's client publication on the topic, available here, may be of interest.

Other COVID-19 Updates by US Federal and State Actors

The COVID-19 pandemic has given rise to a rapidly evolving commercial and regulatory landscape. In addition to the various SEC and other orders and releases highlighted above, it is worth noting that other U.S. federal and state actors have also implemented and continue to implement their own legal measures in response to the pandemic. For instance, the Federal Energy Regulatory Commission (**FERC**) announced new and supplemental policies to assist companies subject to FERC's jurisdiction in meeting regulatory obligations and ensuring business continuity, and The New York Department of Financial Services promulgated regulations on March 24, 2020, to provide financial relief to individuals who can demonstrate a financial hardship as a result of the COVID-19 pandemic. For up-to-date analysis of these and other COVID-19 related topics, Shearman's dedicated resource hub, which we will continue to update as the situation evolves, may be a useful point of reference.

Other SEC and NYSE Developments

SEC Provides Guidance on Revised MD&A Rules

Separate from subsequent COVID-19-related disclosure guidance, on January 30, 2020, the SEC issued guidance on key performance indicators and metrics used in MD&A disclosure, effective from February 25, 2020.

The focus of the guidance is primarily on key performance indicators and metrics that are not line-item disclosures, and which are typically used to enhance the understanding of MD&A disclosure. These could be qualitative or quantitative metrics used in the industry or metrics that are unique to the company, and could be related to external or macro-economic matters or internally focused (e.g., same-store sales and revenue per user/subscriber).

In the guidance, the SEC is essentially reminding companies that when including such metrics in their disclosure, companies need to include any information necessary to make the presentation of the metric not misleading. Companies should consider what additional information is needed to provide the right context to understand the metric and the why the company is using it. The SEC has stated that it would generally expect the following disclosures to accompany the metric:

- a clear definition of the metric and how it is calculated;
- a statement indicating the reasons why the metric provides useful information to investors; and
- a statement indicating how management uses the metric in managing or monitoring the performance of the business.

The guidance also states that companies should consider whether there are estimates or assumptions underlying the metric or its calculation, and whether disclosure of such items are necessary for the metric not to be misleading. In addition, if the metric is a non-GAAP measure, companies should consider the existing regulatory requirements applicable to non-GAAP measures. If a company changes the way it calculates a metric from period-to-period, it should consider the need to disclose, to the extent material:

- differences in the way the metric is calculated or presented compared to prior periods;
- the reasons for such changes;

- the effects of any such change on the amounts or other information being disclosed and on amounts or other information previously reported;
- such other differences in methodology and results that would reasonably be expected to be relevant to an understanding of the company's performance or prospects; and
- subject to the significance of the changes, whether it is necessary to recast prior metrics.

SEC Proposes New Rule on Financial Disclosure Requirements; Declines to Propose Changes to Climate Change Disclosure Requirements

On January 30, 2020, the SEC proposed a new rule on financial disclosure requirements that would, among other things, replace the off-balance sheet disclosure requirements with a more principles-based disclosure rule, eliminate the contractual obligations table and revise the current requirement in MD&A disclosure to permit a company to compare the current quarter to either the corresponding quarter in the prior year (as currently required) or the immediately preceding quarter. This is only a proposal pending adoption as a final rule, with comments due on April 28, 2020 (pending extension due to COVID-19).

After some discussion (and internal disagreement—see Commissioner Lee's statement on the subject here), the SEC chose not to include specific requirements on climate change or other Environmental, Social and Governance disclosure in these proposed amendments, showing a preference for the same principles-based disclosure approach discussed above. In a statement on January 30, 2020, Chairman Clayton discussed his views on the topic. He pointed to guidance from 2010 in which the SEC indicated four items of Regulation S-K that could require disclosure regarding the impact of climate change (description of business, legal proceedings, risk factors and MD&A disclosures), and provided some guidance on areas of particular interest to the SEC and to Chairman Clayton personally within this space. These areas include the extent to which companies use, and their experience with, environmental and climate-related models and metrics in their operations and planning, and asset managers' experience with the use of environmental and climate-related models and metrics to allocate capital on an industry- or company-specific basis.

SEC Releases Guidance on IP and Technology Risks in International Transactions

Following an earlier adoption of interpretative guidance on public company disclosures regarding cybersecurity risks and incidents (a prior Shearman publication, available here, addressed this earlier guidance), on December 19, 2019, the SEC released guidance on disclosure obligations companies should consider relating to intellectual property and technology risks that may arise in international transactions, and in particular, those outside the United States and in jurisdictions that may not have comparable levels of protection with respect to such corporate proprietary information and assets. The new guidance does not create a line-item disclosure requirement, but indicates that companies should assess potential disclosure of these risks in light of overall materiality.

The guidance identifies both direct and indirect sources of risk to intellectual property and technology in the international context, noting that while many companies may face these risks, companies that operate internationally may have more significant exposure. Direct sources of risk include the risk of theft of technical data, business processes, data sets or other sensitive information through a direct intrusion by private parties or foreign actors. This risk may arise by means of cyber intrusions into a company's computer systems or via physical theft by way of corporate espionage, including with the assistance of insiders. Indirect sources of risk include reverse engineering of a company's products by joint venture partners or other parties, and infringement or theft of know-how or trade secrets of the company. Such indirect intrusion may also occur by way of patent license agreements, foreign ownership restrictions in various agreements, the use of unusual terms favoring foreign persons or governments and/or regulatory requirements restricting the ability of companies to conduct business unless they comply with various conditions requiring them to store data and operate locally. Each of these risks is further spelled out in the SEC's guidance.

In assessing and disclosing risks related to potential theft or compromise of technology and intellectual property in the international context, the guidance states that the cornerstone of the system is the timely, robust and complete disclosure of material information, allowing investors to evaluate the risks through the eyes of management and make informed investment and voting decisions.

The guidance also sets out that a hypothetical disclosure of potential risks is not sufficient to satisfy a company's reporting obligations when the company's technology, data or intellectual property has previously been compromised, stolen or illicitly accessed, and encourages companies to continue to consider such reporting on an ongoing basis in view of various factors. Some of these factors (posed in the guidance in the form of questions) are listed below:

- heightened risk due to requirement to maintain significant assets or revenue abroad;
- operations in an industry or foreign jurisdiction that has caused the entity to be particularly susceptible to theft of technology or intellectual property, including being subject to counterfeiting and sale (including through e-commerce);
- entering into a patent or technology license agreement with a foreign entity or government, and providing the entity with rights to improvements and continued used of the technology following the licensing term;
- being subject to having foreign parties as controlling shareholders (or holding a majority of shares in a joint venture) or being involved in a joint venture subject to foreign ownership restrictions or requirements that a foreign party retain certain ownership requirements;
- providing access of technology or IP to a state actor in connection with foreign regulatory or licensing procedures;
- being required to yield rights to technology or intellectual property as a condition to conducting business in a foreign jurisdiction; and
- operating in a foreign jurisdiction having limited statutory rights to enforcing intellectual property rights.

SEC Adopts Amendments to Regulation S-X Rules 3-10 and 3-16 to Simplify and Improve Disclosure for Debt Offerings Conducted on a Registered Basis

On March 2, 2020, the SEC released its final amendments to the rules governing the supplemental financial information required for SEC-registered debt securities that have guarantees or that are collateralized by shares or other securities of subsidiaries or other affiliates. These amendments significantly reduce the amount of financial information required for those securities, in addition to the parent company's consolidated financial statements.

Among other things, the amendments eliminate the requirement to include detailed consolidated audited three-year financial information for each company or guarantor in the parent company's annual and interim financial statements, allowing instead for unaudited combined summarized financial information for the most recent year and interim period. Further, this disclosure may now be provided outside the footnotes to the parent company's audited annual and unaudited interim consolidated financial statements, an amendment intended to reduce audit-related costs and delays.

Similarly, with respect to securities secured by pledges of shares or other securities of affiliates of the company, the amendments remove the requirement to provide separate financial statements of those affiliates if the pledged securities represent a numerically substantial portion of the collateral. Companies will instead be required to file certain abbreviated financial and non-financial disclosures about the affiliate and the collateral arrangement (if material to investors/holders of the collateralized securities), including combined summarized financial information for affiliates whose securities are pledged.

The amendments will become effective on January 4, 2021, but the SEC has expressly permitted voluntary compliance with the new rules before then. If you wish to receive further details on these amendments and others, you may wish refer to Shearman's related client publication, available here.

SEC Proposes Rule Changes to Harmonize, Simplify and Improve the Exempt Offering Framework

On March 4, 2020, the SEC proposed a set of amendments to the exemptive framework under the U.S. Securities Act of 1933, as amended (**Securities Act**), to promote capital formation while preserving or enhancing important investor protections. Key highlights from the proposal include the following:

- modernization and simplification of the integration framework (i.e., the determination of whether multiple securities transactions are considered part of the same offering) for registered and exempt offerings, including (a) the provision of a general guiding principle to use in determining whether integration might apply in a particular proposed transaction, together with corresponding applications to specific fact pattern examples, and (b) the establishment of four new safe harbors (set forth below);

Safe Harbor 1	Any offering made more than 30 calendar days before the commencement of, or more than 30 calendar days after the termination or completion of, any other offering, would not be integrated with another offering; provided that, for an exempt offering for which general solicitation is not permitted, the purchasers either: (i) were not solicited through the use of general solicitation; or (ii) established a substantive relationship with the issuer prior to the commencement of the offering for which general solicitation is not permitted.
Safe Harbor 2	Offers and sales made in compliance with Rule 701, pursuant to an employee benefit plan, or in compliance with Regulation S would not be integrated with other offerings.
Safe Harbor 3	An offering for which a Securities Act registration statement has been filed would not be integrated with another offering if made subsequent to: (i) a terminated or completed offering for which general solicitation is not permitted; (ii) a terminated or completed offering for which general solicitation is permitted and made only to qualified institutional buyers and institutional accredited investors; or (iii) an offering that terminated or completed more than 30 calendar days prior to the commencement of the registered offering.
Safe Harbor 4	Offers and sales made in reliance on an exemption for which general solicitation is permitted would not be integrated with another offering if made subsequent to any prior terminated or completed offering.

- increase in the offering limits for Regulation A, Regulation Crowdfunding, and Regulation D Rule 504 offerings, in each case under the Securities Act, and revision of certain individual investment limits;
- provision of greater certainty to issuers and protection to investors by setting clear and consistent rules governing offering communications between investors and issuers, including permitting certain "demo day" activity without running afoul of the prohibition on general solicitation;
- harmonization of certain disclosure and eligibility requirements and bad actor disqualification provisions to reduce differences between exemptions, while preserving or enhancing investor protections; and
- addition of a new item to the non-exclusive list of verification methods in Rule 506(c) of Regulation D, allowing an issuer to rely on a written representation from a previously verified accredited investor that said investor remains an accredited investor, so long as the issuer is not aware of information to the contrary.

SEC Issues Clarifications on Omission of Discussion of Third-year Financials from MD&A Disclosure

Recent amendments adopted by the SEC aimed to simplify MD&A disclosure. These amendments permitted entities to omit discussion of the earliest year of the three-year period presented in their financial statements if such discussion was already included in prior filings made by the company and the location of such discussion was identified. On January 24, 2020, the SEC issued further clarifications in the form of three new compliance and disclosure interpretations, setting out as follows:

- **Incorporation by Reference**: In relying upon a disclosure already made in a discussion in a prior filing, the company is required to expressly state that the information is intended to be incorporated by reference in the current filing; merely identifying the location of the discussion in the prior filing does not automatically incorporate such disclosure.
- **Omission of material third-year discussions**: A company is required to provide in its MD&A disclosure all information that the company believes is necessary to develop an understanding of the financial condition of the company, any changes in its financial condition and its results of operations. If the company assesses the third-year information and determines that it is required, the company must include such information in the current disclosure or expressly incorporate such information by reference to its discussion in a previous filing.
- **Updating an Effective Registration Statement by a new Annual Report on Form 10-K**: If a company has an effective registration statement, any statement incorporating by reference information filed in a prior Annual Report on Form 10-K will establish a new effective date for such registration statement. However, any omission of such discussion of the earliest of three years will exclude such discussion from the Form 10-K, unless such information is expressly incorporated by reference therein. This would correspondingly apply to FPIs who file their Annual Report on Form 20-F or Form 40-F, as applicable.

SEC Adopts Amendments to Accelerated and Large Accelerated Filer Definitions

On March 12, 2020, the SEC adopted certain amendments to the accelerated filer and large accelerated filer definitions. The amendments will:

- exclude from the accelerated and large accelerated filer definitions a company that is eligible to be a smaller reporting company (**SRC**) and that had annual revenues of less than $100 million in the most recent fiscal year for which audited financial statements are available. Business development companies will be excluded in analogous circumstances;
- increase the transition thresholds for accelerated and large accelerated filers becoming non-accelerated filers from $50 million to $60 million, and for exiting large accelerated filer status from $500 million to $560 million;

- add a revenue test to the transition thresholds for exiting from both accelerated and large accelerated filer status; and
- add a check box to the cover pages of Forms 20-F, 40-F and 10-K to indicate whether an internal control over financial reporting (**ICFR**) auditor attestation is included in the filing.

Following the adoption of the amendments, SRCs with less than $100 million in revenues will no longer be required to obtain a separate attestation of their ICFR from an outside auditor, although they will remain obligated to, among other things, establish and maintain ICFR and have management attest to the effectiveness thereof.

Under the proposed amendments, an FPI would be excluded from the accelerated and large accelerated filer definitions if the FPI qualifies as an SRC under the SRC revenue test in Rule 12b-2 of the Exchange Act. Foreign issuers that qualify as FPIs or SRCs are permitted to avail themselves of special accommodations unique to each reporting regime, but must select one reporting regime or the other. The amendments provide an exemption from the ICFR auditor attestation requirement for low-revenue SRCs. Companies that qualify as FPIs and elect to use the FPI reporting regime have alternative accommodations available to them, such as the ability to disclose material changes in their ICFR and effectiveness of disclosure controls and procedures on an annual basis, as compared to the quarterly basis required of U.S. issuers, including SRCs.

NYSE Publishes Annual Guidance Memo for NYSE-Listed Companies

On January 9, 2020, the NYSE published its annual guidance memo for NYSE-listed companies. The memo includes a discussion of new developments since last year's annual guidance memo, as well as important reminders for the year ahead. This year, the new developments section included a reminder that the NYSE's Listing Manager, which is a fully integrated web application that allows for electronic submission and management of listing related documents (**Listing Manager**), launched certain enhanced functionality features on April 1, 2019. These new features include the ability to update personnel info, file annual and interim written affirmations and submit various disclosures through the platform, among other things. The Listing Manager is the successor to the NYSE's eGovDirect, which was decommissioned on March 29, 2019.

In addition, the memo sets forth the following key compliance requirements and reminders from the Listed Company Manual for NYSE-listed companies to keep in mind, including, among others:

- **NYSE Timely Alert/Material News Policy**: NYSE-listed companies are required to promptly release to the public any news or information which might reasonably be expected to materially affect the market for its securities. The memo includes information on the timing and methods for such disclosure and provides a non-exhaustive list of examples of news or information that may be deemed to trigger this requirement, including earnings, mergers/acquisitions, executive changes, redemptions/conversions, securities offerings and pricings related to these offerings, major product launches, regulatory rulings, new patent approvals and dividend or major repurchase announcements.
- **Scheduling of Earnings Releases**: NYSE-listed companies should provide prompt and broad dissemination to the market of news around scheduling of earnings releases and any changes to said schedules.
- **Annual Meeting Requirement**: With respect to the requirement for NYSE-listed companies to conduct an annual shareholders' meeting, the memo emphasizes that the requirement is not met if the meeting is postponed or adjourned.
- **Record Date Notification**: Subject to certain limited exceptions, NYSE-listed companies are required to notify the NYSE at least 10 calendar days in advance of setting a record date for any purpose. If an NYSE-listed

company changes a record date, it must provide prior notice of at least 10 calendar days. Notifications can be submitted electronically through the Listing Manager or emailed to proxyadmin@nyse.com.

- **Redemption and Conversion of Listed Securities**: Prior notice to the NYSE is required in the case of a full call redemption or conversion of a listed security. NYSE-listed companies should promptly contact their Corporate Actions analyst at +1-212-656-5505 prior to issuing an announcement about the redemption or conversion of a security that is listed on the NYSE.
- **Annual Report Website Posting Requirement**: NYSE-listed companies that are required to file annual reports with the SEC must simultaneously make such reports available to shareholders on or through the company's website. NYSE-listed companies that are not required to comply with the SEC proxy rules must also (a) include a prominently-placed posting on their website that provides all shareholders with the ability to request and receive hard copies of the company's complete, audited financial statements free of charge, and (b) issue a press release which (x) states that the company's annual report (as filed on Forms 20-F, 10-K, 40-F or N-CSR) has been filed with the SEC, (y) includes the company's website address; and (z) explicitly states that shareholders may receive free hard copies of the audited financials upon request.
- **Annual Written Affirmation**: Each calendar year, NYSE-listed companies must file an Annual Written Affirmation to affirm compliance with the NYSE's corporate governance rules. FPIs are required to file such affirmation 30 calendar days after the Company's annual report is filed with the SEC. These affirmations can be created and filed electronically through the Listing Manager, and the forms and instructions are also available on the NYSE's website. Please note that Written Affirmations for FPIs can no longer be submitted via email to corporategovernanceintl@nyse.com. Instead, FPIs choosing to submit hard copy Written Affirmations may submit via email to corporategovernance@nyse.com.
- **Transactions Requiring Supplemental Listing Applications (SLAP)**: An NYSE-listed company is required to file a SLAP to seek authorization from the NYSE for a variety of corporate events, such as the issuance of additional shares of a listed security (including those issuable upon conversion of another security), listing of a new security, or change in corporate information. The SLAP must be approved before any of the new shares are actually issued. The NYSE requests at least two weeks to review and authorize SLAPs and recommends that the SLAP be submitted electronically through the Listing Manager as soon as the company's board of directors approves the proposed transaction. Generally, FPIs may follow home country practice in lieu of these requirements.
- **FPI Semi-Annual Reporting**: NYSE-listed FPIs are required to submit a Form 6-K to the SEC containing semi-annual unaudited financial information no later than six months following the end of their second fiscal quarter. The Form 6-K must include (a) an interim balance sheet as of the end of their second fiscal quarter, and (b) a semi-annual income statement that covers their first two fiscal quarters. If the FPI fails to file its semi-annual financial statements within the prescribed time period, the FPI will be subject to the late filer rules in accordance with Section 802.01E of the NYSE Listed Company Manual, including requirements to contact the NYSE to discuss the status of the delinquent filing and to issue a press release disclosing the occurrence of such delinquency). The contravention of these rules could potentially lead to suspension and delisting procedures.

The annual guidance memo and the NYSE Listed Company Manual qualify the above summary. NYSE-listed companies should review the guidance and the NYSE Listed Company Manual carefully.

Noteworthy US Securities Litigation and Enforcement

Judge Overturns FCPA Jury Verdict against Former Alstom Executive

On February 26, 2020, Judge Janet Arterton of the U.S. District Court for the District of Connecticut overturned the jury's conviction of Lawrence Hoskins, a British citizen and former executive of a French multinational company, Alstom S.A. (**Alstom**) as to seven Foreign Corrupt Practices Act (**FCPA**)-related counts. Hoskins was convicted in a November 2019 trial of six counts of FCPA violations, a related conspiracy count, and four separate money-laundering-related counts.

Judge Arterton's ruling is the latest development in a case raising significant issues with respect to the jurisdictional requirements of the FCPA. Hoskins was charged with conducting a multimillion-dollar bribery and money laundering scheme while he was a senior vice president at Alstom. According to the indictment, Hoskins conspired to pay bribes to Indonesian officials to win a bid for a $118 million government contract.

In 2018, the U.S. Court of Appeals for the Second Circuit held that the U.S. Department of Justice (**DOJ**) could not charge Hoskins with conspiracy to violate the FCPA unless it could prove that he acted "while in the United States." The Court explained that "the FCPA does not impose liability on a foreign national who is not an agent, employee, officer, director, or shareholder of an American issuer or domestic concern – *unless* that person commits a crime within the territory of the United States."

The Second Circuit's decision, in effect, closed a loophole–at least in actions brought within the Second Circuit–by which the DOJ had extended, to a significant degree, the potential extraterritorial reach of the FCPA. The Court's decision, at the same time, left open the possibility that Hoskins could be convicted as an agent of a U.S. person, which is the theory that the DOJ pursued at trial.

In overturning the jury's conviction of Hoskins on the FCPA-related counts, Judge Arterton found that the DOJ presented insufficient evidence at trial to establish that Hoskins was an agent of Alstom Power Inc. (**Alstom Power**), a U.S.-based subsidiary of Alstom. According to the agency theory that the DOJ pursued, Hoskins was Alstom Power's agent because Alstom Power controlled the project and instructed Hoskins. Judge Arterton rejected this theory, largely on the grounds that Alstom Power did not have the power to terminate Hoskins' participation in the recruitment of consultants, assess Hoskins' performance, determine his compensation, or otherwise exert direct control over him.

The DOJ has filed a notice of appeal. If the DOJ continues to pursue that appeal, which seems likely, it will lead to yet another chapter in this high-profile FCPA case that already has had many twists and turns.

SEC Brings Accounting Charges against Alcoholic Beverages Company

On February 19, 2020, the SEC announced charges against Diageo plc (**Diageo**), a British multinational alcoholic beverages company, for failure to make required disclosures of certain trends related to the shipment of products by its North American subsidiary, Diageo North America (**DNA**).

According to the SEC's Cease and Desist Order (**Order**), DNA engaged in a "channel stuffing" scheme to give the false impression that it had growth in several performance metrics. While market conditions declined, DNA allegedly pressured third-party distributors to purchase alcoholic products in excess of customer demand to meet internal sales targets. Diageo failed to disclose that it knew its distributors were overstocked with excess inventory and sales were likely to decline in the future. The SEC asserted that this failure to disclose resulted, at least in part, from Diageo's inadequate internal procedures. The SEC contended that as a result of its nondisclosure, Diageo's financial results were materially misleading.

The SEC charged Diageo under the antifraud provisions of Section 17(a)(2) and (3) of the Securities Act, as well as Section 13(a) of the Exchange Act and Rule 13a-1, which requires accurate and complete filings made to the SEC. Diageo did not admit or deny the findings in the SEC's Order, but agreed to pay $5 million to settle the SEC's action.

This matter underscores that the SEC may charge a company with failing to disclose a trend even when it was never identified by the company, because the company lacked adequate internal procedures in place to ensure that the trend was identified and appropriately disclosed. Although it is more commonplace for a company's failure to identify "known" trends or uncertainties to form the basis of a securities violation, this matter illustrates that the failure to identify a significant trend, whether or not the company has actual knowledge of it, also may be actionable.

Supreme Court of Delaware Endorses Federal-Forum Selection Provisions for Securities Act Claims

On March 18, 2020, the Supreme Court of Delaware reversed a lower court decision and clarified that Delaware corporations can require that claims under the Securities Act of 1933 be filed in federal court as opposed to state court. *Salzberg v. Sciabacucchi*, No. 346 2019 (Del. Mar. 18, 2020). This decision likely will provide much needed clarity and uniformity to the question of where Securities Act claims may be filed. Moreover, many Delaware corporations are likely to revise their articles of incorporation or bylaws to add federal forum-selection provisions, substantially reducing the number of state court Securities Act claims going forward.

As originally drafted, the Securities Act provided for concurrent jurisdiction in state and federal courts for Securities Act claims, such as allegations of misrepresentations in public offering materials (Section 11). After Congress enacted the Private Securities Litigation Reform Act of 1995 (**PSLRA**), which raised pleading standards for federal securities class actions, the plaintiff's bar shifted to filing securities class actions in state courts. Congress again amended the law via the Securities Litigation Uniform Standards Act of 1998 (**SLUSA**), which was designed to prevent such an end-run around the PSLRA. Over time, different lower courts developed varying standards as to whether securities class actions based on Securities Act claims could be brought in, or removed from state courts. In 2018, however, the U.S. Supreme Court–in *Cyan Inc. v. Beaver County Employees Retirement Fund*–clarified that state courts have jurisdiction over securities class actions based on Securities Act claims notwithstanding SLUSA, and that such actions generally cannot be removed from state to federal court. In response to *Cyan*, companies have been subject to an increase in Securities Act claims filed in state court, where such claims are often less easily dismissed, or less efficiently litigated.

The *Sciabacucchi* decision alters this dynamic by providing a means by which Delaware corporations can limit, if not eliminate, the filing of Securities Act claims against them in state court. At issue in *Sciabacucchi* is a federal forum-selection clause: a provision in a company's certificate of incorporation or bylaws that limits jurisdiction over Securities Act claims to only federal courts. Plaintiff shareholders challenged the validity of this provision, and the lower court in Delaware, the Court of Chancery, previously found federal forum-selection clauses invalid under Delaware law based upon a narrow reading of the types of provisions permitted in a Delaware corporation's charter as set forth in Section 102(b)(1) of the Delaware General Corporation Law. The Supreme Court of Delaware reversed this decision, finding that the Court of Chancery read Section 102(b)(1) too narrowly, and that federal forum-selection provisions are a permissible procedural limitation on Securities Act claims, which fall within the "outer band" of intra-corporate affairs. The court also held that federal forum-selection provisions do not violate public policy because they permit a plaintiff to file in the federal court of its choosing, and also promote predictability, uniformity, judicial economy, and the avoidance of duplicative efforts among courts in resolving disputes.

The primary implication of the decision is that corporations (especially those incorporated in Delaware) should consider adding federal forum-selection provisions to their charters. Delaware corporations should be able to limit, if not eliminate, state court jurisdiction over Securities Act claims arising from future public offerings. The *Sciabacucchi* decision does not address, however, whether a newly instituted forum-selection clause would apply to ongoing state court litigation. In addition, as plaintiffs challenge federal forum-selection clauses in other jurisdictions, including on federalism grounds, it remains to be seen whether this holding will be followed by other courts. In any event, this decision should be viewed by corporations as welcome relief that will likely lower insurance costs and reduce the incidence of unpredictable litigation of Securities Act claims.

Second Circuit Broadens Scope of Liability for Insider Trading

On December 30, 2019, the U.S. Court of Appeals for the Second Circuit issued an opinion that broadens the scope of liability for insider trading. In *United States v. Blaszczak*, the Department of Justice brought criminal insider trading claims under the Exchange Act (**Title 15 securities fraud**), the 2002 Sarbanes-Oxley Act (**Title 18 securities fraud**), and the wire fraud statute. The alleged underlying conduct involved government employees at the Centers for Medicare & Medicaid Services (**CMS**) disclosing confidential information to a former CMS employee. The former CMS employee allegedly disclosed the confidential information to a hedge fund that used it as a basis to short the stocks of certain healthcare companies.

Under Supreme Court precedent, insider trading liability under Title 15 requires proof that the provider of the confidential information (**tipper**) breached a duty by providing the confidential information in exchange for a direct or indirect personal benefit, and that the downstream recipient of the confidential information (**tippee**) knew of a personal benefit to the tipper. On appeal, the *Blaszczak* defendants argued that the district court erred by not instructing the jury that the personal benefit requirement also applied to the wire fraud and Title 18 securities fraud charges. In essence, the defendants argued that the elements of an insider trading claim should be the same under each of those provisions.

The Second Circuit disagreed and upheld the district court's approach. In particular, the Second Circuit found that the personal benefit requirement for Title 15 insider trading liability was a "judge-made doctrine premised on the Exchange Act's statutory purpose" of eliminating the use of inside information for personal advantage. In contrast, Title 18 securities fraud was intended to provide prosecutors with "a different–and broader–enforcement mechanism to address securities fraud than what had been previously provided in the Title 15 fraud provisions". Accordingly, the Second Circuit held that it would not "graft" the personal benefit requirement onto wire fraud and Title 18 securities fraud.

In addition, the Second Circuit considered whether confidential information about a regulatory decision held by a government agency is "property" for purposes of wire fraud and Title 18 securities fraud. The Second Circuit held that an agency has a "property right in keeping confidential and making exclusive use" of this information. In addition, the agency "invests time and resources into generating and maintaining the confidentiality of" the information, which suggests that it has an economic interest in that information. The Second Circuit therefore held that, "in general, confidential government information may constitute government 'property' for purposes of" wire fraud and Title 18 securities fraud. This portion of the decision, however, generated a dissenting opinion from one of the panel judges. The *Blaszczak* defendants have sought a rehearing of their appeal.

The *Blaszczak* decision, if it stands, clearly increases the risk of federal criminal prosecution for insider trading. Prosecutors now have the latitude to bring cases where there is no evidence of a personal benefit to the tipper. Moreover, the fact that the SEC–which is limited to civil claims under the Title 15 securities fraud provisions–cannot bring these types of cases creates a disparity that could lead to further changes in U.S. insider trading law. The Second Circuit's finding that confidential government information is "property" also means that investors will need to be very careful about trading on information from government sources (whether obtained directly or indirectly), unless it is absolutely clear that the information is publically available.

EU DEVELOPMENTS

Developments Related To COVID-19

European Securities and Markets Authority Recommendations to Financial Market Participants

On March 12, 2020, the European Supervisory & Markets Authority (**ESMA**) issued recommendations to financial markets in light of the impact of COVID-19.

The key recommendations are that:

- Financial markets should be ready to apply contingency plans, including business continuity measures, to ensure they can continue to operate in line with regulatory obligations.
- Issuers should disclose any relevant significant information concerning the impacts of COVID-19 on their fundamentals, prospects or financial situation as soon as possible in accordance with the EU Market Abuse Regulation (**MAR**).
- Issuers should also provide transparency on the actual and potential impacts of COVID-19 in their 2019 year-end financial report. If finalized already, they should provide this in their interim reports. Where possible, disclosures should be based on both a qualitative and quantitative assessment of the impact on the issuer's business activities, financial situation and economic performance.
- Asset managers should continue to follow risk management requirements, and react accordingly.

ESMA states that it is prepared to use its powers to ensure the orderly functioning of markets, financial stability and investor protection.

EU Merger Regulation and COVID-19: Commission Notice of Special Measures (Corporate Aspects)

On March 16, 2020, the European Commission published a notice on special measures for COVID-19.

The note says that despite measures to ensure business continuity in the enforcement of the EU Merger Regulation, companies should, where possible, delay merger notifications originally planned until further notice.

European Commission Guidance Concerning Foreign Direct Investment

On March 25, 2020, the European Commission published a communication to member states aimed at ensuring a comprehensive EU-wide approach to the screening of foreign direct investment (**FDI**) so as to prevent a sell-off of strategic assets. The guidance comes ahead of the FDI Screening Regulation becoming fully applicable in October 2020 (for further reading, you may wish to reference Shearman's related client publication here), in light of particular vulnerabilities stemming from the COVID-19 pandemic.

The guidance notes that risks to critical healthcare infrastructure and related inputs (including research facilities) are mentioned explicitly in the FDI Screening Regulation as factors to be considered when determining whether FDI may threaten national security or public order within the EU.

The European Commission calls upon member states with an existing screening mechanism to use it to prevent third-country FDI which could undermine national security or public order. It also states that members without a comprehensive screening system should set up such a system and, in the interim, use all tools available, in accordance with EU and international law, to prevent the acquisition or control of assets which could undermine national security or public order. Member states should be vigilant so that the COVID-19 pandemic does not result in a sell-off of EU strategic assets. In particular, member states should be aware of FDI which is likely to impact projects of EU interest such as those which have received EU-backed research funding. Such projects, and any proposed acquisition thereof, will receive increased scrutiny from the European Commission.

If you wish to receive more information on the EU's approach to FDI, you may wish to refer to Shearman's prior publication, available here.

European Securities and Markets Authority Statement on Financial Reporting Deadlines under the Transparency Directive

On March 27, 2020, the ESMA issued a public statement noting that it does not expect national competition authorities (**NCA**) to prioritize supervisory actions against issuers as regards deadlines under the Transparency Directive.

ESMA notes that it does not expect NCAs to take actions against issuers in respect of annual financial reports for a period of two months after the TD deadline and in respect of half-yearly financial reports for a period of one month after the TD deadline (in both cases where the relevant reporting period was between December 31, 2019 and April 1, 2020).

ESMA states that it encourages a "risk-based" approach by NCAs in the exercise of their supervisory powers, but it also expects issuers who "reasonably anticipate" the publication of financial reports to be delayed beyond relevant deadlines to keep both the applicable NCAs and markets informed. Issuers must still comply with their obligations under MAR during this time and must in particular disclose to the market any inside information which directly concerns them as soon as possible.

Both ESMA and the NCAs continue to monitor the situation and will take or recommend any measures necessary to mitigate the impact of COVID-19 on timely and appropriate financial disclosures by issuers.

Details of other regulatory responses to COVID-19 are available at Shearman's COVID-19 resource hub.

Developments Related to Financial Reporting

Updated European Securities and Markets Authority Questions and Answers on the Prospectus Regulation

On February 18, 2020, ESMA published the fourth version of its questions and answers on Regulation (EU) 2017/1129 (the **Prospectus Regulation**).

ESMA added two new Q&As in the update, relating to the length of the prospectus summary:

- Where there are multiple securities, ESMA states that an additional two A4 pages can be included in a summary. The page limit may only extend to a maximum of nine A4 sides (an increase from seven sides as set out in Article 7(3) under Article 7(7) of the Prospectus Regulation). Where a key information document is used, the summary can be extended by three pages for each additional security.
- Where there are multiple guarantors, ESMA states the summary may be extended by one additional A4 side per guarantor. The summary may be extended by one page for a single guarantor under Article 7(7) of the Prospectus Regulation. ESMA expects summaries with multiple guarantors be kept as short as possible. Additional pages are to be used for information relating to the guarantors only.

European Securities and Markets Authority Amended Guidelines on Enforcement of Financial Information

On February 4, 2020, ESMA published amendments to a 2014 publication on the enforcement of financial information by competent authorities of EU member states and other European Economic Area (**EEA**) countries that undertake enforcement action under the Transparency Directive.

The amendments are intended to harmonize the enforcement of financial information by national regulators. The changes will require NCAs to further align on:

- the way they select issuers for examination (guideline 5), by requiring that their selection should be based on a combination of:
  - a risk-based approach;
  - random selection; and
  - rotation; and
- the way in which they undertake their examinations (guideline 6), including by requiring that a minimum proportion of examinations should cover the entire financial statement and involve interaction with the issuer.

The amendments are intended to protect investors by strengthening supervisory convergence across the EEA in the area of enforcement of financial information and preventing regulatory arbitrage.

The amended guidelines will become effective on January 1, 2022.

UK DEVELOPMENTS

Developments Related To COVID-19

FRC Advice to Companies and Auditors on Coronavirus Risk Disclosures

On February 18, 2020, the UK's Financial Reporting Council (**FRC**) published an update to its year-end letter of October 30, 2019, encouraging companies to consider carefully any disclosures which may need to be made in year-end accounts relating to the impact of Coronavirus. Companies may wish to consider whether to refer to the possible impact of COVID-19 on their business in their reporting of principal risks and uncertainties, as well as whether the carrying value of assets and liabilities may be affected.

Although the advice was released in the earlier stages of the pandemic (for instance, encouraging companies to think about China-specific exposure in their businesses and supply chains), companies are encouraged to monitor developments and amend their required disclosures accordingly.

FRC Guidance on Audit Issues Arising from the COVID-19 Pandemic

On March 16, 2020, the FRC published its guidance on audit issues which may arise as a consequence of the COVID-19 pandemic. It acknowledges that companies and auditors face practical issues in preparing accounts and carrying out audits, stemming from restrictions imposed on travel and meetings and the need to develop alternative audit procedures to gather sufficient and appropriate evidence.

The FRC is concerned that the current situation should not undermine the delivery of high-quality audits and stresses that audits should comply fully with required standards, even if this results in audits taking longer.

Auditors will need to consider the impact of COVID-19 on several factors relevant to their work. This includes considering whether their risk assessments need to be revised and how to gather all of the evidence needed to perform the audit. Auditors should also consider the adequacy of disclosures made by management about the impact of COVID-19 on their specific companies, while recognizing the current high degree of general uncertainty. Auditors should be prepared to reassess key aspects of their audits as a result of the fast-changing situation up until the auditor's report is signed.

Auditors should set clear expectations as to the level of disclosure they expect to see from companies regarding the impact of COVID-19 on that company. Additionally, companies and audit committees must understand that auditors need sufficient time and support to carry out their work; in some cases, companies should reconsider reporting deadlines to allow this.

FCA Publishes Primary Market Bulletin Issue No. 27 – Coronavirus Update

The UK's Financial Conduct Authority (**FCA**) published its latest Primary Market Bulletin (Issue No. 27) on March 17, 2020, as updated on April 3, 2020.

The FCA's core focus continues to be on protecting consumers and ensuring the proper functioning of markets. The bulletin covers the following:

- The FCA expects issuers to abide by MAR and the relevant FCA rules during the COVID-19 pandemic. Issuers should be aware that their own operational responses to the crisis may meet requirements for disclosure under MAR. The FCA expects issuers to meet their disclosure obligations in a timely fashion, but appreciates that there may be slight delays in the short-term.
- The FCA will continue to consider issuers' requests to suspend trading in certain circumstances, in line with established practices and based on an assessment of the risk to the markets and investors. Issuers should fully examine their justifications prior to requests to suspend trading.
- The FCA expects persons discharging management responsibilities and persons closely associated to continue to meet their disclosure obligations under MAR within the prescribed time frame.
- The FCA, FRC and Prudential Regulation Authority (**PRA**) joint statement on corporate reporting during the COVID-19 crisis (see "Joint Statement by the FCA, FRC and PRA on Corporate Reporting" below). The FCA acknowledges that virtual meetings and communications may need to be used to enable shareholders to exercise their rights, particularly in the case of premium listings.
- The FCA will continue to review documents for corporate transactions and admissions to trading in line with existing practices. It notes that where issuers are looking to carry out urgent transactions, they should consult with sponsors and advisors in the first instance.

Delayed Publication of Preliminary Results Announcements

On March 21, 2020, the FCA announced that it was strongly requesting all listed companies not to publish preliminary announcements of their annual results for at least two weeks. This was to encourage companies to take the necessary time in the rapidly changing environment to prepare appropriate disclosures and to avoid unnecessary pressures on both companies and their auditors on producing a disclosure that is not actually required under the UK's Listing Rules. It has also published a Q&A on this request. The FRC subsequently confirmed that it fully supported the FCA's request.

Joint Statement by the FCA, FRC and PRA on Corporate Reporting

On March 26, 2020, the FCA, FRC and PRA issued a joint statement on actions to be taken to support the efficient and proper functioning of the UK's capital markets, including ensuring the continued timely and accurate flow of information to investors.

In addition to the action taken by the FCA in relation to DTR 4.1 (see "Extensions to Deadlines to the Filing or Publication of Accounts" below), the statement highlighted the following guidance from the FRC:

Company Reporting Guidance

The following FRC guidance (which has been supplemented by the PRA with respect to the approach that should be taken by banks and other financial institutions in assessing expected loss provisions under IFRS 9) covers the following issues:

- **Dividends and Capital Maintenance**: Directors should be satisfied when recommending a dividend that the company is able, legally and prudently, to pay the dividend when due. Where the dividend (including a final dividend) can no longer be paid without amounting to an unlawful return of capital it should not be paid.
- **Strategic Report and Viability Statement**: The FRC notes that the retention and protection of the workforce may be crucial to the company's survival and that disclosures around the company's viability and ongoing operations will therefore need to show how the workforce is being retained and supported. While boards have to have a reasonable expectation of the company's viability over the viability statement's period, the FRC recognizes that currently any reasonable level of expectation will naturally carry a much lower level of confidence.
- **Going Concern, Material Uncertainties and Significant Judgments**: The FRC expects many more companies to be disclosing material uncertainties with respect to their going concern status and gives advice as to the assessments that companies should make in developing their material uncertainty disclosures. Equally, full, entity-specific and detailed disclosures are expected of many more "significant judgments" made in relation to the application of accounting policies, etc.
- **Adjusting and Non-Adjusting Balance Sheet Date Events**: For companies with balance sheet dates ending on or before December 31, 2019, it is expected that COVID-19 factors will be a non-adjusting event disclosure. However, the FRC notes that companies will need to assess whether COVID-19 related factors or events simply helped shine a brighter light on conditions at the balance sheet date or in fact resulted in those conditions actually changing (in which case full and appropriate disclosure will be required). Estimates of the financial effect of the non-adjusting event should be provided where possible, but such estimates need not be exact.

Audit Guidance

- **Professional Skepticism**: The FRC emphasizes the importance of an auditor's professional skepticism in carrying out his audit work, especially where management comes to the view that the current circumstances are not reasonably expected to have any material financial impact on the company and that there are no material uncertainties to be disclosed with respect to its going concern status.
- **Audit Opinions**: Where the limitations experienced by the auditor in obtaining sufficient audit evidence could have a material and pervasive impact on the financial statements, the auditor should disclaim his opinion. If the impact is material but not pervasive, the auditor can issue a qualified opinion. Written representations in lieu of audit evidence will never by themselves amount to sufficient appropriate audit evidence.
- **Non-Audit Services**: Auditors are reminded that their ethical standards allow them to provide non-audit services to public interest entities to deal with time critical and price sensitive issues so long as the provision of such services does not undermine the auditor's independence. The FRC states explicitly that this should be taken to include supporting companies in making applications to any of the business support schemes announced by the government in response to COVID-19.

- **Appointment of New Auditors**: Companies are encouraged to delay planned tenders for new auditors, even where mandatory rotation is due. The FRC has powers, when an application is made to it by a company, to extend the rotation period. Similarly, the FRC points out that the five year audit partner rotation period can be extended to seven years when there are compelling reasons to do so. Such extension must be agreed with the audit committee of any affected entity, but does not require FRC approval or clearance.

See the FRC's audit guidance here.

Extensions to Deadlines to the Filing or Publication of Accounts

Companies House extension

On March 25, 2020, Companies House (the UK registrar of companies) announced that companies will be able to apply for a three-month extension for filing their accounts. Those citing issues around COVID-19 in their applications will be automatically and immediately granted an extension.

FCA DTR 4.1 extension

On March 26, 2020, the FCA published a Statement of Policy in which it said that it would forbear from suspending a company's listing (or taking other enforcement action) if it failed to publish its annual financial report within the four months after its financial year end as required by the Disclosure Guidance and Transparency Rules (DTR 4.1), so long as the report is published within six months of that year end. This extension will continue on a temporary basis and will remain under review by the FCA while the COVID-19 crisis persists. A Q&A has also been published in relation to this Policy.

AIM and AQSE Growth Market accounts publication extensions

On March 31, 2020, Aquis Stock Exchange (AQSE, and formerly NEX Exchange) announced that for companies admitted to trading on its multilateral trading facility (**MTF**) market, the AQSE Growth Market, it would be extending the existing six month deadline by which annual audited accounts must be published by one month (from the end of the financial year). This will be a temporary extension and AQSE has said that it will continue to engage with stakeholders during the present crisis and may extend the deadline further if beneficial to companies.

On March 26, 2020, the London Stock Exchange's (**LSE**) MTF market, AIM, also announced that companies whose financial year ends fall between September 30, 2019, and June 30, 2020, may apply for a three-month extension to the six month deadline by which they must publish their annual audited accounts under the AIM Rules for Companies. The application must be made by the company's nominated adviser and before the expiry of the existing six-month deadline. The LSE also said that it would keep under review the current three-month deadline by which AIM companies must publish a half-yearly report.

BEIS Announcement on COVID-19 Changes to Insolvency Laws and AGMs

Insolvency law changes

On March 28, 2020, the Secretary of State for Business, Energy & Industrial Strategy (**BEIS**) announced a series of proposed measures intended to protect UK companies facing major funding and operational difficulties related to the current COVID-19 crisis. These measures will involve legislation (not yet published) being brought forward at the earliest possible opportunity to introduce:

- a new moratorium to protect companies while they explore options for a financial rescue or restructuring, as an addition to existing moratoria provided by the Insolvency Act 1986 (**IA 1986**) in connection with administrations;

- a temporary suspension of the wrongful trading provisions of the IA 1986, retrospectively from March 1, 2020, under which the court can require a director to make a financial contribution to the assets of the company where the company has gone into insolvent liquidation and before winding up the director knew or ought to have known that there was no reasonable prospect that the company would avoid entering into insolvency; and
- three significant insolvency law reforms that the UK government reported in 2018 it would legislating for, following its earlier review of the corporate insolvency and governance regime; these reforms will include a new restructuring plan that will operate in a similar way to existing creditor schemes of arrangement though with some significant differences and prohibitions on suppliers exercising termination rights under their supply agreements.

These changes will likely have a significant impact on the position of creditors and their existing rights to seek repayment of overdue indebtedness, etc., even though BEIS has said that when introducing these changes it will attempt to strike a balance between protecting companies from short-term liquidity challenges and ensuring that creditors get the best return possible in the current circumstances. BEIS has also said that all other existing checks and balances under the IA 1986 and companies legislation will remain in force to ensure that directors fulfil their duties properly.

AGM flexibility

When announcing the above insolvency law changes, BEIS also said that it would be putting measures in place to help companies with holding (or postponing) of annual general meetings (**AGM**s) while the current restrictions on public gatherings remain in place. In the interim, public companies required to hold AGMs within six months of their financial year-end while those restrictions remain in force will need to consider holding virtual meetings where possible and consider the UK's Chartered Governance Institute's (**ICSA**) advice discussed below.

If you wish you receive more information on these insolvency measures, you may wish to refer to Shearman's prior publication on the subject, available here.

Chartered Governance Institute Guidance on Virtual Meetings

ICSA has issued three sets of guidance on the holding of virtual meetings by companies during the current COVID-19 crisis:

AGM guidance

On March 17, 2020, ICSA issued guidance with respect to the contingency planning that companies should consider implementing with respect to forthcoming AGMs in light of the spreading COVID-19 virus and the impact it is having on social gatherings, etc.

On March 27, 2020, ICSA supplemented this guidance following the implementation of new legal prohibitions on social gatherings which would have the effect of preventing companies holding physical shareholder meetings. This further guidance deals with a number of legal and practical issues that may arise as a result of the inability to hold physical meetings in the usual way. These include advising shareholders that they cannot attend the meeting in person and how they can nevertheless participate in the business of the meeting through proxy voting and submitting questions to directors, etc.

Board and committee meetings

On March 28, 2020, ICSA issued further guidance on the holding of virtual board and committee meetings during the current crisis, as well as alternatives to such meetings, such as written resolutions.

As well as covering some legal issues, the guidance offers practical advice on matters such as setting up meeting calls and how virtual board meetings may be chaired and run. Specifically, the guidance does not recommend that meetings be recorded but that instead minutes of the meeting be taken in the usual way.

Pre-Emption Group 20% Statement

On April 1, 2020, the UK's Pre-Emption Group (**PEG**) issued a statement in which it encouraged investors, on a temporary case by case basis, to consider supporting non pre-emptive equity issues by listed companies of up to 20% of their issued share capital to assist those companies in their efforts to raise urgently needed capital in the current environment. The PEG's existing pre-emption principles allow companies to make non pre-emptive issues of up to 5%, with a further 5% permitted for specific identified investments. Larger non pre-emptive issues are permitted where a specific disapplication of shareholder pre-emption rights is obtained from shareholders.

The PEG has attached a number of conditions to this relaxation of its pre-emption principles, including that, so far as possible, share issuances making use of this additional flexibility should be made on a soft pre-emptive basis and with proper consultation with a representative sample of the company's major shareholders. This recommendation is to be reviewed by the PEG by September 30, 2020, in light of how companies and investors have responded to it.

Investment Association Letter to FTSE 350 Chairs

On April 7, 2020, the Investment Association (**IA**) wrote a letter to the chairs of the FTSE 350 companies, outlining certain of its members' views in relation to the COVID-19 pandemic, including the following:

- **Engagement and Communication**: The IA requests that companies maintain an open dialogue with shareholders and other stakeholders over the next few months. The IA continues to support firms who value sustainable long-term targets over short-term financial returns.
- **Financial Reporting**: Companies and auditors should take time to prepare financial statements, including using the additional two months permitted by the FCA in which to publish them where necessary (please see discussion of "Delayed Publication of Preliminary Results Announcements" above).
- **AGMs**: The IA welcomes the ICSA guidance on how companies can hold AGMs and GMs under the "Stay at Home" measures (see "Chartered Governance Institute guidance on Virtual Meetings" above). Companies are asked to consider how to engage effectively with shareholders in lieu of an AGM.
- **Dividends**: IA members support the recent joint statement (see "Joint Statement by the FCA, FRC and PRA on Corporate Reporting" above), and consideration should be given to the position of the company when a dividend is paid as well as when it is declared (including the ability to pay employees and suppliers). However, dividends provide an important income stream to pensions and charities, and shareholders would likely be concerned were companies to unnecessarily reduce dividend levels. Ultimately companies should be transparent about dividends, particularly in situations where they are seeking additional capital.
- **Executive Pay**: Executive pay should take account of shareholder experience, not just financial performance. Where companies makes changes to employee pay or dividends, IA members will support boards and committees who demonstrate how these changes should be reflected in executive pay.
- **Long-Term Capital Raising**: IA members believe that the existing PEG guidelines should be respected, but all stakeholders (including regulators and lawyers) should consider ways to shorten applicable timetables. A cashbox may be the only suitable option in some situations, and IA members support the PEG statement (see "Pre-Emption Group 20% Statement" above) allowing companies flexibility for a limited period on a case-by-

case basis. Shareholders would expect the placing to be issued to long-term shareholders in the first instance.

ISS Policy Guidance on the Impacts of the COVID-19 Pandemic

On April 8, 2020, the Institutional Shareholder Services group of companies (**ISS**) published guidance on the application of its benchmark and specialty proxy voting policies during the COVID-19 pandemic. Further background on the latest ISS policies can be found in the February 2020 Governance & Securities Law Focus.

Topics on which guidance was issued include:

- **Meeting Postponements**: Many companies continue to delay AGMs given the challenges of holding physical meetings in the current climate. ISS acknowledges that health and safety is the paramount concern. In jurisdictions where online meetings are prohibited, local regulatory guidance should be followed and physical meetings only held where it is safe to do so. Shareholders are still likely to expect standard disclosure documents and for companies to provide updates via press releases and websites. ISS states that it will be positively noted when companies use electronic communications (such as webcasts and conference calls) to engage with shareholders.
- **Virtual-Only Meetings**: In the limited number of jurisdictions in which ISS policy discourages "virtual-only" meetings, ISS will be altering the application of such policies so as not to include adverse vote recommendations (provided that virtual-only meetings are already allowed by law and where no amendments to bylaws are required). Where boards decide to hold virtual-only meetings, the reason for this decision should be disclosed and shareholders allowed the opportunity to participate meaningfully.
- **Director Attendance**: ISS notes that some markets allow directors to attend board or shareholder meetings electronically or by phone. In jurisdictions where such attendance is not routinely permitted, ISS will look for companies to provide adequate explanations for directors' absences (while being mindful of privacy concerns). Adequate information should be provided to allow shareholders to make informed judgments and considered voting decisions if relevant to directors' attendance or absence.
- **Changes to the Board of Directors or Senior Management**: ISS states that it recognizes the need for flexibility during the COVID-19 pandemic and that boards should have broad discretion to ensure that they have the correct teams in place, including where appointments are made on an interim basis.
- **Compensation**: Even though decisions as to 2020 compensation will typically be made in the 2021 AGM season, boards are encouraged to make contemporaneous disclosure about any metrics or targets used to calculate short-term compensation programs. ISS will look at any in-flight changes to long-term compensation programs on a case-by-case basis to ensure adequate rationale is provided. Structural changes to long-term programs will be assessed in accordance with ISS's existing policies.
- **Dividends**: Where market-specific ISS policies look for dividend payout ratios to be within a certain range, this year ISS will support broad discretion for boards to set ratios which may fall below historic or market practice. In assessing such proposals, ISS will look to whether preserved cash supports and protects the business and workforce.
- **Share Repurchases**: ISS notes that companies will likely face intense criticism and reputational damage if share buy-backs are conducted during the COVID-19 pandemic, even if such buy-backs have previously been approved by shareholders. While, in the absence of serious concern about a company or prohibiting regulations, ISS continues to be in favor of share repurchases, those conducted in 2020 will be analyzed in

the run-up to the next AGM to check whether directors managed risks associated with repurchases responsibly.

- **Share Issuances**: ISS notes that companies may need additional sources of financing to help them through the crisis. The existing framework policy will continue to be applied to general authorization and share issuance requests, but will be adapted to take into consideration any local regulatory relaxations or new guidance.

FCA Statement of Policy for Listed Companies and Recapitalization Issuances during COVID-19

On April 8, 2020, the FCA announced, in a new Statement of Policy, a number of important primary market regulatory changes and approaches to assist listed companies hoping to undertake recapitalization and other transactional activity in the current COVID-19 crisis.

Raising capital

The FCA endorsed the earlier statement by the PEG, released on April 1, 2020 (see "Pre-Emption Group 20% Statement" above) that encourages investors to support, on a temporary and case-by-case basis, companies that are seeking to raise new capital on a non-pre-emptive basis of up to 20% of their existing issued share capital, which is twice as much as the existing guidance of the PEG allows.

The FCA also reminded issuers about the simplified form of prospectus that is now available under the new Prospectus Regulation for secondary issues and encouraged issuers to use this form where possible for COVID-19 recapitalization exercises where it is available under said regulation.

In addition, the FCA, again on a temporary basis, said that issuers should be permitted to disclose in the working capital statements that they are required to make in prospectuses or certain shareholder circulars, key modelling assumptions in relation to business disruption during the COVID-19 crisis that underpin the issuer's "reasonable worst-case scenario".

This represents a significant departure from the ESMA's "Prospectus Recommendations" that "clean" working capital statements should not contain any assumptions. The disclosure is justified by the FCA on the basis that issuers are required to model a "worst-case scenario" when producing their working capital statements and so may want investors to be aware of specific assumptions they have taken into account in relation to business disruption caused by COVID-19, without having to qualify those statements by that disclosure. By being able to make that disclosure with an otherwise clean working capital statement, investors should find it easier to distinguish between companies whose financial position is affected by more than just COVID-19 uncertainties (and which could only issue qualified working capital statements) and companies whose future working capital position might be impacted by COVID-19 uncertainties but whose financial position and business model is otherwise financially sound.

The FCA acknowledges that this additional disclosure may not be appropriate for all issuers and that a qualified working capital statement may still be appropriate for other issuers. This additional disclosure in relation to clean working capital statements will also only be available where there relevant assumptions underpinning the reasonable worst-case scenario are subject to significant uncertainty.

The FCA has published a technical supplement to its Statement of Policy, which provides more detail about its approach and which emphasizes that apart from this limited additional disclosure, the rest of the working capital statement must remain "clean" (and to that end, lists other disclosures that will not be permitted in such statements).

Shareholder approval for Significant Transactions and Related Party Transactions

The UK's Listing Rules require premium listed companies to obtain shareholder approval for certain transactions that can be significant for their shareholders, either because of their relative size to the company or because they are with related parties of the company (directors or shareholders with 10% or more voting stakes). In the current environment, holding shareholder meetings, as well as the delay to deal timetables in convening those meetings, are likely to pose significant obstacles for the company. Therefore, in its statement of policy, the FCA announced that it will be prepared to grant a dispensation from these requirements on a temporary, case by case basis, depending on the particular transaction.

The FCA has issued a technical supplement to explain how this approach will operate. The issuer must have obtained or confirm that it will obtain a sufficient number of written undertakings from shareholders that they approve the transaction and would vote in its favor at a general meeting (**GM**), as would meet the relevant threshold for shareholder approval in a meeting under the Listing Rules. It must also announce to the market (and in a shareholder circular, which must still be posted, giving further detail of the relevant transaction) that it has obtained these undertakings and that, if allowed by the FCA, a shareholder meeting will not be held.

The transaction can be completed either when the circular is issued (where the required undertakings have already been obtained) or following a further announcement that the required undertakings have now been obtained.

Alternatively, if the company is able to hold a shareholder meeting virtually, the FCA has said that it will support that approach.

Finally, in its Statement of Policy, the FCA reminds market participants that no changes are being made to the operation of MAR and that MAR compliance remains critically important in the current environment. It also says that its response to COVID-19 will continue to evolve as the situation develops and that it welcomes views on further actions that might be required.

Market Abuse Regulation

In several of its COVID-19 announcements (see, e.g., "FCA Publishes Primary Market Bulletin Issue No. 27 – Coronavirus Update", above), the FCA has stressed that the current crisis has not lessened or relaxed the need for companies and firms to continue to comply fully with all the requirements of MAR. This is particularly the case as regards the careful assessment of whether they are in possession of inside information, recognizing that the current crisis and the various policy responses thereto may alter the nature of information that is material to a company's prospects, and whether there are valid reasons under MAR to justify a delay in the prompt disclosure of that information to the market.

Corporate Governance Updates

FRC Annual Review of UK Corporate Governance Code

On January 9, 2020, the FRC published its annual review of the UK Corporate Governance Code (**Annual Review**), which assesses reporting against the 2016 UK Corporate Governance Code (**2016 CGC**) and early adoption of the 2018 UK Corporate Governance Code (**2018 CGC**).

The Annual Review highlights that there has been a focus on achieving strict compliance with the provisions of the UK Corporate Governance Code (a "tick box" approach) and that there should instead be a focus on the activities and outcomes of the principles of the 2018 CGC, especially on board effectiveness and decision-making, and how this has led to sustainable benefits for shareholders and wider stakeholders (including the economy and wider society) in a manner that shareholders can evaluate.

All premium listed companies will report against the 2018 CGC in 2020.

Investment Association Statement on Shareholder Priorities for 2020

On February 5, 2020, the IA published guidelines setting out shareholder priorities for 2020 for listed companies. In particular, the IA has developed expectations on four areas it believes can be critical drivers of long-term value in 2020, and which it hopes will better the UK's listed market to make it more diverse, future-proof, holistic and resilient, as set forth below:

- **Responding to Climate Change**: More scrutiny should be placed on how companies manage climate change risks and how they are responding to these risks and activities, including necessary disclosures.
- **Audit Quality**: The annual report and accounts should be high quality so investors can rely on them to make long-term investment and engagement decisions.
- **Stakeholder Engagement**: Following the 2018 CGC, greater emphasis is placed on how directors take employee and other stakeholder interests into account in their decision-making.
- **Diversity**: The IA recognizes that this is improving, following the Hampton-Alexander Review FTSE Women Leader's report, but underscores that more progress is needed to ensure companies are embedding diversity throughout the organization.

The IA also described the particular approaches that its corporate governance research service, the Institutional Voting Information Service, is taking in these areas.

Parker Review Update Report on Ethnic Diversity on Boards

On February 5, 2020, the Parker Review Committee published an updated report on ethnic diversity on boards. The original report, published on October 12, 2017, highlighted two main imperatives:

- Greater alignment of the board with the customer base at home and overseas.
- Recognizing the changes and growing talent pool of ethnically diverse candidates in our home and overseas markets which will influence recruitment patterns.

The new report includes detailed data, both on the current profile of FTSE 350 boards and on ethnic diversity reporting. This data has been described by the FRC as unsatisfactory in a press release, which highlighted the following statistics:

- 3% of the FTSE 100 and 11% of the FTSE 250 do not have a policy on board diversity;
- over half of FTSE 100 companies (54) provided little elaboration in their policy beyond some acknowledgement of the value of board diversity; and
- only 21 FTSE 100 companies specified ethnicity in director succession planning,

The FRC said that it would be closely monitoring how companies report on their policies or explain their lack of progress in the above areas.

PLSA Stewardship Guide and Voting Guidelines 2020

On February 21, 2020, the Pensions and Lifetime Savings Association (**PLSA**), which represents the interests of the occupational pensions industry and provides services to its members, published its revised Stewardship Guide and Voting Guidelines. These guidelines offer practical guidance for schemes to act as good stewards of their assets, including clear guidance on how to exercise votes on key issues. They are intended to be a practical, step-by-step checklist.

The 2020 amendments reflect the UK Stewardship Code 2020 (which came into effect on January 1, 2020, and sets high stewardship standards for asset owners and asset managers, and for the service providers supporting them) and its greater focus on environmental, social and governance issues, along with amendments in relation to disclosure requirements. Following findings in the 2019 PLSA AGM Voting Review, which analyzes the results and key themes of the 2019 voting season and focuses on resolutions attracting significant dissent across the FTSE 350, the update also urges investors to consider executive pension contributions, which the PLSA says should be in line with percentages applied to the overall workforce.

The guidelines set out corporate governance and stewardship regimes in the UK and also cover the following topics:

- what recent regulations on shareholder engagement mean for scheme investors and how corporate governance and stewardship relate to each other;
- what investors should look for when it comes to assessing corporate behavior and governance; and
- key issues of interest to investors (e.g. audit, remuneration and climate change), including an examination of what investors should look for from companies, where they might find key evidence and metrics to help them decide, which resolutions are most relevant and how investors should consider voting.

In the update, the PLSA emphasizes that investors should conduct a "stock-take" after working with their advisers and managers to consider their approach to voting on any company issues and to think about their views of the board as a whole, and also consider the board's responsiveness to investor concerns. To assist investors, the guidelines provide three checklists on stewardship, engagement and voting, along with voting recommendations.

See a helpful summary of the voting recommendations by the PLSA here.

Audit Updates

BEIS Committee Inquiry on Delivering Audit Reform

On March 20, 2020, the BEIS Committee launched a follow-up inquiry on delivering audit reform to map implementation of meaningful reform of the UK's audit industry following independent reviews carried out in the past two years (i.e., the Brydon Review, the Kingman Review and the CMA Audit Market Study) and a Future of Audit Report published by the BEIS Committee on April 2, 2019. The BEIS Committee invites written submissions dealing with the following key questions:

- Do the proposals from the three reviews of audit fit together as a coherent package that can deliver meaningful reform?
- Which reforms can be delivered without legislation and what progress has the FRC made in implementing such reforms ahead of future legislation?
- Will the reforms proposed by the audit industry itself address the failings that were identified by the reviews and the BEIS Committee's Future of Audit Report?
- When will the Government bring forward its proposals and the necessary legislation where required?
- Will audit reform help track progress made by companies in meeting the UK's Sustainable Development Goal commitments and in particular Net Zero (a statutory target set by the Climate Change Act 2008 for at least a 100% reduction of UK greenhouse gas emissions by 2050 compared to 1990 emissions)?
- How will audit reform fit with wider corporate governance reform?

The deadline for written submissions is July 31, 2020.

FRC Final Strategy and Budget 2020–2021

On March 23, 2020, the FRC published its strategy and budget for 2020–2021 following positive responses to the consultation draft it published in February 2020. The FRC's purpose, objectives, regulatory principles and business model in the final plan are substantially the same as in the consultation. However, its key priorities and outputs for 2020–2021 have been amended to include:

- considering the merits and otherwise of endorsing a framework to measure the impact of companies on society and the environment;
- establishing an audit market monitoring function and devising an appropriate strategy;
- establishing the necessary capacity to undertake regulatory duties over actuaries;
- developing and publishing the FRC's views on what constitutes good external audit;
- in relation to the oversight of professional bodies, making significant progress on moving decision-making about auditor registration to the FRC in line with the Kingman Review recommendations; and
- ensuring that more enforcement cases deliver their primary reports to related parties within two years.

The FRC's new purpose is to serve the public interest by setting high standards of corporate governance, reporting and audit and by holding to account those responsible for delivering them. One of the key changes the FRC is making to effect its new purpose is reorganizing the FRC into four Divisions:

- Regulatory Standards and Codes;
- Supervision;
- Enforcement; and
- Corporate Services.

The FRC has suggested it will develop a more long-term strategy when the UK government has finalized its position on public policy issues in relation to the audit market.

Corporate Reporting and Disclosure Updates

Companies House Guidance on Reporting Discrepancies about Beneficial Owners

On January 10, 2020, Companies House published guidance on reporting a discrepancy about a beneficial owner on the "people with significant control" (**PSC**) register by an obliged entity (which includes credit institutions, financial institutions, trust or company service providers, and other persons trading goods in cash amounting to EUR 10,000 or more). Our 2017 client briefing on the UK PSC reporting regime is here.

Amendments transposing the Fifth Money Laundering Directive ((EU) 2018/843) (**5MLD**) require the reporting of material discrepancies.

From January 10, 2020, a report is required if a discrepancy is found when a new business relationship is being set up between an obliged entity and a customer, and must be made as soon as reasonably practical. The discrepancy report should include the obliged entity's name, type of business and address; date when the discrepancy was noticed; specified contact details of the person reporting; company name and number being reported on; type of discrepancy (for example, if it relates to a person, relevant legal entity, statement or missing PSC); and details of the discrepancy (for example, an incorrect address or invalid PSC statement).

Companies House will then investigate the discrepancy. If it is valid, it will contact the company concerned for further action and if the discrepancy is not resolved, it may remove the incorrect information from the PSC register. The company will not be informed that a report has been made, though the obliged entity will be informed of the outcome of the investigation.

FRC Lab Report on Workforce-Related Corporate Reporting

On January 20, 2020, the FRC's Financial Reporting Lab (**Lab**) published a report on workforce-related corporate reporting. This report follows a call for participation from investors and companies, and sets out practical guidance on how companies can make their reporting more effective and comprehensive by providing a set of questions they should ask to help develop their reporting. It follows four key elements of investor interest, i.e. governance and management, business model and strategy, risk management, and metrics and targets.

The report highlights that investors overwhelmingly support clearer disclosure of workforce matters and are interested in how a company intends to support the development of its workforce in a sustainable, long-term manner. Further to this, the report encourages companies to think of the workforce as a strategic asset and explain how it is invested in, with appropriate data.

See a helpful summary by the Lab of its report here, covering questions companies should ask themselves about their reporting on workforce matters.

The Lab highlights that the reporting recommendations can be applied to other sustainability-related topics, such as climate change, which it reported on here.

Transparency International UK Report on Open Business (Corporate Aspects)

On March 12, 2020, Transparency International UK (**TI UK**), a civil society organization campaigning against corruption, published a report challenging companies to fundamentally rethink how they disclose their work to combat corruption. This report, which sets a new bar for disclosures in anti-corruption and governance, outlines the business case for greater corporate transparency and provides an aspirational but achievable roadmap to better corporate practice, including responses on legal challenges that might inhibit companies from disclosing information. To this end, it calls on companies to:

- increase meaningful disclosures on their anti-corruption programs;
- improve meaningful disclosures around beneficial ownership;
- publicly disclose all fully consolidated subsidiaries and non-fully consolidated holdings (specifying the percentage owned), and publicly state that they will not work with businesses with deliberately opaque structures;
- publicly disclose the nature of the work, their countries of operation and the countries of incorporation of their fully consolidated subsidiaries and non-fully consolidated holdings, and publicly disclose country-by-country breakdowns of their payments to governments; and
- increase meaningful disclosures on their corporate political engagement.

An executive summary by TI UK is here.

FCA Handbook Notice 75 and Response to CP19/33 (Corporate Aspects)

On March 27, 2020, the FCA published Handbook Notice 75 in response to feedback regarding changes to the Listing Rules (**LRs**) set out in chapters 3 and 4 of the Quarterly Consultation No 26 (CP19/33) and the final Listing Rules Instruments implementing the changes.

The FCA is proceeding to amend LR 13, Annex 1 so that the sale and purchase agreement or equivalent document will no longer need to be made available online for a Class 1 transaction. Subject to minor alterations, the FCA will also proceed to amend the LRs to require issuers with listed securities to keep available in the National Storage Mechanism (NSM) either the securities' approved prospectus, a document with the securities' terms and conditions, or a description of the securities rights and how to exercise them at all times while the securities are admitted to the Official List. To effect this, new continuing obligations will be inserted in the relevant LRs.

These changes will come into force on April 27, 2020.

Developments Relating To Brexit

Government Brings EUWA 2018 Provisions into Force Concerning Post-Exit Day and Post-Transition Period Legislation Status: Brexit Statutory Instrument

On January 29, 2020, the Department for Exiting the European Union made the EUWA 2018 (Commencement No. 5, Transitional Provisions and Amendment) Regulations 2020 (SI 2020/74).

Regulation 2 brings into force the following provisions of the European Union (Withdrawal) Act 2018 (**EUWA 2018**) on exit day:

- **Section 7(1)**: This provides for the legislative status of primary legislation, subordinate legislation and other enactments that are preserved in UK law after exit day by virtue of sections 1A(2) or 1B(2) of the EUWA 2018, which respectively concern the savings provisions for the effects of the European Communities Act 1972 (**ECA 1972**) and EU-derived domestic legislation. The ECA 1972 will be repealed on exit day by the European Union (Withdrawal Agreement) Act 2020 (the **Withdrawal Agreement**), but much of it will remain until the end of the transition period (11:00pm on December 31, 2020).
- **Section 7(6)**: This distinguishes between direct principal EU legislation and retained direct minor EU legislation, both of which are retained EU law under section 3 of the EUWA 2018. After the end of the transition period, the UK will have a more restricted ability to modify retained direct principal EU legislation than retained direct minor EU legislation.
- **Section 23(5) and Schedule 8**: These concern the government's existing and future powers to make subordinate legislation.

Furthermore, Regulation 3 amends the date that the European Union Act 2011 will be repealed, from January 31, 2020 (exit day) to the end of the transition period (11:00 pm on December 31, 2020).

Brexit: FCA Handbook Notice No 73 (Corporate Aspects)

On January 31, 2019, the FCA published Handbook Notice 73, detailing two instruments concerning the Brexit implementation period. Both instruments (neither of which were consulted on) came into force with immediate effect.

The Withdrawal Agreement defers the commencement of amendments that have already been made to the FCA Handbook rules and Binding Technical Standards in connection with Brexit from 11 pm on January 31, 2020 (exit day) to 11 pm on December 31, 2020 (implementation period completion day).

However, where the Withdrawal Agreement does not defer the commencement of exit instruments made last year (or provisions within them), the FCA has made Exiting the European Union: Implementation Period (Guidance) Instrument 2020 (FCA 2020/7) which amends the General Provisions in the Handbook by inserting a new Chapter 2A. Chapter 2A notes that during the implementation period, the FCA Handbook and other documents issued by the FCA should not be read without reference to section 1B of EUWA 2018. This section makes cross-cutting provisions to ensure that UK legislation gives effect to the implementation period at Part 4 of the Withdrawal Agreement.

In addition, the FCA has made the Exiting the European Union: Deferral of Commencement and Miscellaneous Fees Instrument 2020 (FCA 2020/6). This amends the FCA Fees Manual, by deferring the commencement of FCA Handbook guidance until the end of the implementation period.

The FCA has not yet amended all references to "exit day" in the annexes of its exit instruments but intends to make the updates this year.

Statutory Auditors and Third Country Auditors (Amendment) (EU Exit) Regulations 2020: Brexit Statutory Instrument

On February 4, 2020, the Statutory Auditors and Third Country Auditors (Amendment) (EU Exit) Regulations 2020 were published. This instrument aims to address failures of and deficiencies in retained EU law and ensure the regulatory systems and professional recognition of statutory auditors and third-country auditors in the UK works effectively after withdrawal.

The instrument does the following:

- gives provisional adequacy status to China's competent authorities from the end of the implementation period (currently December 31, 2020) until November 30, 2024;
- gives South Africa competent authority with a period of provisional adequacy from the end of the implementation period to July 31, 2022;
- removes Indonesia's competent authority from the list of authorities having provisional adequacy status; and
- inserts transitional provisions to ensure that the audit exemption currently available to subsidiaries of UK and EEA parent undertakings continues to be available to those subsidiaries where their financial years have already begun. Notably, the exemption will cease to apply for subsidiaries of EEA parent undertakings for financial years beginning on or after the day after the end of the implementation period.

The regulations also introduce an assessment framework for the equivalence of third countries' audit regulatory frameworks and the adequacy of third-country competent authorities' arrangements for the handling of audit working papers and investigation reports, as well as make minor amendments to the current implementation of the Audit Directive and Accounting Directive.

The regulations will come into force 21 days after the day on which they were made (January 31, 2020), except for Part 2, which will come into force immediately before the end of the implementation period.

Brexit: BEIS/FRC Letter on Accounting and Corporate Reporting

On February 13, 2020, BEIS and the FRC published a letter to the accounting sector concerning implications of Brexit during and after the transition period. The letter provides updates to advice published in February 2019. In summary the updates are as follows:

- during the transition period there will be no change to the UK's accounting and corporate reporting framework; and
- the Accounts and Reports (Amendment) (EU Exit) Regulations 2019 and International Accounting Standards (**IAS**) and European Public Limited Liability Company (Amendment etc.) (EU Exit) Regulations 2019 will now come into force at the end of the transition period, and the government's equivalence direction that EU-adopted IAS are equivalent to UK-adopted IAS for the purposes of preparing financial statements for the

Transparency Directive regime requirements and a prospectus under the Prospectus Directive regime will also come into force at the end of the transition period.

The letter also provides the following clarification for UK public companies with a UK listing for financial years overlapping exit day:

- for financial years beginning during the transition period, they will continue to use EU-adopted IAS, including any new or amended standards adopted by the EU during the transition period; and
- where new or amended standards are adopted by the UK after the transition period but before those companies file their accounts for the relevant financial years, companies may either (i) continue to use EU-adopted IAS as at the end of the transition period, or (ii) choose to apply the new UK-adopted IAS. If companies choose option (ii) they will have to state the use of that option. Regulations to permit the second option are yet to come before the UK Parliament.

The UK is seeking equivalence decisions on accounting and audit, and an adequacy decision on audit from the European Commission. Conclusions are expected in June 2020.

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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