



COVID-19: PRESSURE POINTS: US SECURITIES DISCLOSURE IMPLICATIONS FOR FOREIGN PRIVATE ISSUERS (UNITED STATES)

02 April 2020 | New York

- By **Dinesh Banani, Tom O'Neill, Dennis Hermreck and Elizabeth Bramon**

Many companies are facing operational and other challenges as a result of COVID-19 and satisfying securities disclosure and financial reporting obligations is certainly one of them. In this memo we describe how US securities law disclosures are likely to evolve in the coming weeks and months in light of COVID-19, with a particular focus on foreign private issuers

These disclosure considerations will be especially relevant to those foreign private issuers who are updating their disclosure in anticipation of accessing the US capital markets as part of capital solutions to address the consequences of COVID-19, and may be updating their annual reports at the same time. They are relevant both to offerings of securities registered with the US Securities and Exchange Commission (the “**SEC**”) and to offerings of securities under Rule 144A (where US execution and disclosure standards will often apply by analogy as a matter of market practice).

The challenge of crafting disclosures regarding the coronavirus crisis is made all the more difficult by the potential that a securities class action may be filed alleging that over coronavirus-related disclosures were inadequate. Indeed, some such suits have already been filed. In addition, the SEC in the recent past has charged companies for allegedly insufficient disclosures made in reaction to crisis situations, and can be expected to scrutinize disclosures made in the current pandemic.

CONDITIONAL SEC RELIEF FOR DELAYING DISCLOSURES

The SEC has emphasised that health and safety of employees should be the first priority for companies at this time and these matters should not be compromised to meet financial reporting requirements. As a result, for companies reporting under the Securities Exchange Act of 1934 (the “**US Exchange Act**”), the SEC has issued conditional relief from deadlines to file certain reports. The relief comprises an extension of 45 days to file Form 10-K, Form 10-Q, Form 20-F, proxy statements and, in some cases, beneficial ownership reports, provided:

The filing was originally due to be made between March 1, 2020 and July 1, 2020;

The reporting company is unable to meet the original deadline as a result of the pandemic;

By the original deadline to make its filing, the company furnishes instead a Form 8-K or Form 6-K stating that it is relying on the relief and the reasons for doing so, and the expected date of making the filing. Companies are encouraged to consider whether including risk factor disclosure on COVID-19 would be appropriate; and

The company makes its original filing within 45 days of its original deadline, noting that it relied on the relief and why.

It will be interesting to see how many issuers take advantage of the SEC’s relief. At the time of any Form 8-K or Form 6-K announcing reliance on such relief, there will be pressure on companies to explain, with some detail, the impact that COVID-19 is having on their business at that time, and companies may not be ready to make such disclosures as they assess impact in an incredibly dynamic environment. The SEC did clarify that any filing that is made on a delayed basis in reliance on the relief will not constitute a “late filing” under the securities rules (and issuers will not need to rely on the usual safe harbour for late filings under US Exchange Act Rule 12b-25).

KEY DISCLOSURE CONSIDERATIONS

On March 25, 2020, the SEC’s Division of Corporation Finance issued CF Disclosure Guidance: Topic No. 9 (the “**COVID-19 Disclosure Guidance**”), which provides the Division of Corporation Finance’s current views regarding disclosure and other securities law obligations that companies should consider with respect to the COVID-19 and related business and market disruptions. In the guidance, the Division noted:

“The Division encourages timely reporting while recognizing that it may be difficult to assess or predict with precision the broad effects of COVID-19 on industries or individual companies. We also recognize that the actual impact will depend on many factors beyond a company’s control and knowledge. Nevertheless, the effects COVID-19 has had on a company, what management expects its future impact will be, how management is responding to evolving events, and how it is planning for COVID-19-related uncertainties can be material to investment and voting decisions.”

As the wider effects of the pandemic continue to become more manifest across the globe, we expect that most, if not all, public companies reporting financial results during the outbreak will include disclosure on the impact of COVID-19 on the issuer’s business and how the issuer is responding to that impact. This will raise several questions for companies with US reporting obligations, including foreign private issuers:

When should disclosure be provided? If they have not already, foreign private issuers should be prepared to provide disclosure of the impact of COVID-19 on their business, results of operations, financial condition and prospects in their next periodic financial report filed with the SEC. This is likely to be their annual report on Form 20-F, which, for issuers with a December 31 year end, is due to be filed by April 30, although there may be circumstances in which the filing of the Form 20-F can be delayed (see the conditional relief from the SEC discussed above). However, foreign private issuers with home country reporting obligations may need to address the market earlier and those foreign private issuers with only a US listing should, to the extent consistent with the home country reporting requirements, look to the “triggering events” under the SEC’s Form 8-K as a proxy for determining whether a Form 6-K filing is needed regarding a particular COVID-19 related event. These triggering events include, among others:

entry into, or amendment of, a material agreement not made in the ordinary course of business;

termination of a material agreement not made in the ordinary course of business (other than by expiration on a stated termination date, or the completion of all parties’ obligations);

acquisition or disposition of a “significant amount of assets” (otherwise than in the ordinary course of business);

creation of a material direct financial obligation or a material obligation under an off-balance sheet arrangement;

triggering events that accelerate or increase a material direct financial obligation or a material obligation under an off-balance sheet arrangement; and

if an issuer’s board of directors, a board committee or an authorized officer, if board action is not required, concludes that a material charge for impairment to one or more assets (including impairments of securities or goodwill) is required under GAAP or IFRS.

In its recent COVID-19 Disclosure Guidance, the Division of Corporation Finance also stated that although not required to do so, companies often release earnings estimates and other financial results in advance of finalizing the required financial reporting for the relevant period. The Division noted that companies may be considering how to report the evolving impact of COVID-19 in light of unexpected nonrecurring charges and expenses. They also recognized that the impact of COVID-19 on businesses may present a number of novel or complex accounting issues that, depending on the particular facts and circumstances, may take time to resolve.

What to disclose? In its COVID-19 Disclosure Guidance, the Division of Corporation Finance emphasised the need for COVID-19-related disclosures within the context of the federal securities laws and the principles-based disclosure system. The cornerstone of this system is disclosure of material information that is widely disseminated. It is only with this type of disclosure that all investors can make informed decisions.

The SEC’s disclosure requirements can apply to a broad range of evolving business risks even in the absence of a specific line item requirement that names the particular risk presented. In addition, a number of existing rules or regulations require disclosure about the known or reasonably likely effects of and the types of risks presented by COVID-19. As a result, disclosure of these risks and COVID-19-related effects may be necessary or appropriate in management’s discussion and analysis (MD&A), the business section, risk factors, legal proceedings, disclosure controls and procedures, internal control over financial reporting, and the financial statements.

However, assessing the evolving effects of COVID-19 and related risks will be a facts and circumstances analysis. Disclosure about these risks and effects, including how the company and management are responding to them, should be specific to a company's situation. As companies assess COVID-19-related effects and consider their disclosure obligations, the COVID-19 Disclosure Guidance raises a series of non-exhaustive questions for companies to consider with respect to their present and future operations:

How has COVID-19 impacted your financial condition and results of operations? In light of changing trends and the overall economic outlook, how do you expect COVID-19 to impact your future operating results and near-and-long-term financial condition? Do you expect that COVID-19 will impact future operations differently than how it affected the current period?

How has COVID-19 impacted your capital and financial resources, including your overall liquidity position and outlook? Has your cost of or access to capital and funding sources, such as revolving credit facilities or other sources changed, or is it reasonably likely to change? Have your sources or uses of cash otherwise been materially impacted? Is there a material uncertainty about your ongoing ability to meet the covenants of your credit agreements? If a material liquidity deficiency has been identified, what course of action has the company taken or proposed to take to remedy the deficiency? Consider the requirement to disclose known trends and uncertainties as it relates to your ability to service your debt or other financial obligations, access the debt markets, including commercial paper or other short-term financing arrangements, maturity mismatches between borrowing sources and the assets funded by those sources, changes in terms requested by counterparties, changes in the valuation of collateral, and counterparty or customer risk. Do you expect to disclose or incur any material COVID-19-related contingencies?

How do you expect COVID-19 to affect assets on your balance sheet and your ability to timely account for those assets? For example, will there be significant changes in judgments in determining the fair-value of assets measured in accordance with U.S GAAP or IFRS?

Do you anticipate any 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 that have had or are reasonably likely to have a material impact on your financial statements?

Have COVID-19-related circumstances such as remote work arrangements adversely affected your ability to maintain operations, including financial reporting systems, internal control over financial reporting and disclosure controls and procedures? If so, what changes in your controls have occurred during the current period that materially affect or are reasonably likely to materially affect your internal control over financial reporting? What challenges do you anticipate in your ability to maintain these systems and controls?

Have you experienced challenges in implementing your business continuity plans or do you foresee requiring material expenditures to do so? Do you face any material resource constraints in implementing these plans?

Do you expect COVID-19 to materially affect the demand for your products or services?

Do you anticipate a material adverse impact of COVID-19 on your supply chain or the methods used to distribute your products or services? Do you expect the anticipated impact of COVID-19 to materially change the relationship between costs and revenues?

Will your operations be materially impacted by any constraints or other impacts on your human capital resources and productivity?

Are travel restrictions and border closures expected to have a material impact on your ability to operate and achieve your business goals?

In its COVID-19 Disclosure Guidance, the Division of Corporation Finance also recognized that much of the disclosure that would address the types of considerations noted above would involve forward looking information that may be based on assumptions and expectations regarding future events. As a result, providing forward-looking information in an effort to keep investors informed about material developments, including known trends or uncertainties regarding COVID-19, will need to be undertaken in a way to avail companies of the forward-looking statement safe harbours in Section 27A of the Securities Act and Section 21E of the Exchange Act. This will require updating any forward-looking statement disclaimers and legends in public disclosures to specifically refer to the statements associated with COVID-19 and the risks associated therewith.

How do you address market abuse/insider trading concerns? Issuers have an ongoing requirement to monitor and prevent insider trading and market abuse, but that need is even higher as corporate insiders and certain market participants may be receiving material non-public information on a frequent basis. This highlights the need for compliance with internal controls on the flow of material non-public information within an organisation.

In its COVID-19 Disclosure Guidance, the Division of Corporation Finance emphasised the need for companies and other related persons to consider their market activities, including the issuance or purchase of securities, in light of their obligations under the federal securities laws. For example, where COVID-19 has affected a company in a way that would be material to investors or where a company has become aware of a risk related to COVID-19 that would be material to investors, the company, its directors and officers, and other corporate insiders who are aware of these matters should refrain from trading in the company's securities until such information is disclosed to the public.

How often will disclosure need to be updated? In its COVID-19 Disclosure Guidance, the Division of Corporation Finance stated that, depending on a company's particular circumstances, it should consider whether it may need to revisit, refresh, or update previous disclosure to the extent that the information becomes materially inaccurate. As a result, given the rapidly evolving outlook and understanding of the outbreak, issuers need to think proactively about whether to increase the frequency of reporting or issue updates as needed to earlier disclosures:

To reduce the risk of insider trading and market abuse (discussed above), issuers may need to disclose material non-public information outside of their regular reporting schedule.

Where previous public disclosures have become materially false as a result of subsequent developments, issuers may have a “duty to update” the market in light of the changed information. Issuers should work closely with counsel to identify forward-looking statements, including projections and guidance, and determine whether to update or withdraw them.

CHALLENGES TO THE AUDIT PROCESS

The ongoing and evolving COVID-19 impact will likely make it more difficult for companies and their auditors to complete the work required to maintain timely filings and companies will need to proactively address financial reporting matters earlier than usual. For example, to the extent a company or its auditors will need to consult with experts to determine how the evolving COVID-19 situation may impact its assets, including impairment of goodwill or other assets, it should consider engaging with those experts promptly so that its reporting remains as timely as possible, as well as complete and accurate.

However, the successful completion of a financial audit requires access to company information, personnel and often physical premises and documentation. In February 2020 the SEC acknowledged the difficulties some firms may face in providing this access, and urged issuers to be in close contact with their auditors and audit committees in order to achieve the requirements even as novel challenges emerge. Impacted issuers are also encouraged to contact the SEC to seek guidance and potential relief from certain requirements if needed.

Additionally, the SEC has also flagged the need to consider the applicability of ASC 855 (Subsequent Events). Issuers finalizing their financial disclosure should consider, in light of ASC 855, whether disclosure of any impact of COVID-19 is warranted in the notes to the financial statements.

A NOTE REGARDING NON-GAAP MEASURES

In its COVID-19 Disclosure Guidance, the Division of Corporation Finance highlighted that, to the extent a company presents a non-GAAP financial measure or performance metric to adjust for or explain the impact of COVID-19, it would be appropriate to highlight why management finds the measure or metric useful and how it helps investors assess the impact of COVID-19 on the company’s financial position and results of operations. Furthermore, there may be instances where a GAAP financial measure is not available at the time of the earnings release because the measure may be impacted by COVID-19-related adjustments that may require additional information and analysis to complete. In these situations, a non-GAAP financial measure may need to be reconciled to preliminary GAAP results that either include provisional amount(s) based on a reasonable estimate, or a range of reasonably estimable GAAP results.

However, the Division of Corporation Finance has stated that, if a company presents non-GAAP financial measures that are reconciled to provisional amount(s) or an estimated range of GAAP financial measures in reliance on the above position, 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. The Division reminded companies that it is not appropriate for a company to present non-GAAP financial measures or metrics for the sole purpose of presenting a more favourable view of the company. Rather, companies should use non-GAAP financial measures and performance metrics for the purpose of sharing with investors how management and the Board are analysing the current and potential impact of COVID-19 on the company's financial condition and operating results. Also, if a company presents non-GAAP financial measures 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.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



DINESH BANANI
PARTNER, LONDON

+44 20 7466 2042
Dinesh.Banani@hsf.com



TOM O'NEILL
PARTNER, HEAD OF
US SECURITIES,
LONDON

+44 20 7466 2466
Tom.ONeill@hsf.com



DENNIS HERMRECK
COUNSEL (US),
LONDON

+44 20 7466 2909
Dennis.Hermreck@hsf.com

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