CAPITAL MARKETS

Coronavirus under the capital markets microscope

Baker McKenzie lawyers from London, New York and Hong Kong SAR consider the impact of COVID-19 on markets and outline the moves companies and exchanges have already made

On January 30 2020, the World Health Organization (WHO) declared that the coronavirus (officially named COVID-19) outbreak constituted a public health emergency of international concern. The full impact of the outbreak and the resulting precautionary measures around the world remains to be seen but will likely have several implications on business operations, particularly for the travel, financial services and professional services industries, manufacturing facilities and supply chains. Companies will need to consider their obligations in response to government announcements, the level of business disruption, and other commercial risks arising from the coronavirus.

Following constrained activity in the global initial public offering (IPO) market during 2019, we expected activity to remain subdued in 2020. However, the emergence of COVID-19 has resulted in stock market falls – the like of which we have not seen since the 2008 global financial crisis – enhancing concerns about the global economic outlook. At present both the timeframe and extent of the COVID-19 impact are uncertain, but it is likely the situation will evolve for some time as companies try to manage and mitigate the ramifications thereof. Against a backdrop of profit warnings, plunging stock markets and business uncertainty, companies need to consider their financing needs, strategic plans and contractual obligations, and the capital markets are likely to be integral to their deliberations and decisions.

For companies looking to raise capital at this time, COVID-19 may bring with it extra contractual considerations as issuers and underwriters become increasingly focused on *force majeure* and material adverse change (MAC) provisions. Transactional parties also need to navigate the disclosure requirements required by law and regulation and explore alternate means of completing diligence and book builds in light of travel restrictions and the increasing reluctance for face-to-face meetings.

Companies that are already listed or have listed securities will have to consider their continuing disclosure obligations, in particular in relation to emerging inside information as the COVID-19 impact on their businesses evolves, as well as new practices and requirements that may be introduced by regulators as the COVID-19 situation develops.

1 MINUTE READ

On January 30 2020, the World Health Organization (WHO) declared that the coronavirus (officially named COVID-19) outbreak constituted a public health emergency of international concern. In this article, Baker McKenzie lawyers consider the immediate impact on capital markets, including contractual implications for securities offerings, ongoing disclosure requirements, practical effects, and the approaches of stock exchanges and regulators around the world.

In addition, companies must grapple with the challenges of virus-related disclosure in their year-end accounts, and in some cases even with simply fulfilling their financial reporting obligations, given the travel restrictions and shutdowns in place in some areas. Day-to-day corporate governance may also become more problematic, for example with respect to holding annual general meetings (AGMs), since some governments are already imposing suspensions on major public gatherings.

Termination for *force majeure*?

There has been a significant amount of industry and legal commentary around the relevance of *force majeure* provisions with regard to a company's obligations, but these discussions have largely been in the context of commercial contracts within manufacturing and supply chains.

In equity offerings, the underwriters and issuer enter into an underwriting agreement for the sale of securities and a *force majeure* clause is often included under the termination provisions. The provision generally provides a list of events, typically including epidemics, pandemics and outbreaks of diseases, which give the underwriters (but not the issuer) a potential termination right. However, with the impact of COVID-19 still uncertain, underwriters may want to consider the inclusion of a more explicit *force majeure*. For example, since the outbreak of the severe acute respiratory syndrome (SARS) in 2002, SARS has been expressly included as one of the diseases in standard *force majeure* provisions in at least some of the affected jurisdictions, along with swine or avian flu, H5N1, H1N1, H7N9 and such related/mutated forms. Going forward, we expect that termination provisions will also see COVID-19 added as a named disease in more jurisdictions.

If an underwriter were to claim that a *force majeure* event has occurred, the potential termination right would generally still be subject to a requirement that the event makes it impracticable or inadvisable to market the securities, to enforce contracts for sale of the securities, or to prejudice the success of the offering. Since the determination whether the conditions are met is usually down to the sole opinion of the underwriters, it is not unusual for some issuers to have concerns about the extent and operation of the termination provisions. However, such provisions are market standard in an underwriting agreement and although a deal may be pulled or delayed for a variety of reasons prior to the deal pricing, such as poor market conditions or an unforeseen event, the termination provisions take effect only upon signing the agreement after pricing. Consequently, the period between signing and closing during which the underwriters can terminate is limited to a relatively short amount of time.

Once the deal has priced, the underwriters are highly incentivised to close the deal and, historically, have proceeded to do so even in the face of major unforeseen events, such as the 9/11 attacks in the US. It is therefore likely that while deals may get postponed due to COVID-19, any deal that gets as far as the signing of the underwriting agreement is unlikely to be terminated due to the *force majeure* provision.

> **We are now seeing references to the Wuhan coronavirus being expressly included [in offering documents]**

Moreover, since COVID-19's impact is already being felt, it would be unfair to sign an agreement where the termination provision could already be triggered. One solution could be to set the base case as at the date of signing so that only a material deterioration would trigger the termination right. During the Gulf War, for example, certain underwriting agreements specified that the termination clause would only be triggered if the conflict escalated.

A related contractual provision permits termination upon occurrence of a MAC in the financial condition and prospects of the issuer (or the similar concept of material adverse event). Again, it may be hard to argue that the virus constitutes a MAC, though, since any adverse effects of COVID-19 existing at the time of execution of the underwriting agreement would likely be disclosed in the offering document and, therefore, subsumed in a representation regarding the absence of any MAC subsequent to the date of the issuer's most recent balance sheet 'except as disclosed' in the offering document. Only new information pointing to an unforeseen impact on the issuer's business and operations, or the substantial worsening of an already disclosed impact, would therefore trigger the MAC clause in that limited period between signing and closing.

Existing debt securities and other borrowings

For issuers who have issued debt securities, COVID-19 could impact the company's performance to the extent that they have trouble meeting their contractual obligations to pay interest and/or principal under the terms and conditions of the bonds. Such a situation could cause an event of default and potentially trigger an acceleration of the bonds and cross-defaults into other debt securities or credit agreements. There may be a short grace period for non-payment of interest, though this is primarily intended to cover the issuer for purely technical problems in case there is a delay in transmission of payment. Parties may wish to consider extending this grace period to also cover payment delays linked to the virus, such as extended public holidays. It is not market standard for a grace period to be allowed in respect of late payment of principal, since it is thought that, given the amount of money involved, this payment is more significant and therefore should be better planned for.

If the issuer's business is impacted by the virus outbreak to the extent that its ability to meet its payment obligations is compromised then, among its options, it should consider conducting a liability management exercise to help restructure its debt, such as exchanging old bonds for new bonds or conducting a consent solicitation to amend the conditions of the existing bonds. As a result, we expect to see an uptick in liability management exercises being undertaken if the ability of issuers to meet their payment obligations is compromised.

Disclosure

One of the more challenging aspects of the COVID-19 outbreak for capital markets participants relates to the disclosure of business risk and impact. Disclosure can be broken down into two elements: first, the disclosure requirements of the relevant stock

exchange and/or regulator when securities are first offered to the public, and second, the ongoing reporting and disclosure obligations once securities have been listed.

In the first case, a company preparing to list securities will need to prepare an offering document that discloses, among other things, the risks relating to its business. Since the emergence of the SARS outbreak in 2002, offering documents in the Asia Pacific region have regularly included a fairly generic risk factor to disclose that the outbreak of an infectious disease could affect the business, financial condition, results of operation and prospects of the company's group. As new diseases have come along, such as Middle Eastern respiratory syndrome (MERS), Ebola, avian flu, H1N1 and the Zika virus, these have been added to the risk factor. We are now seeing references to the Wuhan coronavirus being expressly included.

Companies in certain jurisdictions, including key financial centres such as London, New York and Hong Kong SAR, will be heavily regulated and their disclosure is likely to be subject to greater scrutiny. For companies listing in these jurisdictions, the general infectious disease risk factor may not be enough to satisfy regulators or investors. In these cases the risk factor will need to provide much greater detail and specificity about how the virus is affecting or could affect the business. The degree of disclosure will depend on many issuer-specific factors such as the level of information and data available, the significance of the affected jurisdictions to the business, the effect on customers and supply chains, business continuity planning measures, and the geographic proximity to the virus.

Given that COVID-19 is a relatively new virus, it is difficult to make any reliable judgments about how long the outbreak will last or the medium to long-term effects on business. For a company listing securities, full and fair disclosure is critical from a risk management perspective. In addition to risk factors, issuers should consider covering the impact of the virus and the measures it is taking to mitigate its effects in the MD&A [management discussion and analysis] and/or a recent developments section so as to explain to investors the specific steps that are being taken, including any business continuity plans.

Securities offerings require due diligence. Underwriters and counsel, in particular, will need to carefully assess their ability to conduct appropriate due diligence if site visits and in-person meetings become more difficult to arrange due to government or business travel restrictions or the unavailability of personnel. We may also start to see COVID-19-specific due diligence questions being asked in management meetings and on bring-down and closing calls. Although a physical signing meeting is now a rarity, the logistical issue that it presents may also need to be considered.

The second disclosure consideration affects those companies who already have listed securities. In the US they will be subject to the Securities Exchange Act's ongoing disclosure obligations while, in London, the Listing Rules, Transparency Rules, the EU Market Abuse Regulation (MAR), the Financial Conduct Authority's Disclosure Guidance and Transparency Rules and the London Stock Exchange's Admission and Disclosure Standards provide several sources of continuing obligations. Companies will have to carefully consider the impact of COVID-19 on their business, operations and revenues to assess whether such information constitutes inside information.

In general, a company whose financial instruments are listed and admitted to trading on a stock exchange will be subject to general disclosure requirements designed to prevent the creation of a false market in the company's securities. For example, under MAR, an issuer is required to inform the public as soon as possible of any inside information which directly concerns the issuer that would be likely to have a significant effect on the price of the issuer's listed securities. What constitutes a significant effect on the price of financial instruments will vary from issuer to issuer and fact pattern to fact pattern.

In the US, the Securities and Exchange Commission (SEC) chair has directed SEC staff to start monitoring companies' disclosures related to the "current and potential effects" of COVID-19 on their businesses. Corporate officers have been making statements on the impact in earnings press releases and conference calls with investors. In addition, because the coronavirus outbreak and its effects have coincided with the peak season for filing year-end annual reports (Forms 10-K and 20-F) with the SEC, risk factors relating to COVID-19 are now appearing in these filings. One report noted that over 600 public companies had mentioned the coronavirus in the risk factors of their filings. In addition to companies with significant operations in China, disclosures are being made by companies with supply chains, distributors and customers in the region. Companies are also adding COVID-19 to their laundry lists of factors that could affect the outcome of the forward-looking statements in their disclosure documents. Travel and leisure companies affected by flight cancellations and travel restrictions are also discussing the impact of COVID-19.

A company's disclosure determination will need to be based on the SEC's longstanding guidance that a company should identify and disclose known trends, events, demands, commitments and uncertainties that are reasonably likely to have a material effect on their financial condition or operating performance, after considering all other relevant information, but with a focus on materiality. It is the SEC's view that disclosure of a trend, demand, commitment, event or uncertainty is required unless a company is able to conclude either that it is not reasonably likely that the trend, uncertainty or other event will occur or come to fruition, or that a material effect is not reasonably likely to occur.

Companies will need to continually assess the impact and whether additional disclosure is required, but if the outcome of a known trend or uncertainty, such as forward-looking disclosure about the impact of COVID-19, is unsure then the SEC requires disclosure that issuers assume that the uncertainty will come to pass and make appropriate disclosure if the effects will be material. Issuers should be continuously evaluating the accuracy of the risk factors in their SEC filings. This is

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especially relevant for US domestic issuers, who are required to update their risk factors on a quarterly basis in their 10-Q reports.

Apart from the public company disclosure issues posed by COVID-19, the virus has affected the timing of public company disclosures in the US. On March 4, the SEC issued an order providing conditional regulatory relief for certain publicly traded company reporting obligations due to the impact of the coronavirus. The order provides that, subject to certain conditions, publicly traded companies are granted an additional 45 days to file most disclosure reports that would otherwise have been due between March 1 and April 30 2020. Among other conditions, companies must convey through a current report (i.e., Form 8-K or, for foreign private issuers, Form 6-K) a summary of why the relief is needed in their particular circumstances. Filings covered by the order include annual, quarterly and interim reports and proxy statements, but not securities transaction reports by directors, executive officers and beneficial owners. In announcing the order, the SEC stated that companies that file the required reports within the 45-day extension will be considered current and timely in their filing obligations. The order also states that the SEC intends to monitor the situation and may, if necessary, extend the time period during which the relief granted by the order applies.

Financial reporting

Companies will also need to factor in guidance related to the preparation of their year-end accounts. The UK's Financial Reporting Council has published advice that disclosure around COVID-19 will depend on the risk and the degree to which it might crystallise, which is specific to business circumstances. It advises: "Companies should consider whether to refer to the possible impact of COVID-19 on their business in their reporting of principal risks and uncertainties", and that any mitigating actions should be also be reported, together with the risk.

The SEC and the Public Company Accounting Oversight Board (PCAOB) in the US released a joint statement on January 30 2020 regarding the effects of the coronavirus on financial reporting in which they acknowledged that "the effects may be difficult to assess or predict with meaningful precision both generally and as an industry- or issuer-specific basis". Despite this, they also highlighted that, "how issuers plan for that uncertainty and how they choose to respond to events as they unfold can nevertheless be material to an investment decision". In a further joint statement on February 19 2020, it was stated that in conversations with audit firms, the SEC and PCAOB had emphasised "the need to consider potential disclosure of subsequent events in the notes to financial statements".

> **It remains to be seen whether one of the lasting effects of the virus could be the widespread adoption of alternative roadshow practices**

While some companies are grappling with the challenges of virus-related disclosure in their year-end accounts, for others there is the practical difficulty of fulfilling their financial reporting obligations due to travel restrictions and shutdowns. On February 4 2020, The Stock Exchange of Hong Kong (HKEX) and the Securities and Futures Commission (SFC) issued a joint statement in relation to results announcements. If a listed issuer believes there is a real possibility that, as a result of the COVID-19 restrictions, it will be unable to publish a preliminary announcement of results (or, as the case may be, issue audited financial statements) in accordance with the relevant listing rules, it should contact the HKEX as early as possible to discuss the situation. The issuer may be required to publish its preliminary results without the agreement of its auditors on or before the deadline, or to publish information that the SFC considers will be sufficient to maintain an orderly, informed and fair market so that trading in the securities of the listed issuer can continue. The issuer should therefore be reasonably satisfied that this information is accurate and complete in all material respects. A company experiencing any such reporting issues will need to assess whether this could also be inside information requiring a separate announcement as soon as reasonably practicable.

Annual general meetings

A practical impact on day-to-day corporate governance, which could become an issue for an increasing number of companies as the virus spreads, is the ability to hold AGMs. In addition to travel restrictions, which may limit the ability to attend meetings, some governments have started to suspend or place limits on major public gatherings. For example, events with more than 1,000 attendees have already been banned in Switzerland.

In Singapore, shareholders have expressed concern about attending AGMs due to the virus situation. As a consequence, the Singapore Exchange (SGX) has announced that it will allow issuers with a December 31 financial year-end, up to June 30 2020 to hold their AGMs and approve their December 31 2019 results. This announcement was in addition to an earlier decision to allow companies with significant operations in China until June 30 2020 to hold AGMs, due to feedback from auditors that there were practical difficulties in performing their audit duties due to the measures put in place by the government in response to the virus situation. The SGX also reminded issuers of their continuing disclosure obligations under the listing rules and that all material information, whether price-sensitive or trade-sensitive, must be disclosed on a timely basis. Any material financial impact of COVID-19 should be made immediately under Listing Rule 703.

In a number of jurisdictions, some companies are already holding virtual annual meetings. While some contend that this is intended to decrease participation by corporate 'gadflies' and others who attend for the specific purpose of posing difficult questions to management, the spread of COVID-19 and related travel restrictions could accelerate this development in those jurisdictions where they are permitted.

New financing models

Previous viruses such as SARS and MERS have meant it was a matter of when, not if, a new threat would emerge. In anticipation of this, the World Bank issued $320 million of so-called pandemic bonds in 2017. In

addition to requiring a certain number of deaths to have occurred, they also prescribe a required waiting period from the initial outbreak. The bonds have faced some criticism for paying out too slowly, meaning they can't be used to fund the critical early preventative stage. At the time of writing, these bonds had not yet paid out and it remains to be seen whether there is future demand for further pandemic bonds, particularly if issued with less strict conditions before a payment can occur.

While the clock ticks on the pandemic bonds, the Chinese government is actively encouraging companies to issue coronavirus bonds to raise money to support their businesses. The key requirement of the bonds is that at least 10% of the proceeds must be earmarked for measures to tackle the epidemic. To support such issuance the approval process has been significantly shortened to a matter of days. The bonds currently offer low coupon rates, which may have deterred some private investors, but state banks have been encouraged to fill this gap in demand to support the initiative.

Outside of China, Agricultural Development Bank of China has recently issued dim sum bonds in Hong Kong SAR to raise funds to tackle the coronavirus outbreak. Depending on the development of the coronavirus situation, we may see more of these fundraising exercises in different jurisdictions.

Lasting impact

COVID-19 has forced businesses to adopt new ways of working. One aspect of the capital raising process that has been around for many years is the investor roadshow to help the bookbuilding process, whereby the underwriters and issuer engage in marketing meetings with investors around the world in order to gauge their interest at different price levels before signing the underwriting agreement reflecting the agreed terms. Although Netroadshow and its competitors have been part of the landscape for some time, given the travel restrictions put in place by governments and the reluctance of many people to travel, issuers and underwriters may move towards conducting more online roadshows, perhaps even exclusively. With the obvious cost-saving advantage and efficiency, not to mention the avoidance of long-haul travel and the resultant reduction in carbon footprints, it remains to be seen whether one of the lasting effects of the virus could be the widespread adoption of alternative roadshow practices.

The outbreak of COVID-19 is having an increasing global impact – including the loss of lives – and growing disruption. Amid this rapidly changing situation, issuers and financial institutions need to be aware of the potential financial, regulatory and legal consequences for their business. Currently, the response from issuers approaching the capital markets has been mixed: in the Asia Pacific region we have noticed a gradual increase in IPOs launching in February and March compared to January, while numerous deals have been delayed elsewhere. Continued volatility in the markets is likely to increase pricing pressure and uncertainty, contributing to more postponed deals. Risk mitigation will be key for informed IPO decisions. For issuers who have decided to go ahead with their IPOs or capital raisings, they will need to include appropriate risk factors and disclosures relating to any impact or potential impact of the virus situation on their business, internal controls and risk management in the offering document. A critical factor in a successful transaction will be to ensure that the issuer provides investors with sufficient and up-to-date information to make an informed investment decision.

Please stay up to date with further developments at the **Baker McKenzie Coronavirus Resource Center**.

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