CORPORATE
UK COVID-19 RESPONSE

UK regulators make haste

Davis Polk lawyers Will Pearce and Jamie Corner consider the unprecedented measures taken by UK regulators and industry bodies to aid listed businesses

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The premium segment of the UK's Main Market offers investors the benefit of a gold plated package of shareholder rights, corporate governance and corporate disclosure above mandated EU-wide minimum standards that apply to all companies traded on regulated markets. In times of crisis these additional regulatory standards can hinder the efforts of a premium-listed company to self-help effectively with the required speed.

While there has been no forbearance from a listed company's key obligation to announce inside information to the market as soon as possible under the EU's Market Abuse Regulation (MAR), UK regulators and industry bodies have moved quickly to address the impact on listed companies of the coronavirus (Covid-19) pandemic and the UK government's social distancing and stay-at-home measures. This is in stark contrast to the approach taken in the financial crisis of 2008 to 2010.

We look at the unprecedented measures taken, and key guidance issued, over the three-week period in the run-up to the Easter weekend, to provide comfort to, and alleviate the regulatory burden on, the UK's 480 or so premium-listed commercial companies.

1 MINUTE READ

London-based Davis Polk partner Will Pearce and counsel Jamie Corner look at the unprecedented measures taken by UK regulators and industry bodies over the last three weeks to alleviate the regulatory burden on, and provide comfort to, the UK's premium-listed companies in light of the impact of the coronavirus (Covid-19) pandemic and the UK government's social distancing and stay-at-home measures.

Corporate reporting

The pandemic hit the UK in the middle of the annual corporate reporting season, with a large number of premium-listed companies releasing preliminary results announcements, publishing their annual report and accounts, and convening their annual general meetings (AGMs). It is therefore not surprising that regulators and industry bodies first focused on measures to help companies meet their reporting obligations.

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Moratorium on preliminary statements of results Under the Listing Rules, with the consent of its auditors, a premium-listed company can publish a preliminary statement of its results for the year, with the formal annual report and accounts to follow. On March 21, one of the first steps taken by the Financial Conduct Authority (FCA) was to write to all listed companies that had indicated imminent plans to publish preliminary statements requesting they observe a moratorium on publication for at least a couple of weeks. The FCA noted that the unprecedented events meant that the basis on which companies were reporting was changing rapidly and it was important that due consideration was given to preparing appropriate disclosures. The FCA was of the view that observing timetables set before the crisis would not give companies time to do this.

Extended period to publish annual report and accounts On March 26, as part of a joint statement with the Financial Reporting Council (FRC) and the Prudential Regulatory Authority (PRA), the FCA published a statement of policy extending the deadline for the publication of a listed company's annual report and accounts from four to six months from the end of its financial year. The FCA noted that this temporary policy would be kept under review and encouraged all companies to make appropriate use of the additional time. The FCA also urged market participants not to draw undue adverse inferences where a company makes use of the extra time available. On March 27, the European Securities and Markets Authority (Esma) announced its support for national competent authorities, including the FCA, demonstrating forbearance to the reporting deadlines set by the EU's Transparency Directive, which has direct effect in the UK within the provisions of the Disclosure Guidance and Transparency Rules.

Focus on disclosure of material risks and uncertainty As part of the joint statement with the FCA and PRA, the FRC provided guidance on how companies should approach the preparation of their financial statements, which supplemented its previously published ordinary course guidance on the forthcoming reporting season and initial guidance on the developing coronavirus pandemic. In terms of general advice, the FRC suggested companies:

- develop and implement mitigating actions and processes to ensure that they continue to operate an effective control environment, by addressing any existing key reporting and other controls which may not prove effective in the current circumstances;
- consider how to secure a reliable and relevant information flow, including from significant subsidiary, joint venture and associate group entities;
- pay attention to capital maintenance, ensuring that sufficient reserves are available when a dividend is made, not just proposed; and that there are sufficient resources to continue to meet the company's needs; and
- focus on those areas of reporting of most interest to investors and provide clarity on the use of key forward-looking judgements.

In relation to the fourth of these suggestions, the FRC also provided specific additional guidance relating to the basis of judgements and matters to consider when confirming the preparation of the financial statements on a going concern basis, disclosure of significant judgements applied to the financial statements and forward-looking information, and appropriate reporting of post-balance sheet events.

Flexibility in approach to audit evidence gathering and reporting On March 16 2020, the FRC offered initial guidance to auditors on how they should seek to discharge their obligations. The FRC noted the practical difficulties in preparing accounts and carrying out audits at this time but underlined its concern to ensure that the quality of audits is not undermined. Accordingly, the FRC encouraged auditors to look at developing alternative audit procedures to gather sufficient and appropriate evidence, noting that auditors will need to consider the impact of the pandemic on their assessment of risk, how sufficient and appropriate evidence is gathered and the work of component auditors is reviewed, their assessment of going concern and prospects of a company, and the adequacy of management disclosure on the company's prospects.

The FRC also noted that auditors will need to manage companies' expectations and that audit committees in particular will need to understand that auditors will require sufficient time and support to carry out their work, including reassessing work done where circumstances change before the audit is finalised, and some companies may have to revisit their reporting timetable.

As part of the joint statement with the FCA and the PRA on March 26, the FRC updated its guidance with a non-exhaustive list of factors that auditors should consider when carrying out audit engagements (including communicating with audit committees, access to audit evidence, scope limitations to audit opinions, going concern assessments, and setting materiality levels) and suggestions as to how such factors might be addressed. Further guidance on evidence-gathering was then subsequently issued on April 9.

Adapting the approach to AGMs On March 17, The Chartered Governance Institute published guidance for listed companies on how to adapt their AGMs in light of the pandemic. The guidance, supported by the various industry bodies and reviewed by the Department for Business, Energy and Industrial Strategy, explores a number of possible options including:

- adapting the basis on which the AGM is held; for example, by encouraging proxy voting, live streaming, and, if permitted under the company's articles of association, conducting a hybrid AGM consisting of a physical and virtual meeting; and
- adjourning or, if permitted under the company's articles of association, postponing an AGM for which notice has been issued, or delaying the convening of the AGM, if notice has not yet been issued, recognising that the latest date to hold an AGM is six months after the financial year end.

On March 27, in response to the UK government's stay-at-home measures, the guidance was updated to explain how a compliant meeting could be held with only quorum in attendance. While some companies have postponed their AGMs in the last couple of weeks, broadly most companies have proceeded with their AGMs but with the chair and company secretary (or a second director) constituting the quorum, other shareholders have been prevented from attending in person and have been encouraged to vote by proxy, and only essential business has been conducted. Similar arrangements appear to have been put in place for those companies with meetings scheduled to be held through to the middle of May.

Finally, consistent with the preservation of cash resources, a number of companies have withdrawn AGM resolutions for the approval of final dividends.

Capital raising and corporate transactions

As the extent of the impact of the pandemic and the UK government's measures required to combat the same have become clearer, the focus of industry bodies and regulators alike has shifted to assisting issuers in accessing equity financing more easily, to meet both their short and medium-term funding requirements.

Acceptance of non-pre-emptive cash placings of up to 20% Shareholders in UK companies benefit from pre-emptive rights to subscribe for new shares issued for cash. However, to facilitate issuing shares on a non-pre-emptive basis, listed companies typically seek authority from their shareholders at each AGM to disapply such rights (typically, in compliance with the Pre-Emption Group's 2015 Statement of Principles, five percent of issued capital, or 10% if the share issue is in connection with an acquisition or specified capital investment).

Following implementation of the new Prospectus Regulation in summer 2017, which increased the threshold for the exemption from the obligation to publish a prospectus for an issue of shares from 10% of the number of shares admitted to trading to 20%, the Pre-Emption Group confirmed that it did not intend to amend its guidance. However, on April 1, the Pre-Emption Group changed its position, announcing that until September 30 2020, investors should consider supporting non-pre-emptive issuances of up to 20% of a company's issued capital, where an issuer:

- fully explains the particular circumstances surrounding the capital raise;
- consults with a representative sample of its major shareholders; and
- allocates the new shares with the involvement of company management on a basis that allows existing shareholders to subscribe for shares in proportion to their existing holdings.

The effect of the guidance is that it endorses a listed company, if the above conditions are met, using a cashbox placing to issue new shares of up to 20% of the company's existing issued capital without obtaining any additional shareholder authorities and publishing a prospectus.

A cashbox placing involves an accelerated non-pre-emptive offering of shares to institutional investors. The structure is intended to allow UK-incorporated issuers to make use of the provisions of the 2006 Companies Act that allow the issue of shares on a non-pre-emptive basis for non-cash consideration – instead of paying cash directly to the issuer for the new shares, the underwriter uses the placing proceeds from investors to subscribe for preference shares in an SPV (typically a new Jersey-incorporated subsidiary of the issuer), which are then transferred to the issuer in consideration of the issue of new shares in the issuer to the investors.

> **Shareholders have been prevented from attending [AGMs] in person and have been encouraged to vote by proxy**

Since the announcement by the Pre-Emption Group, which was supported by the FCA in its statement of policy published on April 8, premium-listed companies including Hays, WHSmith and the Restaurant Group have raised equity capital using the cashbox structure. SSP also used the same structure, pre-empting the Pre-Emption Group announcement by one week.

Encouraged use of simplified prospectuses for secondary offers of 20% or more The FCA's statement of policy released on April 8 also encouraged issuers looking to raise equity capital resulting in an increase in their issued capital of 20% or more to consider using the simplified prospectus regime permitted under the EU's Prospectus Regulation. Where an issuer has been admitted to listing on an EU-regulated market for at least 18 months, the new regime allows it to prepare a shorter prospectus without an operating and financial review or the corporate governance disclosure that would ordinarily be required in a full prospectus. In theory, the shorter document should be quicker for an issuer and its advisers to prepare and for the FCA to review, while not disadvantaging investors who otherwise have access to such information through the issuer's annual report and accounts and other public disclosure and filings. The FCA noted that the regime may not be suitable for offerings that target investors outside the UK or the EU, where lengthier customary market disclosure will still be required.

Flexibility in approach to working capital statements The FCA's statement of policy released on April 8 set out a modified approach to reviewing working capital statements in prospectuses and circulars. The accompanying technical guidance from the FCA states that additional disclosure in a working capital statement may include key coronavirus modelling assumptions in the reasonable worst-case scenario (i.e., how long the issuer expects business disruption or the speed of the recovery) and details of the main sensitivities that have been applied (i.e., the impact on its revenue).

This is a move away from Esma's Recommendations on Prospectuses, which state that it is not normally acceptable to disclose assumptions underpinning a working capital statement. The FCA justifies its position on the basis that there is significant uncertainty as to the size and duration of the current disruption, which makes the construction of a reasonable worst-case scenario uniquely challenging. Further, notwithstanding this flexibility, working capital statements must otherwise comply with Esma's recommendations, and include a statement to that effect. The FCA also reminded issuers that disclosure elsewhere in the document must not be inconsistent with the working capital statement, and noted that any assumptions underpinning a working capital statement will need to be monitored in case they change, resulting in an obligation for the issuer to publish a supplementary prospectus or circular.

Dispensation from holding a general meeting to approve a significant or related party transaction The final measure included in the FCA's April 8 statement of policy is the ability for a listed company to apply for a dispensation from the requirement to hold a general meeting to approve a Class 1 transaction under Listing Rule 10 or a related party transaction under Listing Rule 11.

In order to grant a dispensation, the FCA

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will have to be satisfied that:

- the issuer has a sufficient number of written undertakings from those shareholders eligible to vote on the matter under the Listing Rules that they approve the transaction and would vote in favour of the resolution, to meet the required threshold of shareholder support; and
- the issuer has updated the market that it has obtained such support and will not proceed with the general meeting.

All other provisions of Listing Rules 10 and 11 continue to apply, including the need for a shareholder circular to be prepared and approved by the FCA. The written undertakings may be sought before or after the circular has been published and, if there is a material change to the transaction following shareholder approval, an issuer will have to circle back with shareholders to rerun the process.

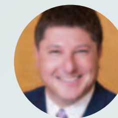
What happens next?

UK regulators and industry bodies have acted quickly and decisively to help premium-listed commercial companies cope with the impact of the coronavirus pandemic, both regarding meeting their reporting obligations and restructuring their businesses. It remains to be seen whether these measures will suffice or if further temporary modifications will be required.

While both regulators and investors are clearly sympathetic to the issues faced by listed companies, one point remains clear: perhaps more than ever, companies need to be transparent and timely in their public disclosure (including complying with MAR) to enable investors to assess the risks and uncertainties that companies now need to address.

Please stay up to date with further developments with Davis Polk coronavirus updates at

www.davispolk.com/coronavirus-updates



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