

THE INTERNATIONAL  
CAPITAL MARKETS  
REVIEW

ELEVENTH EDITION

Editor  
Jeffrey Golden

THE LAWREVIEWS

# THE INTERNATIONAL CAPITAL MARKETS REVIEW

ELEVENTH EDITION

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# CONTENTS

PREFACE.....	v
<i>Jeffrey Golden</i>	
Chapter 1      AUSTRALIA.....	1
<i>Ian Paterson</i>	
Chapter 2      AUSTRIA.....	36
<i>Martin Zuffer</i>	
Chapter 3      BRAZIL.....	48
<i>Ricardo Simões Russo, Marcello Mammocchi Pompilio, Felipe Moraes Assunção and Vinícius Pimenta Seixas</i>	
Chapter 4      DENMARK.....	55
<i>Rikke Schiøtt Petersen, Morten Nybom Bethe and Knuth Larsen</i>	
Chapter 5      FRANCE.....	67
<i>Corentin Coatalem and Côme Chaine</i>	
Chapter 6      GERMANY.....	89
<i>Stefan Henkelmann and Lennart Dahmen</i>	
Chapter 7      JAPAN.....	100
<i>Akihiro Wani and Reiko Omachi</i>	
Chapter 8      KUWAIT.....	120
<i>Abdullah Alharoun</i>	
Chapter 9      LUXEMBOURG.....	132
<i>Frank Mausen, Henri Wagner, Paul Péporté and Franz Kerger</i>	
Chapter 10      MEXICO .....	160
<i>Julián Garza, Gunter A Schwandt and Fernando Quezada T</i>	

Chapter 11	NIGERIA.....	169
	<i>Fred Onuobia, Ayodele Ashiata Kadiri and Lolita Biobele-Georgewill</i>	
Chapter 12	PORTUGAL.....	181
	<i>José Pedro Fazenda Martins, Orlando Vogler Guiné and Soraia Ussene</i>	
Chapter 13	RUSSIA.....	198
	<i>Vladimir Khrenov</i>	
Chapter 14	SPAIN.....	214
	<i>Charles Poole-Warren, Salvador Ruiz Bachs, Juan Hormaechea, Teresa Méndez, Alfonso Gutiérrez and Álvaro Rojo</i>	
Chapter 15	SWITZERLAND.....	229
	<i>François M Bianchi, Daniel Bono, Till Spillmann and Andrea Giger</i>	
Chapter 16	TAIWAN.....	238
	<i>Abe Sung and Mark Yu</i>	
Chapter 17	TURKEY.....	246
	<i>Ömer Çollak and Ökkeş Şaban</i>	
Chapter 18	UNITED ARAB EMIRATES .....	260
	<i>Silvia A Pretorius</i>	
Chapter 19	UNITED STATES .....	276
	<i>Alan Grincer, Michael Hyatte and Sara von Althann</i>	
Appendix 1	ABOUT THE AUTHORS.....	301
Appendix 2	CONTRIBUTORS' CONTACT DETAILS.....	319

# PREFACE

Well, is that light at the end of the tunnel?!

When the 10th edition of this volume appeared a year ago, it included an admission that we had been caught unawares by the pandemic, lockdowns and working from home (WFH).

Yes, there were then capital market challenges that had been anticipated, many of which continue. We knew, for example, that key interbank offered rates (IBORs), benchmarks on which so much financial market activity relies, would be undergoing a period of change and that market participants would have to face up to the adoption of alternative rates and consider adjustments to legacy transactions based on LIBOR or other previously used pricing sources. No one said LIBOR migration would be easy; and that challenge has not gone away. The message from many key regulators is that, pandemic and other operational complications notwithstanding, the shift remains on track. LIBOR, supporting as it does hundreds of trillions of dollars of market activity, is slated for replacement around the time that this edition is scheduled to appear!

However, we did not see and anticipate other challenges brought about by the covid-19 pandemic, basic as some of these may have been – hidden as they may have been also in notice provisions and other boilerplate buried in the back recesses of our transaction documents. How do you give effective notice to offices closed (often with the force of law) and with the decentralisation of WFH? If none of the methods contemplated by the parties' agreement can be used, may a different method be used instead?

Furthermore, is the pandemic itself an excuse for non-performance of financial market obligations? Does it trigger *force majeure* clauses in our contracts? Does it frustrate a relevant commercial purpose?

The global health – not to mention environmental – challenges around us at the moment beg a coordinated international strategy. However, the all-too-often fragmented response we have been seeing has been anything but encouraging. Fragmentation in the financial market regulatory arena also, including Brexit and other devolutionary pressures and juridical competition that have followed, now seems to be the order of the day.

Challenges though there may be, however, the capital markets continue to show their resilience. As I write this preface, share prices and indices are at, or have recently reached, record highs in leading global markets. IPOs for the likes of Robinhood Markets and Krispy Kreme continue to cause excitement and capture headlines.

International capital markets lawyers are still in business, still relevant, although, our *modus operandi* may have changed slightly. While financial institutions and law firms are cautiously encouraging a return to the office (at least for the fully vaccinated), technology and our recent experience by necessity of remote working has encouraged more self-sufficiency.

In a world of WFH, we keep company with the books on our shelves more than the other lawyers in the building. In such circumstances, there are ever more compelling reasons to keep this particular book on that shelf or otherwise remotely accessible through the digital platform maintained by *The Law Reviews*. We can expect to turn more often to published answers when we cannot as easily consult the practitioner in the office next door.

As I have written before, this book serves two purposes – one obvious, but the other possibly less so.

Quite obviously, and one reason for its continuing popularity, *The International Capital Markets Review* addresses the comparative law aspect of our readers' international capital markets (ICM) workload and equips them with a reference source. Globalisation and technological change mean that the transactional practice of a capital markets lawyer, wherever based (even WFH), no longer enjoys the luxury – if ever it did – of focusing solely on a home market within the confines of a single jurisdiction. Globalisation means that fewer and fewer opportunities or challenges are truly local, and technology increasingly permits a practitioner to tackle international issues.

Moreover, clients certainly may have multi-jurisdictional ambitions or, even if unintended, their activities often may risk multi-jurisdictional impact. In such cases, it would be a brave but possibly foolish counsel who assumed: 'The only law, regulation and jurisdiction that matter are my own!'

Ironically, the second purpose this book aims to serve is to equip its readers to do a better job as practitioners at home. In other words, reading the summaries of foreign lawyers, who can describe relevant foreign laws and practices, is perfectly consistent with and helpful when interpreting and giving advice about one's own law and practice.

As well as giving guidance for navigating a particular local but, from the standpoint of the reader, foreign scene, the comparative perspectives presented by our authors present an agenda for thought, analysis and response about home jurisdiction laws and regulatory frameworks, thereby also giving lawyers, in-house compliance officers, regulators, law students and law teachers an opportunity to create a checklist of relevant considerations both in light of what is or may currently be required in their own jurisdiction but also as to where things there could, or should, best be headed (based on best practices of another jurisdiction) for the future.

Thus, an unfamiliar and still-changing legal jurisdiction abroad may raise awareness and stimulate discussion, which in turn may assist practitioners to revise concepts, practices and advice in both our domestic and international work. Why is this so important? The simple answer is that it cannot be avoided in today's ICM practice. Just as importantly, an ICM practitioner's clients would not wish us to have a more blinkered perspective.

Not long ago, I had the honour of sharing the platform with a United Kingdom Supreme Court Justice, a distinguished Queen's Counsel and three American academics. Our topic was 'Comparative Law as an Appropriate Topic for Courts'. The others concentrated their remarks, as might have been expected, on the context of matters of constitutional law, and that gave rise to a spirited debate. I attempted to take some of the more theoretical aspects of our discussion and ground them in the specific example of capital markets, and particularly the over-the-counter derivatives market.

Activity in that market, I said, could be characterised as truly global. More to the point, I posited, that, whereas you might get varied answers if you asked a country's citizens whether they considered it appropriate for a court to take account of the experiences of other jurisdictions when considering issues of constitutional law, in my view derivatives

market participants would uniformly wish courts to at least be aware of and consider relevant financial market practice beyond their jurisdictional borders and comparative jurisprudence (especially from English and New York courts, which are most often called upon to adjudicate disputes about derivatives), even when traditional approaches to contract construction as between courts in different jurisdictions may have differed.

In such cases, with so much at stake given the volumes of financial market trading on standard terms, and given the complexity and technicality of many of the products and the way in which they are traded and valued, there appears to me to be a growing interest in comparative law analysis and an almost insatiable appetite among judges to know at least how experienced courts have answered similar questions.

There is no reason to think that ICM practitioners are any differently situated in this regard, or less in need of or less benefited by a comparative view when facing up to the often technical and complex problems confronting them, than are judges. After all, it is only human nature to wish not to be embarrassed or disadvantaged by what you do not know.

Of course, it must be recognised that there is no substitute for actual and direct exchanges of information between lawyers from different jurisdictions. Ours should be an interdependent professional world. A world of shared issues and challenges, such as those posed by market regulation. A world of instant communication. A world of legal practices less constrained by jurisdictional borders. In that sense and to that end, the directory of experts and their law firms in the appendices to this book may help to identify local counterparts in potentially relevant jurisdictions. In that case, I hope that reading the content of this book may facilitate discussions with a relevant author.

In conclusion, let me add that our authors are indeed the heroes of the stories told in the pages that follow. My admiration for our contributing experts, as I wrote in the preface to the last edition, continues. It remains, too, a distinct privilege to serve as their editor, and once again I shall be glad if their collective effort proves helpful to our readers when facing the challenges of their ICM practices amid the growing interdependence of our professional world – and now the coronavirus pandemic and its impact on the global economy.

Is that light at the end of the tunnel? Let's hope so.

In the meantime, best wishes for this difficult period. Stay safe, stay well and stay alert.

**Jeffrey Golden**

Joint Head of Chambers

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London

October 2021

# UNITED STATES

*Alan Grincer, Michael Hyatte and Sara von Althann<sup>1</sup>*

## I INTRODUCTION

The capital markets in the United States are principally regulated by federal government agencies, particularly the Securities and Exchange Commission (SEC).

The Securities Act of 1933, as amended (Securities Act), requires all offers and sales of securities in the United States to be made pursuant to an effective registration statement or an explicit exemption from registration. Any issuer, including any foreign private issuer, with at least US\$10 million in assets and a class of equity securities held by the requisite number of record holders or with an outstanding class of securities listed on a US national securities exchange must register such class of securities under the Securities Exchange Act of 1934, as amended (Exchange Act), and file annual and other reports with the SEC. Securities registered under the Exchange Act are also subject to the SEC's rules on ownership reporting and tender offers. Issuers may also be subject to the SEC's rules on shareholder voting and corporate governance, but foreign private issuers are generally exempt from such rules.

The perspective of the SEC statutes is that persons making investment decisions in securities transactions should have accurate and reliable information without any material misstatements or omissions. The detailed disclosure requirements that apply to such transactions are found in the rules promulgated by the SEC under the securities laws.

In addition to the SEC, other federal and state regulators and self-regulatory organisations, such as the Commodity Futures Trading Commission (CFTC) and the Financial Industry Regulatory Authority, have important roles in the oversight of the securities activities of banks, insurers and broker-dealers, in particular.

Although the SEC proposes and adopts rules under the federal securities laws every year, particularly wide-ranging rule changes were adopted in response to the financial crisis, including those mandated by the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd–Frank Act). The Dodd–Frank Act increased investor protection through substantive market regulation, a policy somewhat at odds with the SEC's previous efforts to reduce the regulatory burden on issuers, and some industry advocates argue that the Dodd–Frank Act reforms went so far as to have had a chilling effect on the capital markets. After a period of deregulation during the administration of President Donald Trump, the

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1 Alan Grincer is a partner, Michael Hyatte is a senior counsel and Sara von Althann is counsel at Sidley Austin LLP. The authors would like to thank their colleague, Dominic Nelson, for his assistance with this chapter. They would also like to thank their colleagues Nick Brown, Nathan Enfield, Daniel Engoren, Jessica Fitzpatrick, Michael P Heinz, Edward F Petrosky, Lena Qiu, Bill Shirley, Allison Ross Stromberg, Lilya T Tessler, David Sylofski, Dennis Twomey and Mark Walsh.

administration of President Joseph Biden is now pursuing its policy priorities, which may partly involve rolling back policies of the Trump administration that it considers insufficiently focused on investor protection.

## **II THE YEAR IN REVIEW**

Debt and equity markets in the United States had a strong run in 2020, which continued into 2021 despite lingering uncertainty resulting from the covid-19 pandemic. The strong equity markets have led to a rush of initial public offerings (IPOs). From 1 January to 30 September 2021, 776 IPOs raised US\$289.1 billion of proceeds, already greater than any earlier year.<sup>2</sup> A significant portion of this IPO activity arose from special purpose acquisition companies (SPACs), but even outside the SPAC market, traditional IPOs have still had a strong year. Low interest rates have fuelled strong debt market activity, with US\$1,560.5 billion raised in new issuances of corporate debt securities from 1 January to 30 September 2021.<sup>3</sup>

In January 2021, Joseph Biden was inaugurated as US president and the 117th Congress convened, with both executive and legislative branches of government now controlled by the Democratic Party. In March 2021, Congress provided an additional US\$1.9 trillion of economic stimulus to address the ongoing covid-19 pandemic in the American Rescue Plan Act of 2021. With most of the acute economic threats of covid-19 now considered to be receding, the Federal Reserve has started ending and unwinding its temporary actions and programmes to support the US economy and capital markets during the pandemic.

Two market trends in 2021 highlight possible future rule-making. The first is that of SPACs, which present a range of regulatory issues, many of which are addressed below. The second, which emerged in January and February of 2021, is of spikes in trading volumes and price volatility in shares and equity derivatives of distressed companies apparently driven by retail investors trading based on social media discussions. Many such retail investors trade on smart phone app platforms that offer free trades to users by funnelling the deal flow to market makers for fees. Some of these platforms include features resembling video games or betting sites, potentially encouraging trading and customer engagement with the platform, raising questions of conflicts between the trading platform and investors. Losers from these retail trading strategies included professional investors with short-positions, who were squeezed as stock prices rose. In one case, short positions were reportedly held against 140 per cent of a company's stock, which created further upward pressure on the stock price as short sellers scrambled to buy stock to cover their short positions. The spike in trading volumes caused some trading apps to restrict users' trading during volatile periods because the app lacked sufficient capital to post margin to settle trades. Regulators are investigating these events, which could lead to reforms including on the 'gamification' of retail trading, the payment for deal flow model, the execution of orders by market makers rather than through exchanges, the transparency in the stock loan market that underpins short positions, the risk of social media as means to manipulate markets, shortening the settlement cycle from trades and

---

2 Deal Point Data, last accessed on 7 October 2021, available at: <https://www.dealpointdata.com/rj?vb=Action.intras&app=ipo&id=q484963472>.

3 See SIFMA, US Fixed Income Securities Statistics, last accessed on 20 October 2021, available at: <https://www.sifma.org/resources/research/us-fixed-income-securities-statistics/>.

possible systemic risks, such as margin requirements preventing trading, severe losses from short positions and concentrations of risks in the financial system, such as market makers and brokers at settlement houses.<sup>4</sup>

### **i Developments affecting debt and equity offerings**

During 2021, the SEC and other regulators reset their regulatory agendas to reflect the priorities of the Biden administration. In addition, regulators responded to emergent trends that could potentially undermine the efficient functioning of the US capital markets.

#### ***Biden Administration and SEC recomposition***

President Joseph Biden was inaugurated as the 46th president of the United States in January 2021, succeeding President Donald Trump. As is typical in presidential transition periods, the chair of the SEC nominated by the previous president, Jay Clayton, resigned in December 2020. President Biden's nominee for chair of the SEC, Gary Gensler, was sworn into office in April 2021.

The SEC released a regulatory agenda in June 2021 that includes:

- a* revising recently passed rules relating to proxy advisory firms;
- b* further updating regulation of exempt offerings under Regulation D;
- c* disclosure requirements on climate change, human capital management, cybersecurity risks and corporate board diversity;
- d* closing potential loopholes for Rule 10b5-1 plans, which provide a defence for insiders when trading in securities;
- e* modernising requirements for companies to disclose stock repurchases;
- f* disclosure requirements to enhance transparency for beneficial ownership or interests in security-based swaps;
- g* SPACs; and
- h* Dodd-Frank rule-makings on executive compensation.<sup>5</sup>

While Jay Clayton was a political independent, he often voted with the two Republican commissioners on contentious rule-making decisions over the dissent of the two Democratic commissioners.<sup>6</sup> The SEC's regulatory agenda under Chair Gensler reflects plans to revisit certain of these contentious rule-making decisions under Chair Clayton's leadership and potentially to roll-back such rules or reflect the points on which the Democratic commissioners

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<sup>4</sup> See Testimony of Chair Gary Gensler before the House Committee on Financial Services, 6 May 2021, available at: <https://www.sec.gov/news/testimony/gensler-testimony-20210505>.

<sup>5</sup> See SEC contributions related to the Office of Information and Regulatory Affairs, 'Spring 2021 Unified Agenda of Regulatory and Deregulatory Actions', 11 June 2021, available at: <https://www.sec.gov/news/press-release/2021-99>; Gary Gensler, Chair of SEC, Prepared remarks at London City Week, 23 June 2021, available at: <https://www.sec.gov/news/speech/gensler-speech-london-city-week-062321>.

<sup>6</sup> See for example Commissioners Allison Herren Lee and Caroline Crenshaw, 'Joint Statement on the Failure to Modernize the Accredited Investor Definition', 26 August 2020, available at: <https://www.sec.gov/news/public-statement/lee-crenshaw-accredited-investor-2020-08-26>; 'Joint Statement on Amendments to Regulation S-K: Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information', 19 November 2020, available at: <https://www.sec.gov/news/public-statement/lee-crenshaw-statement-amendments-regulation-s-k>; and 'Statement on Primary Direct Listings', 23 December 2020, available at: <https://www.sec.gov/news/public-statement/lee-crenshaw-listings-2020-12-23>.

dissented. This roll-back of recently passed rules will likely occur over the dissent of the two Republican commissioners, who believe such rules should be given a chance to take effect so any review is based on evidence of shortcomings of such rules.<sup>7</sup>

### ***Continued SEC response to covid-19***

Having released a significant amount of guidance and adopted various accommodations to address the rise in remote work and other changes in circumstances imposed on public companies as a result of covid-19 and related governmental, societal and company responses thereto in 2020, the SEC's response to covid-19 in 2021 was relatively quieter. Most SEC staff are expected to remain primarily on a telework basis through at least 3 January 2022.

In April 2021, the SEC staff released updated guidance encouraging issuers, to the extent feasible under state law, to provide shareholder proponents or their representatives with the ability to present their proposals through means other than appearing in person, such as by phone, during the 2020 and 2021 proxy seasons. The staff also indicated that it would consider a shareholder proponent's inability to present his or her proposal in person due to covid-19 to be 'good cause' under Rule 14a-8(h), precluding the company from excluding such shareholder proponent's proposals from the company's proxy statement for two years based on his failure to appear and present the proposal.

The SEC staff also brought a number of enforcement actions and trading suspensions relating to covid-19 in 2021. For example, in December 2020, the SEC charged a company for making misleading disclosures about the impact of the covid-19 pandemic on its business operations and financial condition by claiming that its business was 'operating sustainably' while internal documents at the time showed that the company was burning cash and projected only 16 weeks of cash remaining.<sup>8</sup> In February 2021 and July 2021, the SEC charged two different companies for making misleading statements about, respectively, the development status of covid-19 screening tests and the availability of medical and personal protective equipment for immediate sale.<sup>9</sup> While the nature of these charges is not qualitatively different from past charges the SEC has brought based on misleading disclosure, they illustrate the SEC and SEC staff's focus on ensuring investors receive accurate, timely disclosures regarding the impact of covid-19 on businesses, and on preventing bad actors from profiting from a public health emergency on false pretences.

### ***Alternative pathways to a public listing***

A private company traditionally went public and listed on a US exchange through an underwritten initial public offering (IPO) of shares by the issuer or existing shareholders. Critics complain the IPO process is slow, costly and uncertain. The SEC's review process for the registration statement often takes three to six months. The underwriters purchase

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7 Commissioners Hester M Peirce and Elad L Roisman, 'Moving Forward or Falling Back? Statement on Chair Gensler's Regulatory Agenda,' 14 June 2021, available at: <https://www.sec.gov/news/public-statement/moving-forward-or-falling-back-statement-chair-genslers-regulatory-agenda>.

8 See 'SEC Charges The Cheesecake Factory For Misleading COVID-19 Disclosures,' 4 December 2020, available at: <https://www.sec.gov/news/press-release/2020-306>.

9 See 'SEC Charges California Company and Its CEO with Misleading Investors About Covid-19 Blood Test and Financial Reports,' Litigation Release No. 25029, 11 February 2021, available at: <https://www.sec.gov/litigation/lit/releases/2021/lr25029.htm> and 'SEC Charges Company and Two Executives for Misleading COVID-19 Disclosures,' 7 July 2021, available at: <https://www.sec.gov/news/press-release/2021-120>.

the shares and on-sell the shares to investors, which are primarily institutional investors, at a higher price with a roadshow and sales push. The underwriters pocket this ‘spread’, which can be up to 7 per cent of the offering value. The IPO price, negotiated with underwriters based on investor feedback, can be suppressed by temporary market conditions or be lower than expected at the start of the process if investor interest is tepid. The issuer or selling shareholders may feel the valuation was too low if the shares start trading significantly above the IPO price. Recent developments with direct listings and SPACs respond to perceived shortcomings of the IPO process and increased volatility in the markets.

### *Primary direct floor listings*

Direct listings involve listing the shares on an exchange without an underwritten offering. The opening price is set by a market maker based on buy and sell orders submitted by broker-dealers in an auction process. Proponents of direct listings argue the structure saves costs of underwriters, avoids locking up existing shareholders from selling their shares, and offers a fairer and potentially wider initial distribution of shares and a market-based price discovery method.

The SEC approved stock exchange rules in 2018 allowing secondary direct floor listings, that is, direct listings of outstanding shares held by existing shareholders. In late 2020 and early 2021, the SEC approved further stock exchange rules allowing exchanges to exercise discretion, on a case-by-case basis, to list companies undertaking a primary direct floor listing with, or instead of, a secondary direct floor listing.<sup>10</sup> The exchange’s discretion requires the company to demonstrate it will meet the exchange’s requirement on minimum market value of publicly held shares. Primary direct floor listings allow companies to raise fresh capital as they would in a primary IPO.

The SEC’s approval of primary direct floor listing rules was criticised by institutional investors and the two Democratic commissioners as undermining investor protections.<sup>11</sup> They argued that the US securities laws are structured so underwriters play a gatekeeper role for a company accessing the capital markets by holding underwriters liable for misstatements in the registration statement unless the underwriters have performed adequate due diligence. Thus, removing underwriters could undermine investor protections by removing an independent

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10 The SEC approved the NYSE proposed rules in SEC Release No. 34-90768; File No. SR-NYSE-2019-67, Self-Regulatory Organizations; New York Stock Exchange LLC; Order Setting Aside Action by Delegated Authority and Approving a Proposed Rule Change, as Modified by Amendment No. 2, to Amend Chapter One of the Listed Company Manual to Modify the Provisions Relating to Direct Listings, available at <https://www.sec.gov/rules/other/2020/34-90768.pdf>. The SEC approved the Nasdaq proposed rules in SEC Release No. 34-91947; File No. SR-NASDAQ-2020-057, Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Order Approving a Proposed Rule Change, as Modified by Amendment No. 2, to Allow Companies to List in Connection with a Direct Listing with a Primary Offering In Which the Company Will Sell Shares Itself In the Opening Auction on the First Day of Trading on Nasdaq and to Explain How the Opening Transaction for Such a Listing Will be Effected, available at <https://www.sec.gov/rules/sro/nasdaq/2021/34-91947.pdf>. The rules are in footnote E to section 102.01 of the NYSE Listed Company Manual and in NASDAQ Stock Market Rules IM-5315-1.

11 See Public Statement: Statement on Primary Direct Listings by Commissioners Allison Herren Lee and Caroline A Crenshaw, 23 December 2020, available at <https://www.sec.gov/news/public-statement/lee-crenshaw-listings-2020-12-23> and the Council of Institutional Investors petition for review of the SEC order, available at [https://www.cii.org/files/issues\\_and\\_advocacy/correspondence/2020/20200908%20Letter%20to%20SEC%20w%20attachments.pdf](https://www.cii.org/files/issues_and_advocacy/correspondence/2020/20200908%20Letter%20to%20SEC%20w%20attachments.pdf).

check on the quality of the registration statement. Furthermore, because primary direct listing may often also involve concurrent sales by other shareholders, these listings could present ‘traceability’ challenges for investors to enforce rights under the securities laws for misstatements under the registration statement.

#### *Surge in special purpose acquisition companies*

Special purpose acquisition companies (SPACs) first appeared in the US capital markets in the 1990s, but SPAC-listings surged in 2020 and further intensified in 2021. In 2020, there were 248 SPAC initial public offerings, more than the prior 10 years combined. In the first quarter of 2021, there were more SPAC IPOs than throughout 2020. From 1 January to 30 September 2021, there were 450 SPAC IPOs.<sup>12</sup> This surge in SPACs offered exit opportunities for private equity firms and venture capital investors and a second chance at listing for previously failed IPOs. SPACs appear to offer a faster, more flexible path to listing compared to traditional IPOs and an opportunity for SPAC sponsors and underwriters to earn significant returns. The SEC staff saw potential pitfalls for investors and its response became increasingly muscular, evolving from investor education, to guidance to SPACs on disclosure and compliance responsibilities, to scrutiny of the SPAC structure and, finally, to enforcement action against bad actors.

A SPAC starts as a newly formed shell company with no assets. A sponsor contributes ‘at-risk’ capital to fund the SPAC’s initial activities for warrants and a ‘promote’ generally comprising 20 per cent of the SPAC’s common stock. The sponsor generally forfeits its warrants and promote if the SPAC fails to complete an initial business combination within 24 months. The SPAC issues its remaining common stock and warrants to public investors in an IPO. The SEC review of the SPAC’s registration statement can be completed within two to three months. Proceeds of the IPO are deposited in a segregated trust account with an independent trustee pending the business combination, redemption by public shareholders or liquidation of the trust account. After its IPO, the SPAC hunts for a target for its initial business combination. The SPAC’s management negotiates the terms of the business combination, including the price. The securities laws apply to proxy votes, tender offers and the exchange of securities in the business combination, which require, as applicable, proxy solicitation or tender offer materials reviewed by the SEC staff or the filing of a registration statement on Form S-4 or F-4, also reviewed by the SEC staff (and typically combined with the proxy statement into one filing), to effect the exchange of securities in the business combination. If the business combination is consummated, the target continues operations as a listed public company. Public investors can decline to participate in the business combination by selling their shares or warrants, or by electing redemption of their shares. This redemption risk requires the SPAC to arrange backstop financing for the business combination, which is typically a private-investment-in-public-equity (PIPE) commitment.

Sponsoring a SPAC can be lucrative, with the sponsor typically generally receiving 20 per cent of the SPAC’s equity by contributing 3–4 per cent of the SPAC’s IPO proceeds as at-risk capital. But the sponsor’s pay-off is conditioned on the SPAC completing the initial business combination prior to the SPAC’s expiration date, which is typically 24 months after the SPAC’s IPO. Otherwise, the sponsor forfeits its investment to the public shareholders. The SPAC’s advisors can face similar pressure for the SPAC to complete a business combination

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12 Deal Point Data, last accessed on 7 October 2021, available at: <https://www.dealpointdata.com/rj?vb=Action.intras&cap=ipo&cid=q1683127801>.

if payment of some or all the advisor's fees, including underwriter fees for the SPAC's IPO, is conditioned on the completion of the initial business combination. A sponsor may also gain in other ways from the business combination, such as when the SPAC's target is affiliated with the sponsor. The SEC staff warned that careful disclosure to investors is required as part of the IPO or when presenting an initial business combination about potential conflicts of interest, including duties the sponsor and management may have to other entities, the differences in economic interests of the sponsor and public stockholders from a business combination or the SPAC not completing a business combination, terms of a PIPE or other financing for the initial business combination, the process for the sponsor in identifying and negotiating terms for the initial business combination, and incentives for underwriters who deferred compensation in the initial public offering if such underwriters have provided services for the initial business combination.<sup>13</sup> The staff also warned investors about investing in SPACs solely on the involvement of celebrities or information received on social media or internet chat groups.<sup>14</sup>

Proponents of SPACs tout the faster path to listing compared to a traditional IPO. But a risk of speedy listings is that a SPAC's target might be insufficiently prepared for life as a public company. The staff repeated guidance and reminders on the initial and ongoing public filing requirements, and building adequate accounting functions, and internal control and corporate governance frameworks.<sup>15</sup>

The staff also addressed SPACs including heady projections of the target business in their proxy solicitation or tender offer materials for initial business combinations. SPACs generally present projections that its board considered in recommending the business combination in the proxy statement/registration statement. Some market participants have asserted that lower liability standards apply to such projections than in a traditional IPO.<sup>16</sup> The liability difference stems from the Private Securities Litigation Reform Act of 1995 (PSLRA), which creates a safe harbour for forward-looking statements to promote discussion about a company's prospects as part of its ongoing reporting. The PSLRA does not apply to an 'initial public offering', but because the proxy solicitation or tender offer materials are filed after the initial listing of the SPAC, the PSLRA may provide protection for disclosures in the business combination filings. The staff has warned the PSLRA safe harbour might not apply to such disclosures because the presentation of the target in the proxy solicitation or tender offer materials for the initial business combination is, in economic essence, an initial public offering, though it is not clear to what extent the SEC has the authority or intent to enforce

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13 SEC Division of Corporation Finance, CF Disclosure Guidance: Topic No. 11, 'Special Purpose Acquisition Companies', updated 22 December 2020, available at: <https://www.sec.gov/corpfin/disclosure-special-purpose-acquisition-companies>.

14 SEC Office of Investor Education and Advocacy, Investor Alerts and Bulletins 'What you Need to Know About SPACs', updated 25 May 2021, available at: <https://www.sec.gov/oiea/investor-alerts-and-bulletins/what-you-need-know-about-spacs-investor-bulletin>.

15 Paul Munter, Acting Chief Accountant, 'Financial Reporting and Auditing Considerations of Companies Merging with SPACs', 31 March 2021. Public Statement, Division of Corporation Finance, 'Staff Statement on Select Issues Pertaining to Special Purpose Acquisition Companies', 31 March 2021, available at: <https://www.sec.gov/news/public-statement/munter-spac-20200331>.

16 See Bloomberg, 'Why Chamath Palihapitiya Loves SPACs So Much', 28 January 2021, available at: <https://www.bloomberg.com/opinion/articles/2021-01-28/why-chamath-palihapitiya-loves-spacs-so-much>.

this position in light of the language in the PSLRA, which was adopted by Congress. The staff's position is that the SPAC structure should not present a regulatory arbitrage around the panoply of securities laws applicable to a traditional IPO.<sup>17</sup>

In April 2021, the staff challenged the accounting classification of warrants typically issued by SPACs as equity rather than liabilities.<sup>18</sup> Many SPACs had issued warrants to the sponsor and public investors expiring five years after the initial business combination under a similar warrant agreement. This delayed most pending SPAC initial public offerings and business combinations until a consensus was reached among the legal and accounting communities of modifications to the warrant agreement to qualify for equity treatment. SPACs who had completed their IPOs and former SPACs with warrants still outstanding that had completed a business combination were required to review the materiality of the misclassification in their previously issued financial statements and determine whether a restatement was required. This uncertainty limited access to the capital markets for these issuers, and led to a wave of restatements.

In July 2021, the SEC announced enforcement action against a SPAC, its sponsor, the SPAC's chief executive officer, the SPAC's target and the target's chief executive officer for misleading statements to investors prior to the business combination about the viability of the target's technologies and regulatory restrictions because of the target's CEO.<sup>19</sup> The SEC described this as a cautionary tale of the risks inherent in SPAC transactions. The SEC imposed sanctions including civil penalties, the right for PIPE investors to terminate their investment and requiring the sponsor to relinquish founders' shares.<sup>20</sup> The SEC is continuing with litigation against the target's CEO seeking permanent injunctions, penalties, disgorgement plus prejudgment interest and an officer-and-director bar.<sup>21</sup>

In August 2021, an investor brought private derivative lawsuits against three SPACs and their sponsors, each alleging that the SPAC constitutes an 'investment company' so the SPAC is subject to the heightened regulation and registration requirements of the Investment Company Act of 1940 and that the SPAC's sponsor constitutes an 'investment advisor' so the sponsor's compensation exceeded limitations on the form and amount of compensation under the Investment Advisor Act of 1940.<sup>22</sup> An 'investment company' is a person that 'is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities'. The complaints argue the SPACs are each

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17 John Coates, Acting Director, Division of Corporation Finance, 'Public Statement: SPACs, IPOs and Liability Risk under the Securities Laws', 8 April 2021, available at: <https://www.sec.gov/news/public-statement/spacs-ipos-liability-risk-under-securities-laws>.

18 John Coates, Acting Director, Division of Corporation Finance, and Paul Munter, Acting Chief Accountant, 'Staff Statement on Accounting and Reporting Considerations for Warrants Issued by Special Purpose Acquisition Companies', 12 April 2021, available at: <https://www.sec.gov/news/public-statement/accounting-reporting-warrants-issued-spacs>.

19 See Press Release, 'SEC Charges SPAC, Sponsor, Merger Target, and CEOs for Misleading Disclosures Ahead of Proposed Business Combination', dated 13 July 2021 available at: <https://www.sec.gov/news/press-release/2021-124>.

20 See the SEC Order available at: <https://www.sec.gov/litigation/admin/2021/33-10955.pdf>.

21 See the SEC Complaint available at: <https://www.sec.gov/litigation/admin/2021/33-10955.pdf>.

22 *Assad v. Pershing Square Tontine Holdings, Ltd. et. al*, Docket No. 1:21-cv-06907 (S.D.N.Y. 17 August 2021); *Assad v. GO Acquisition Corp., et. al*, Docket No. 1:21-cv-07076 (S.D.N.Y. 20 August 2021); *Assad v. E.Merge Tech. Acquisition Corp., et. al*, Docket No. 1:21-cv-07072 (S.D.N.Y. 20 August 2021). A copy of Pershing Square Tontine Holdings, Ltd. complaint is available at: <https://www.dandodiary.com/wp-content/uploads/sites/893/2021/08/Pershing-Square-complaint.pdf>.

an investment company because their only activities have been investing the proceeds from their initial public offerings in short-term treasuries and qualifying money market funds prior to their initial business combination, which will involve a further investment in securities. The lawsuits are supported by two academics, Robert Jackson and John Morley. Robert Jackson was a SEC commissioner between January 2018 and February 2020. In response, more than 60 law firms, including our own, signed a public statement that, consistent with long-standing interpretations of the Investment Company Act, and its plain statutory text, SPACs are not investment companies because they are engaged primarily in identifying and consummating a business combination with one or more operating companies within a specified period of time, rather than investing in securities, and holding short-term treasuries and qualifying money market funds in a trust account pending completion of a SPAC's initial business combination does not characterise the SPAC as an investment company.<sup>23</sup>

In September 2021, the Investor Advisory Committee, a body established by the Dodd-Frank Act to advise the SEC, recommended the SEC regulate SPACs more closely by focusing on and enforcing existing disclosure rules on a range of issues so investors can be equipped with a clearer understanding of the SPAC structure and process for the initial business combination, and so that the SEC prepare and publish an analysis of the players in the various SPAC stages, and each player's compensation and incentives.<sup>24</sup> These recommendations intend to enhance investor protections immediately for existing SPACs while allowing the committee to revisit SPACs once data from the current burst of SPACs is available.

Also in September 2021, the SEC's Office of the Chief Accountant notified auditing firms that the redemption features in public shares issued by SPACs in their IPOs meant that the shares should be classified as temporary equity rather than as permanent equity. A consequence of this accounting change is that SPACs generally no longer meet minimum equity capital requirements to be eligible to list on the Nasdaq Capital Market (NCM), where SPACs had generally listed on the Nasdaq, so SPACs looking to list on the Nasdaq were required to list on the higher Nasdaq Global Market tier. This change in tier required SPACs to have a minimum of 400 shareholders instead of 300, as required on the NCM. The difference in accounting treatment does not affect the eligibility of SPACs to list on the New York Stock Exchange.

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23 See Sidley Austin LLP, 'Over 55 of the Nation's Leading Law Firms Respond to Investment Company Act Lawsuits Targeting the SPAC Industry,' 30 August 2021, available at: <https://www.sidley.com/-/media/update-pdfs/2021/08/joint-statement.pdf?la=en>.

24 See Investor Advisory Committee, 'Recommendations of the Investor as Purchaser and Investor as Owner Subcommittees of the SEC Investor Advisory Committee regarding Special Purpose Acquisition Companies,' draft as of 26 August 2021, available at: <https://www.sec.gov/spotlight/investor-advisory-committee-2012/draft-recommendation-of-the-iap-and-iao-subcommittees-on-spacs-082621.pdf>. The draft recommendations were unanimously approved at the meeting of the Investor Advisory Committee on 9 September 2021, available at: [https://www.sec.gov/video/webcast-archive-player.shtml?document\\_id=iac090921-2](https://www.sec.gov/video/webcast-archive-player.shtml?document_id=iac090921-2).

## Other SEC rulemaking

### *Amendments to management's discussion and analysis and other financial disclosure requirements*

In late 2020, the SEC finalised rules modernising, streamlining and enhancing the requirements for disclosure for management's discussion and analysis (MD&A), selected financial data and supplementary financial information in Regulation S-K.<sup>25</sup>

The changes eliminated the requirements for tabular disclosure of five years of selective financial information in Item 301 of Regulation S-K. This information is otherwise readily available to investors, and the SEC saw this tabular disclosure as overlapping with the requirement to describe material trends in the MD&A section. The requirement to provide two years of quarterly financial information and variances from amounts reported in Forms 10-Q in Item 302 of Regulation S-K was replaced with a principles-based requirement to disclose material retrospective changes and explain the reasons for the changes. The quarterly information previously required to be disclosed is readily available to investors, but material variances are still required to be disclosed and highlighted.

The changes to MD&A disclosure requirements in Item 303 of Regulation S-K reflect the SEC's recent trend under multiple administrations towards principles-based disclosure requirements, which allow issuers to tailor their disclosures to their specific industry and circumstances. Critics observe that this flexibility can reduce comparability between and among issuers and industries. The changes to the MD&A disclosure requirements include:

- a* expanding requirements to disclose known material cash requirements, including capital expenditure requirements;
- b* expanding the standard for the disclosure of trends from those that will affect financial results to those that are reasonably likely to do so;
- c* requiring disclosure of the underlying reasons for changes in line items in quantitative and qualitative terms rather than merely causes of such changes;
- d* eliminating specific requirements to discuss the effects of inflation and price changes, disclose off-balance sheet arrangements under a separate header and present tabular disclosure of future contractual obligations; and
- e* allowing quarterly periods to be compared to the most recently completed quarter rather than be required to compare to the corresponding quarter of the prior year.

Where specific disclosure requirements were eliminated, the SEC generally considered that such matters would be covered by other sections, if material, or introduced a principles-based requirement to discuss the relevant matter. For example, the revised rules require registrants to discuss commitments or obligations, including contingent obligations, arising from arrangements with unconsolidated entities or persons that have, or are reasonably likely to have, a material current or future effect on such registrant's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, cash requirements or capital resources (including off-balance sheet arrangements) in the broader discussion of liquidity and capital resources. The SEC declined to add specific disclosure requirements for environmental, social and governance (ESG) or sustainability matters but continued to encourage issuers to comply with its existing guidance. Notably, in the third quarter

25 See SEC Release No. 33-10890; 34-90459, 'Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information', 19 November 2020, available at: <https://www.sec.gov/rules/final/2020/33-10890.pdf>.

of 2021, the SEC staff began issuing comments to a selection of public companies across different industry sectors regarding their environmental disclosures.<sup>26</sup> Some of the comments specifically made reference to disclosures made in reports, such as sustainability reports or corporate social responsibility (CSR) reports, released publicly by companies but not included in their SEC reports. The comments made reference to the SEC's 2010 guidance on climate change disclosures.<sup>27</sup>

In most cases, the rules will start to apply for 2021 annual reports are required to be filed in 2022, though early adoption is permitted.

### ***Replacement of LIBOR with SOFR***

US regulators continued to make substantial progress with the replacement of US dollar LIBOR as a floating rate benchmark with the Secured Overnight Financing Rate (SOFR). Further developments on changes in the replacement of LIBOR are discussed below under 'Developments affecting derivatives, securitisations and other structured products' – US regulators have taken actions related to the LIBOR discontinuation.

#### **ii Developments affecting derivatives, securitisations and other structured products**

In recent years, US regulatory changes in relation to derivatives, securitisations and other structured products have been focused on rule changes mandated by the Dodd-Frank Act, including Section 619, commonly known as the Volcker Rule. There has also been focus on financial markets' transitioning from LIBOR as the principal benchmark for floating interest rates. Following the 2020 presidential election and the resulting change in administration and follow-on leadership changes at the SEC and other regulatory authorities, actual rulemaking and other policy initiatives related to derivatives, securitisations and other structured products have been limited, as the related regulatory agenda looking forward has evolved.

### ***The Volcker Rule***

The Volcker Rule comprises statutory provisions and implementing regulations that restrict banks from engaging in proprietary trading and from acquiring ownership interests in, or sponsoring, hedge funds, private equity funds and certain other private issuing entities – defined as 'covered funds'. Following a significant series of amendments completed in July 2020, the SEC, the Federal Reserve Board (FRB) and other US federal agencies charged with administering the Volcker Rule have paid little attention in 2021 to amending the rule further.

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26 The SEC staff publicly released sample comments, available at: <https://www.sec.gov/corpfin/sample-letter-climate-change-disclosures>.

27 Commission Guidance Regarding Disclosure Related to Climate Change, Release No. 33-9106 (2 February 2010) [75 FR 6290] (8 February 2010), available at: <https://www.sec.gov/rules/interp/2010/33-9106.pdf>.

### ***Risk retention***

Since their effective date several years ago, the rules implementing the Exchange Act's risk retention requirements have not been amended. Court cases have also been quite limited in that time. As with the Volcker Rule, the SEC, the FRB and other US federal agencies charged with administering the US risk retention requirements have given little concrete attention to those requirements in 2021.

### ***The CFTC adopts a cross-border swaps rule***

A CFTC rule took effect in November 2020 that determines the cross-border application of certain of the CFTC's swaps regulations for swap dealers and major swap participants, including applicable registration thresholds. The rule extends the cross-border approach of the CFTC's 2016 cross-border rule relating to the application of margin requirements for uncleared swaps, and it harmonises, to a significant degree, the CFTC's cross-border approach to swap dealer regulation with the SEC's cross-border approach to security-based swap dealer regulation. The rule will supersede the CFTC's 2013 cross-border interpretive guidance with respect to the requirements that the rule addresses. In other respects, the 2013 interpretive guidance will remain relevant.

### ***The SEC continues to stand up its security-based swap regime***

In late 2019, the SEC took a number of actions to stand up its security-based swap regime. Security-based swaps are under the SEC's jurisdiction rather than that of the CFTC (which has jurisdiction over swap transactions that are not security based). In May 2021, the SEC approved the registration of its first security-based swap data repository (SDR). The approval established 8 November 2021, as the first compliance date for SEC Regulation SBSR, which governs regulatory reporting and public dissemination of security-based swap transactions. Regulation SBSR provides for the reporting of security-based swap information to registered SDRs and for public dissemination of transaction, volume and pricing information.

### ***The SEC adopts new derivative risk management requirements for certain registered investment companies***

In November 2020, the SEC adopted a rule that addresses derivatives risk management for mutual funds (other than money market funds), exchange-traded funds (ETFs) and certain other fund entities. The rule takes a new approach to how such fund entities must manage the risks presented by derivatives transactions. The rule requires such risks to be managed fund wide by a derivatives risk management programme coupled with maximum value-at-risk (VaR) limits.

### ***US regulators have taken actions related to the LIBOR discontinuation***

US dollar LIBOR, like LIBORs in other currencies, is being discontinued as a floating-rate benchmark. Rates based on the Secured Overnight Financing Rate (SOFR) are expected to replace LIBOR in the United States as the principal floating-rate benchmark. US regulators have taken various actions related to the LIBOR discontinuation.

In the United States, the cash markets have generally coalesced around recommendations for a LIBOR replacement from the Alternative Reference Rates Committee (ARRC), which was convened by the FRB and the Federal Reserve Bank of New York (FRBNY). In July 2021, the ARRC formally recommended CME Group's forward-looking SOFR term rates

(SOFR Term Rates) as the replacement for US dollar LIBOR for certain purposes.<sup>28</sup> The ARRC's formal recommendation means that contracts with existing LIBOR obligations (i.e., cash market products) with ARRC-recommended fallback language are expected to transition to SOFR Term Rates at the LIBOR replacement date under the contract, but the ARRC's recommendation will generally not affect existing LIBOR swaps that include ISDA fallback language (because it does not refer to SOFR Term Rates).

Earlier in 2021, New York state passed legislation to address New York-law governed contracts, securities and instruments with interest or dividend rates determined by reference to US dollar LIBOR that have no fallback rate provisions or have fallback rate provisions that will not work after US dollar LIBOR is discontinued.<sup>29</sup> The effect of the legislation on covered contracts will be either to automatically replace LIBOR with the applicable SOFR-based rate or, if the contract designates a person to select an alternative benchmark based on LIBOR or to replicate LIBOR, to authorise that person to select the applicable SOFR-based rate as the LIBOR replacement and, in each case, to provide conforming changes.

The ARRC also sets forth recommendations regarding best practices for the scope and use of SOFR Term Rates in new SOFR-based contracts. The ARRC stated its support for the use of SOFR Term Rates (in addition to other forms of SOFR) for new business loan activity. The ARRC also recognised that SOFR Term Rates may also be appropriate for certain new securitisations that hold underlying business loans or other assets that reference SOFR Term Rates and where those assets cannot easily reference other forms of SOFR. However, for other new floating rate contracts, the ARRC recommended, as a general principle, that market participants use overnight SOFR and SOFR averages rather than SOFR Term Rates. The ARRC stated that the following kinds of new transactions should use overnight SOFR and SOFR averages rather than SOFR Term Rates: floating rate notes; consumer products (including adjustable rate mortgages and student loans); and most securitisations (subject to certain exceptions). In addition, the ARRC stated that it did not support the use of SOFR Term Rates for the derivatives markets (with narrowly limited exceptions).

SOFR is intended to be a broad measure of the cost of borrowing funds overnight in transactions that are collateralised by US Treasury securities. SOFR is calculated by the FRBNY based on transaction-level repo data collected from various sources. Because SOFR is a financing rate based on overnight secured funding transactions, it differs fundamentally from LIBOR. It is expected that more than one SOFR-based rate will be used in the financial markets. Similar to LIBOR, some SOFR-based rates will be forward-looking term rates; other SOFR-based rates will be intended to resemble rates for term structures through their use of averaging mechanisms applied to rates from overnight transactions, as in the case of simple average or compounded average SOFR.

Most existing US dollar LIBOR obligations are expected to transition to another benchmark after 30 June 2023. Certain US regulators have stated that, despite expected publication of US dollar LIBOR through to 30 June 2023, no new contracts using US dollar LIBOR should be entered into after 31 December 2021. Regulators have also stated that, for certain purposes, market participants should transition away from US dollar LIBOR sooner.

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28 Alternative Reference Rate Committee, 'ARRC Formally Recommends Term SOFR,' 29 July 2021, available at: [https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/ARRC\\_Press\\_Release\\_Term\\_SOFR.pdf](https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/ARRC_Press_Release_Term_SOFR.pdf).

29 The legislation is a new Article 18-C of the New York General Obligations Law, available at: <https://www.nysenate.gov/legislation/laws/GOB/A18-C>.

A committee of the CFTC adopted a market best practice known as SOFR First. SOFR First is a phased initiative for switching trading conventions from LIBOR to SOFR for certain US dollar swaps and other derivatives.

### iii US federal cases of relevance to the capital markets

During 2021, US federal courts have rendered decisions of interest to capital markets practitioners, some of which are discussed below. An important issue continues to be the extraterritorial application of US laws and the jurisdictional reach of US courts.

#### *Circuit split on the domestic transaction test*

In 2010, the United States Supreme Court held, in *Morrison v. National Australia Bank*,<sup>30</sup> that Section 10(b) of the Exchange Act only applies to transactions in securities listed on domestic exchanges and domestic transactions in other securities.

After *Morrison*, there was some ambiguity around what constituted a ‘domestic transaction’ in securities. The Second Circuit established the irrevocable liability test to determine when a securities transaction is domestic for purposes of the Exchange Act.<sup>31</sup> In *Absolute Activist*, the Second Circuit held that ‘to sufficiently allege the existence of a “domestic transaction in other securities,” plaintiffs must allege facts indicating that irrevocable liability was incurred or that title was transferred within the United States.’<sup>32</sup> Additional federal circuit courts have adopted this test, including the First Circuit in May 2021.<sup>33</sup> In *Morrone*, the First Circuit found that the relevant stock subscription agreements gave rise to ‘irrevocable liability’ in the United States because, among other factors, they were ‘executed’ and ‘issued’ in Boston and ‘nearly all of [the] activities in furtherance of the fraud’ were conducted in the United States.<sup>34</sup>

Since setting forth the standard in *Absolute Activist*, the Second Circuit has supplemented the irrevocable liability test, and added another test, referred to as the ‘predominantly foreign test’, to determine whether Section 10(b) applies to the claims in question – creating an additional question in that circuit for whether a claim will satisfy *Morrison*. In *Parkcentral*, the Second Circuit did not reach the question of whether irrevocable liability was incurred in the United States because it found the transactions in securities-based swap agreements to be ‘so predominantly foreign as to be impermissibly extraterritorial’.<sup>35</sup> In doing so, the Second Circuit interpreted *Morrison* to require more than a domestic transaction for Section 10(b) to apply: one is necessary for a Section 10(b) claim but not sufficient. In January 2021, the Second Circuit, in *Cavello Bay*, reaffirmed *Parkcentral* and the continued applicability of the

30 *Morrison v. Nat'l Australia Bank Ltd*, 561 U.S. 247 (2010).

31 *Absolute Activist Value Master Fund Ltd. v. Ficeto*, 677 F.3d 60 (2d. Cir. 2012).

32 *id.* at 62.

33 See *SEC v. Morrone*, 997 F.3d 52, 60 (1st Cir. 2021) (‘We agree with the reasoning of the Second, Third, and Ninth Circuits and hold that a transaction is domestic under *Morrison* if irrevocable liability occurs in the United States.’); *Stoyas v. Toshiba Corp.*, 896 F.3d 933, 949 (9th Cir. 2018) (‘We are persuaded by the Second and Third Circuits’ analysis and therefore adopt the irrevocable liability test to determine whether the securities were the subject of a domestic transaction.’); *U.S. v. Georgiou*, 777 F.3d 125, 137 (3d Cir. 2015) (‘We now hold that irrevocable liability establishes the location of a securities transaction.’).

34 *Morrone*, 997 F.3d at 60–61.

35 *Parkcentral Global Hub Ltd. v. Porsche Auto. Holdings SE*, 763 F.3d 198, 216 (2d Cir. 2014).

‘predominantly foreign’ test in that circuit.<sup>36</sup> The court assumed that the transaction at issue was domestic and affirmed dismissal because it agreed the transaction was ‘predominantly foreign’.<sup>37</sup>

The federal circuit courts’ decisions in 2021 show a fundamental disagreement regarding whether *Parkcentral* and its predominantly foreign test is consistent with the Supreme Court’s decision in *Morrison* and the circuit courts’ subsequent adoption of the ‘irrevocable liability’ standard for determining ‘domestic transactions’ under Section 10(b). Indeed, the First Circuit, in *Morrone*, described ‘*Parkcentral* as inconsistent with *Morrison*,’ citing *Stoyas*.<sup>38</sup> At this time, what is clear is that disputes before the courts of the Second Circuit may involve the additional analysis of the foreign nature of the transaction. Given the structure of the US court system, this circuit split may need to be resolved by the Supreme Court.

### ***Amici curiae granted in Stoyas v. Toshiba***

Since the decision in *Morrison*, US courts have typically held that foreign issuers whose securities are represented and traded in the United States as American depositary receipts (ADRs) or American depositary shares (ADSs) cannot be sued under Section 10(b) of the Securities Exchange Act and Rule 10b-5 by purchasers or sellers of a company’s stock traded abroad but can be sued by buyers or sellers of ADRs<sup>39</sup> if the suit is based on a purchase or sale on a US exchange or that otherwise takes place in the United States (such as an over-the-counter (OTC) trade or private placement in which the parties commit to the trade within the United States). However, those cases have typically addressed sponsored ADR facilities, in which there could be no question of the foreign issuer’s involvement.

In 2016, the decision of the US District Court in *Stoyas* was the first to expressly rule on how *Morrison* applies to unsponsored ADR facilities. The defendant, Toshiba, had only stock listed on the Tokyo and Nagoya exchanges and ADRs traded on US OTC markets – specifically, OTC Link – through an unsponsored ADR facility set up without the involvement of the company; it did not list or trade any securities in the United States.<sup>40</sup> The plaintiffs in *Stoyas* argued that it was enough that the issuer had complied with disclosure requirements in Rule 12g3-2 (an exemption from Exchange Act registration for foreign-listed issuers) ‘and never objected to the sale of its securities in the United States’.<sup>41</sup> The Ninth Circuit described the unsponsored ADR issuance as ‘without Toshiba’s “formal participation” and possibly without its acquiescence’.<sup>42</sup>

The *Stoyas* court held that a foreign issuer’s lack of involvement in the unsponsored facility means it cannot be sued in the United States for statements that it made to the markets overseas.<sup>43</sup> On appeal, in 2018, the Ninth Circuit reversed, holding that an issuer can be sued by purchasers of ADRs through an unsponsored facility.<sup>44</sup> The Ninth Circuit declined

36 *Cavello Bay Reinsurance Ltd. v. Shubin Stein*, 986 F.3d 161, 164 (2d Cir. 2021).

37 *id.*

38 *Morrone*, 997 F.3d at 60.

39 ADR and ADS are used interchangeably here, despite the distinct role of the two instruments in trading.

40 *Stoyas v. Toshiba Corp.*, 191 F. Supp. 3d 1080, 1084 n.1, 1089, 1091 (C.D. Cal. 2016) (*Stoyas I*) (noting that the depositary bank had to purchase the stock on a foreign exchange); *Stoyas v. Toshiba Corp.*, 896 F.3d 933, 939 (9th Cir. 2018) (*Stoyas II*).

41 *Stoyas I*, 191 F. Supp.3d at 1093.

42 *Stoyas II*, 896 F.3d at 941.

43 *Stoyas I*, 191 F. Supp. 3d at 1095.

44 *Stoyas II*, 896 F.3d at 952.

to decide, as to *Morrison*'s reference to Section 10(b) covering domestic exchanges,<sup>45</sup> whether OTC Link is a domestic exchange, but disagreed with the District Court that only national securities exchanges, as defined in the Exchange Act, qualify under *Morrison*. Additionally, the Ninth Circuit criticised the Second Circuit's reasoning in *ParkCentral* and concluded that the Exchange Act covers any ADR transaction in the United States regardless of whether the facility is sponsored.<sup>46</sup> However, that was not the end because the Ninth Circuit concluded that a claim could be stated only if there were sufficient facts pleaded to show a sufficient connection between the issuer and the transaction – a requirement that may in practice insulate some foreign issuers who had no involvement in an unsponsored ADR facility.<sup>47</sup> The Ninth Circuit sent the case back to let the plaintiffs plead more facts on this point.<sup>48</sup> It did not, however, suggest that investors other than ADR purchasers could ever sue.

On 14 January 2019, the Supreme Court invited the Solicitor General to file an *amicus* brief in the *Stoyas* case to express the views of the United States.<sup>49</sup> The Solicitor General submitted the *amicus* brief in May 2019, urging the Supreme Court to deny certiorari. In its brief, the Solicitor General argued that the Ninth Circuit's holding in *Stoyas* was correct because the Section 10(b) claim at issue originated from a domestic transaction under *Morrison*.<sup>50</sup> Therefore, in the Solicitor General's opinion, *Stoyas* did not represent 'an impermissible extraterritorial application of Section 10(b)' because neither party disputed that the purchases of the unsponsored ADRs took place in the United States.<sup>51</sup> The Solicitor General also agreed with the Ninth Circuit, however, that the case should be remanded to allow for factual development.

On 24 June 2019, the Supreme Court denied certiorari in the *Stoyas* case, allowing the Ninth Circuit's decision to stand and the case to be remanded for further development of the facts.<sup>52</sup>

On remand, the District Court denied Toshiba's motion to dismiss.<sup>53</sup> The court found that the complaint pleaded sufficiently that the ADRs were purchased in domestic transactions, meaning that 'the parties incurred irrevocable liability within the United States',<sup>54</sup> based on the complaint's allegations 'regarding the location of the broker, the tasks carried out by the broker, the placement of the purchase order, the passing of title, and the payment made'.<sup>55</sup>

The District Court also applied the Ninth Circuit's 'in connection with' language to address the nature of the non-US issuer's involvement or lack of involvement in the

45 *Morrison*, 561 U.S. at 267.

46 *Stoyas II*, 896 F.3d at 950.

47 *Stoyas II*, 896 F.3d at 951.

48 *id.*

49 *Toshiba Corp v. Automotive Industries Pension Trust Fund, et al.*, 2019 U.S. LEXIS 680 (2019).

50 Brief for the United States as *Amicus Curiae* on Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit, *Toshiba Corp v. Automotive Industries Pension Trust Fund, et al.*, 2019 U.S. LEXIS 680 (2019) (No. 18-496), 2019 U.S. S. Ct. Briefs LEXIS 1836, \*15 (US Brief).

51 US Brief, 2019 U.S. S. Ct. Briefs LEXIS at \*22.

52 *Toshiba Corp v. Automotive Industries Pension Trust Fund, et al.*, 2019 U.S. LEXIS 4259 (2019).

53 *Stoyas v. Toshiba Corp.*, 424 F. Supp. 3d 821 (C.D. Cal. 2020) (*Stoyas III*).

54 Citing *Absolute Activist Value Master Fund Ltd. v. Ficeto*, 677 F.3d 60, 68 (2d Cir. 2012).

55 *Stoyas III*, 424 F. Supp. 3d at 827.

establishment of the unsponsored ADRs. The District Court found that there were sufficient facts pled to support that Toshiba provided some consent to or participated in the establishment of the ADRs even if Toshiba had not actually sponsored the ADR programme.<sup>56</sup>

The case is now proceeding before the District Court, and the plaintiffs have moved the court to certify the class, which the defendants oppose. On 7 June 2021, the District Court granted the motion of the Ministry of Economy, Trade and Industry of Japan (METI) for leave to participate as an *amicus curiae*.<sup>57</sup> The METI is a ministry of the government of Japan and asserted in its motion that it will ‘offer perspective and information concerning the potential legal and economic repercussions of class certification on Japanese capital markets, issuers, industries, and the country’s economy, as well the implications . . . on Japanese securities laws and international comity.’<sup>58</sup> In granting the motion, the District Court explained that the METI could provide ‘perspective’ and that ‘[i]nternational comity may be relevant to a variety of issues’ the court must decide, including whether or not to certify the class.<sup>59</sup>

#### iv Bankruptcy cases of relevance to the capital markets

##### *Disputes over make-whole premiums continue to be prominent in bankruptcy cases*

Over the past several years, bankruptcy courts in the United States have wrestled with the question of whether make-whole or similar early payment premiums under credit agreements or indentures may be included as part of a creditor’s allowed claim under the Bankruptcy Code. Whether such premiums are part of an allowed claim can have significant ramifications on a debtor’s restructuring options and other creditors’ recoveries, and are frequently disputed in connection with confirmation of a plan of reorganisation. The uncertainty regarding allowance has led many parties to reach settlements rather than risk an unfavourable outcome and prolonged litigation. However, the Bankruptcy Court in the Southern District of Texas in *Ultra Petroleum*<sup>60</sup> allowed a make-whole premium in a recent decision, bolstering creditors’ arguments that such premiums are payable in a bankruptcy proceeding and providing creditors with more leverage for negotiations with debtors and other creditor groups.

While specific triggering events for early payment premiums may vary under a particular credit agreement or indenture, lenders and noteholders typically argue that the early payment of debt through a bankruptcy liquidation or plan of reorganisation constitutes an early redemption or payment that triggers the premium under the contract, and therefore the premium should be included as part of their contractual claims. Outside of contractual arguments, one primary objection to these early payment premiums is that they are tantamount to claims for unmatured interest, which is disallowed under the Bankruptcy Code,<sup>61</sup> because such premiums partly compensate lenders or noteholders for the future interest, they are unable to collect if the obligations are paid prior to the intended maturity date. Objecting parties may further argue that payment of a premium triggered by a bankruptcy filing is contrary to bankruptcy policy because the premium penalises a debtor for filing bankruptcy. Furthermore, particularly in cases where unsecured creditors are not receiving payment in

<sup>56</sup> id. at 827-828.

<sup>57</sup> *Stoyas v. Toshiba Corp.*, No. 15-CV-4194 DDP, 2021 WL 2315200, at \*1 (C.D. Cal. 7 June 2021).

<sup>58</sup> id.

<sup>59</sup> id.

<sup>60</sup> *In re Ultra Petroleum Corp.*, 624 B.R. 128 (Bankr. S.D. Tex. 2020).

<sup>61</sup> 11 U.S.C. § 502(b)(2) (disallowing claims to the extent that such claim is for unmatured interest).

full, objecting parties highlight equitable arguments that the payment of a premium would siphon value away from other creditors (or shareholders) even after the principal amount of the debt obligations has been satisfied.<sup>62</sup>

Prior to the *Ultra Petroleum* decision in October 2020, the leading cases addressing allowance of make-whole premiums in bankruptcy proceedings focused on interpretations of the contractual language purporting to trigger the premiums rather than the statutory or bankruptcy policy arguments. In two significant decisions, the Second Circuit ruled that the make-whole premiums were not payable under the relevant indentures, and therefore did not address the bankruptcy-specific arguments.<sup>63</sup> In both cases, the court ultimately held that the terms of the indenture did not require payment of the premiums after the maturity of the notes, and the indentures provided for the automatic acceleration of the notes. Accordingly, the distributions provided for in the bankruptcy proceedings were post-maturity payments that did not trigger the premiums. The Third Circuit, however, has taken a different approach and found that the make-whole premiums at issue were not limited to pre-maturity redemptions of the relevant notes.<sup>64</sup> The Third Circuit determined that the make-whole premiums were payable under the indentures regardless of the automatic acceleration due to the bankruptcy, and therefore were due when the debtor satisfied the notes through the plan of reorganisation. The Third Circuit did not, however, address arguments as to whether make-whole premiums are disallowed as claims for unmatured interest, or whether there could be an equitable basis for disallowing the make-whole premiums.<sup>65</sup>

In *Ultra Petroleum*, however, the bankruptcy court specifically addressed whether a make-whole premium must be disallowed under Section 502 of the Bankruptcy Code as unmatured interest.<sup>66</sup> Significantly, the bankruptcy court held that the relevant make-whole premium was not a claim for unmatured interest, nor was it the economic equivalent

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- 62 While section 506(b) of the Bankruptcy Code provides that oversecured creditors can receive interest on their claim as well as ‘any reasonable fees, costs, or charges provided for under the agreement’ giving rise to the claim, objecting parties may additionally argue that the make-whole premium is not reasonable, and the court has discretion to disallow the premium on equitable grounds. See 11 U.S.C. § 506(b).
- 63 *In re AMR Corporation*, 730 F.3d 88 (2d Cir. 2013) (holding that pre-payment premium was not due under terms of indenture where bankruptcy filing caused an automatic acceleration of the debt and pre-payment premium expressly was not due after accelerated maturity; further rejecting the noteholders’ requests to decelerate the notes after the bankruptcy filing); *In re MPM Silicones, L.L.C.*, 874 F.3d 787 (2d Cir. 2017) (similarly concluding that premium was not owed under the terms of the indenture because the premium was triggered by a pre-maturity redemption of the notes, and bankruptcy filing automatically accelerated the maturity date; the lack of express language disclaiming the premium following acceleration was not sufficient to distinguish the court’s prior ruling in *AMR*).
- 64 *In re Energy Future Holdings Corp.*, 842 F.3d 247, (3d Cir. 2016) (rejecting the Second Circuit’s conclusion that redemption could only occur prior to maturity and further distinguishing *AMR* on the basis that the relevant indenture in *AMR* had express language disclaiming the premium following acceleration).
- 65 The Third Circuit noted that it assumed the debtors were solvent and able to pay creditors in full, and did not consider whether insolvency may affect the debtor’s obligations, *id.* at 253.
- 66 In a prior decision, the bankruptcy court concluded that the make-whole premium was due under the indenture and was required to be paid under the plan in order for the noteholders to be treated as unimpaired creditors that were not entitled to vote on the plan. *In re Ultra Petroleum Corp.*, 575 B.R. 361 (Bankr. S.D. Tex. 2017). The Fifth Circuit reversed the decision of the bankruptcy court, holding that a creditor may be treated as unimpaired if the creditor’s claim is disallowed by the Bankruptcy Code, and remanded the case to the bankruptcy court to determine whether the make-whole premium is disallowed under Section 502. *In re Ultra Petroleum Corp.*, 943 F.3d 758 (5th Cir. 2019).

of unmatured interest. The court emphasised that interest is consideration for the use or forbearance of another's money accruing over time, and the premium was a damages provision earned at a specific point in time when the debtor ceased to use or forebear the noteholders' money. Accordingly, the bankruptcy court allowed the make-whole premium, and concluded that the noteholders were entitled to receive the full amount of the premium before shareholders were entitled to receive a distribution.

The bankruptcy court's decision in *Ultra Petroleum* has been appealed to the Fifth Circuit, and it remains uncertain whether the Fifth Circuit will uphold the bankruptcy court's analysis of the unmatured interest argument. The Fifth Circuit's pending decision has the potential to heavily influence negotiations between debtors and creditors regarding disputes over make-whole premiums, and parties should carefully consider the developing case law regarding these types of premiums when drafting new credit agreements or indentures. Additionally, the *Ultra Petroleum* decision did not address equitable arguments for disallowance, and it can be expected that objecting parties will continue to emphasise the effect that large premiums may have on other creditors' recoveries in arguing for disallowance. While the uncertainty of the enforceability of make-whole premiums has driven parties to reach settlements in several recent cases, disputes and litigation over this issue will continue to be prominent in US bankruptcy cases.

## **v US tax law changes of relevance to the capital markets**

### ***The insurance exception to PFIC status***

US tax reform legislation in 2017 fundamentally changed the passive foreign investment company (PFIC) rules that applied to non-US insurance companies. US taxable investors continue to monitor this development as important issues of timing, character of income, and potential interest and penalties, turn on the application of the PFIC rules to non-US insurance companies and other financial institutions.

Section 1297 of the Internal Revenue Code of 1986, as amended (Code), defines a PFIC as:

- a* a foreign corporation, 75 per cent or more of the gross income of which is 'passive income'; or
- b* a foreign corporation, 50 per cent or more of the assets of which consists of assets producing, or held for the production of, 'passive income.'

The 2017 US tax reform legislation revised a long-standing insurance exception to PFIC status so that passive income does not include income derived from the active conduct of an insurance business by a qualifying insurance corporation (QIC). A QIC is generally defined as a non-US corporation that would be subject to tax under subchapter L of the Code, which covers insurance companies, if it were a US corporation and has insurance liabilities that constitute more than 25 per cent of its total assets for the taxable year.

On 15 January 2021, the US Internal Revenue Service (IRS) and the Treasury Department (Treasury) released final and proposed regulations relating to PFICs, in general, and the insurance exception to PFIC status, in particular (2021 Final Regulations and 2021 Proposed Regulations). Notable aspects of these regulations that are relevant to the PFIC insurance exception include:

- a* The active conduct percentage test introduced as part of previously proposed regulations from July of 2019 (2019 Proposed Regulations) was withdrawn, revised and re-proposed. The 2021 Proposed Regulations also introduce a new, alternative factual requirements

test. A QIC that satisfies either test would be considered 'engaged in the active conduct of an insurance business', and therefore not subject to the PFIC rules. Under the 2021 Proposed Regulations, a QIC satisfies the factual requirements test if its officers and employees (1) carry out 'substantial managerial and operational activities' on a 'regular and continuous basis' with respect to the QIC's 'core functions'; and (2) perform virtually all the 'active decision-making functions' relevant to underwriting. The 2021 Proposed Regulations define each of these terms in a manner that would require a high level of oversight by the QIC's officers and employees. The 'core functions' of a QIC would generally consist of underwriting, investment, contract and claims management and sales activities. The revised active conduct percentage test would generally require a QIC to allocate at least half of its total costs for services (whether performed internally or externally) to the QIC's own officers and employees who carry out certain core functions. The IRS and Treasury specifically excluded investment activities as a 'core function' for purposes of this test in response to comments that it is increasingly common for insurance companies to rely on third-party investment managers. The oversight requirement under the 2021 Proposed Regulations, however, would still apply to the QIC's investment activities even if they are outsourced to third-party investment managers. Notably, the 2021 Proposed Regulations would automatically treat two types of companies as PFICs because they are deemed not to be engaged in the active conduct of an insurance business: (1) companies with no employees or only nominal employees; and (2) SPVs (e.g., securitisation vehicles, catastrophe bond issuers and insurance-linked securities funds that invest in securitisation vehicles).

*b* The 2021 Final Regulations provide additional, helpful guidance on certain technical aspects of determining QIC status. This guidance includes rules for determining the balance-sheet items included in the calculation of an insurance company's liabilities, particularly in the case of balance sheets prepared in accordance with GAAP or IFRS.

*c* As part of the 2021 Final Regulations, the IRS and Treasury built upon guidance from the 2019 Proposed Regulations relevant to the application of certain 'look-through' rules for purposes of determining the PFIC status of a QIC. Of note, the assets and liabilities of a subsidiary do not need to be included on the financial statements of a parent QIC for the parent QIC to apply the look-through rules to such subsidiary, thereby addressing a concern that certain assets and liabilities would be improperly excluded if the QIC parent did not consolidate with its subsidiary for financial reporting purposes. The 2021 Final Regulations, however, introduce a new limitation on the amount of income or assets of a subsidiary that is treated as active in the hands of a parent QIC under the look-through rules. The application of this rule depends on the QIC's net equity in such subsidiary.

*d* The 2021 Proposed Regulations build upon the concept of a 'qualifying domestic insurance corporation' (QDIC) introduced as part of the 2019 Proposed Regulations, which provided that the income and assets of a QDIC would be treated as per se active. The 2021 Proposed Regulations would impose a new limitation on the amount of income or assets of a QDIC that is treated as per se active in the hands of a QIC. The limitation depends on whether the QDIC is a life or non-life insurance company for US federal income tax purposes, and is intended to apply in a circumstance where the QDIC holds substantially more passive assets than necessary to support its insurance and annuity obligations.

The latest round of guidance on the PFIC rules generally applies (or is proposed to apply) only prospectively. However, taxpayers may choose to apply various provisions to certain prior years, subject to consistency requirements. These regulations provide welcome certainty on some questions, but significant areas of uncertainty remain. As of the date of writing, commentators have submitted letters and reports to the IRS and Treasury regarding certain aspects of the 2021 Proposed Regulations. The comments have addressed the scope of activities that are properly considered ‘core functions’ for purposes of the active conduct percentage test, the factual requirements test as applied to certain reinsurance companies and the scope of the QDIC limitation rule discussed above, among other topics.

### III OTHER AREAS OF REGULATORY FOCUS

#### i Emerging markets

##### *Delisting of foreign companies not audited by PCAOB inspected auditors*

The Public Company Accounting Oversight Board (PCAOB) is currently unable to inspect audit work papers and practices in several countries, including China and Hong Kong. As a result, investors do not have the benefit of the PCAOB’s assessment and quality control of the auditor’s compliance with US law and professional standards in connection with its audits of public companies. Chinese laws also limit access by third parties, including non-Chinese regulators, to corporate books and records and audit work papers. These concerns were exacerbated in 2020 when it came to light that a China-based company with American Depositary Receipts (ADRs) listed on the Nasdaq had fabricated its accounting records to create the appearance of rapid growth and to meet earnings expectations. Reports of the fraud caused the company’s ADRs to lose most of their trading value, the Nasdaq to delist the ADRs and the SEC to bring enforcement action against the company.<sup>67</sup>

In response to these concerns, Congress passed the Holding Foreign Companies Accountable Act in December 2020 by unanimous consent.<sup>68</sup> This law may ultimately prohibit a company from listing and trading its securities on any US securities exchanges or through any other method regulated by the SEC if the PCAOB is prevented from reviewing the company’s audits.

The law requires the SEC to identify companies subject to the reporting requirements of the Exchange Act that are audited by a foreign audit firm that cannot be inspected by the PCAOB because of a position taken by an authority in the foreign jurisdiction.<sup>69</sup> The SEC has been directed to identify issuers of securities on US securities exchanges that issue audit reports prepared by registered public accounting firms with offices located in foreign jurisdictions and that fail to allow PCAOB to conduct an audit of the reports prepared by the accounting firm because of a position taken by an authority within the foreign jurisdiction.

67 See SEC Press Release, ‘Luckin Coffee Agrees to Pay \$180 Million Penalty to Settle Accounting Fraud Charges’, 16 December 2020, available at: <https://www.sec.gov/news/press-release/2020-319>.

68 The act is available at: <https://www.congress.gov/116/plaws/publ222/PLAW-116publ222.pdf>.

69 The PCAOB adopted a new rule, PCAOB Rule 6100, Board Determinations Under the Holding Foreign Companies Accountable Act, to provide a framework for its determinations that it is unable to inspect or investigate completely registered public accounting firms located in a foreign jurisdiction because of a position taken by one or more authorities in that jurisdiction on 22 September 2021, available at: [https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/rulemaking/docket048/2021-004-hfcaa-adopting-release.pdf?sfvrsn=f6dfb7f8\\_4](https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/rulemaking/docket048/2021-004-hfcaa-adopting-release.pdf?sfvrsn=f6dfb7f8_4).

All these issuers would be required to report whether or not they are owned or controlled by a foreign government in the foreign jurisdiction in which the public accounting firm has an office.<sup>70</sup> Foreign issuers must also disclose that:

- a* their auditors cannot be inspected by the PCAOB;
- b* the percentage of their shares owned by government entities;
- c* whether government entities in their auditors' jurisdiction have a controlling financial interest in the company;
- d* the name of any Chinese Communist Party officials who are members of their boards or the boards of their operating entities; and
- e* whether the constitutional documents of such companies contain any charter from the Chinese Communist Party.

If such a company's foreign audit firm cannot be inspected by the PCAOB for three consecutive years, the SEC must prohibit such company's securities from being traded on any US exchange or other method regulated by the SEC, including the over-the-counter market.

### ***Sanctions on investments in Chinese military-industrial complex companies***

In late 2020, President Donald Trump issued an executive order restricting transactions by US persons in publicly traded securities of Communist Chinese military companies under the International Emergency Economic Powers Act.<sup>71</sup> The Department of Defense and the Department of the Treasury were empowered to identify targets for the sanctions. In June 2021, President Joseph Biden amended this executive order and criteria for the target of the sanctions as Chinese military-industrial companies.<sup>72</sup> Treasury's Office of Foreign Assets Control (OFAC) has developed lists under these executive orders.<sup>73</sup> The executive order prohibits transactions by US persons in any publicly traded securities, derivatives of such securities or securities designed to provide similar investment exposure of identified Chinese military-industrial companies after a divestment period.

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70 The SEC released interim final rules on 22 March 2021, available at: <https://www.sec.gov/rules/interim/2021/34-91364.pdf>.

71 See Executive Order 13959 of 12 November 2020, 'Addressing the Threat From Securities Investments That Finance Communist Chinese Military Companies' in 85 Fed. Reg. 73185 (17 November 2020), available at: <https://www.federalregister.gov/documents/2020/11/17/2020-25459/addressing-the-threat-from-securities-investments-that-finance-communist-chinese-military-companies> as amended by Executive Order 13974 of 13 January 2021 'Amending Executive Order 13959—Addressing the Threat From Securities Investments That Finance Communist Chinese Military Companies', in 86 Fed. Reg. 4875 (19 January 2021), available at: <https://www.federalregister.gov/documents/2021/01/19/2021-01228/amending-executive-order-13959addressing-the-threat-from-securities-investments-that-finance>.

72 See Executive Order 14032 of 3 June 2021, 'Addressing the Threat From Securities Investments That Finance Certain Companies of the People's Republic of China' in 86 Fed. Reg. 30145 (7 June 2021), available at: <https://www.federalregister.gov/documents/2021/06/07/2021-12019/addressing-the-threat-from-securities-investments-that-finance-certain-companies-of-the-peoples>.

73 See Office of Foreign Assets Control, Non-SDN Chinese Military-Industrial Complex Companies List, 16 June 2021, available at: <https://www.treasury.gov/ofac/downloads/ccmc/nsccmiclist.pdf>.

### ***Comments on disclosures of China-based companies***

In the third quarter of 2021, the SEC staff began issuing comments to companies based in China (including US issuers and foreign private issuers) requesting more disclosure in their annual reports regarding risks arising from their business and operations in China. While comments of this nature have previously been issued in response to transactional filings such as registration statements, the number and detailed nature of the annual report comments represent a new regulatory trend.

#### **ii Cryptocurrency**

The status of digital assets as securities for the purposes of the Securities Act continues to be a focus for issuers and regulators alike.<sup>74</sup> The SEC has typically analysed the offer and sale of digital assets under the test set forth in *SEC v. W. J. Howey Co.*<sup>75</sup> for determining whether an arrangement is an investment contract, and thus a security.<sup>76</sup> The SEC has brought a number of enforcement actions against token issuers for conducting unregistered offerings, suggesting that a generally agreed-upon bright line test does not exist for determining when a token is a security.<sup>77</sup> Even within the SEC, there is disagreement as to when the securities laws should apply. Notably, Commissioner Peirce has been outspoken about the regulation of digital assets and publicly disagreed with the analytical framework applied by the SEC in its approach to the *Telegram* case.<sup>78</sup> Historically, registration of digital assets as securities has presented certain challenges. However, there were qualified offerings of tokens pursuant to Regulation A+ in 2019 and the first registered IPO of a digital asset security in 2020.<sup>79</sup> There are also signs that the broker-dealer market necessary to support liquid markets in digital asset securities is slowly developing, in response to recent regulatory guidance.<sup>80</sup>

The investment contract analysis is not the sole test for whether a digital asset is a security. For instance, Chair Gensler has recently stated that stablecoins, which are digital assets designed to have fixed value and could be pegged or linked to the value of a fiat currency

74 The SEC has used the term 'digital asset' to refer to an asset that is issued or transferred, or both, using distributed ledger or blockchain technology (distributed ledger technology), including, but not limited to, 'virtual currencies', 'coins', and 'tokens'. A particular digital asset may or may not meet the definition of 'security' under the federal securities laws. See, for example, SEC Division of Examinations Risk Alert, 26 February 2021, available at: <https://www.sec.gov/files/digital-assets-risk-alert.pdf>

75 328 U.S. 293 (1946).

76 See SEC FinHub Staff, Framework for 'Investment Contract' Analysis of Digital Assets, 3 April 2019, available at: <https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets>.

77 See, for example, the SEC's complaint regarding Telegram Group Inc., available at: <https://www.sec.gov/litigation/complaints/2019/comp-pr2019-212.pdf>; and its announcement of a settlement with the same company, available at: <https://www.sec.gov/news/press-release/2020-146>.

78 Hester M. Peirce, Not Braking and Breaking, 21 July 2020, available at: <https://www.sec.gov/news/speech/peirce-not-braking-and-breaking-2020-07-21>.

79 The issuer of one such offering has since filed an exit report under Regulation A, terminating its ongoing reporting obligations based on the issuer's determination that the token is no longer a security under the Howey test.

80 See, for example, SEC, Custody of Digital Asset Securities by Special Purpose Broker-Dealers, 27 April 2021, available at: <https://www.sec.gov/rules/policy/2020/34-90788.pdf>, discussing the inability of traditional broker-dealers to provide custody of digital asset securities; No-Action Letter to FINRA re: ATS Role in the Settlement of Digital Asset Security Trades, 25 September 2020, available at: <https://www.sec.gov/divisions/marketreg/mr-noaction/2020/finra-ats-role-in-settlement-of-digital-asset-security-trades-09252020.pdf>.

such as one token being equal to one US dollar, may 'be securities and investment companies' (similar to money market funds).<sup>81</sup> The future evolution of this market within the United States will depend, in part, on identifying clear and consistent criteria for determining when a digital asset is a security, as well as the continued development of the market infrastructure necessary to support digital asset securities.

#### **IV OUTLOOK AND CONCLUSIONS**

The US capital markets continue to demonstrate their resilience and innovation despite the lingering challenges of covid-19. The new cohort of private companies that have, or will soon be, listing on US markets through the surge in traditional IPOs and SPACs in 2021 could be viewed as a rejoinder to concerns that the regulatory burden on US listed companies had grown so great that it was leading companies to remain private longer. The US regulatory authorities have shown a willingness to accommodate evolutions under the capital markets that promote capital formation, but that they will take action where they perceive such changes risk materially compromising investor protections. The new direction of US regulatory developments involves quickly rolling back part of the easing of regulatory burdens in recent years, as well as responding to emergent trends.

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81 Gary Gensler, Remarks Before the Aspen Security Forum, 3 August 2021, available at: <https://www.sec.gov/news/public-statement/gensler-aspen-security-forum-2021-08-03>.

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Prior to joining Sidley in 2016, Alan was counsel in the corporate practice of another US law firm, during which he spent six months on secondment at Credit Suisse.

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Michael Hyatte joined the firm after nearly 20 years with the Securities and Exchange Commission's (SEC) Division of Corporation Finance, including more than 10 years in its Office of Chief Counsel and five years in its Office of International Corporate Finance. At the SEC, his duties included interpreting regulatory and disclosure rules in advice to the Commission, the Division staff and the public. The written record of his work for the SEC includes more than 500 no-action letters, the Trust Indenture Reform Act of 1990, Exchange Act Rule 12h-5 and provisions of the Commodity Futures Modernisation Act of 2000.

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Prior to joining Sidley, Sara spent five years in the SEC's Division of Corporation Finance, where she focused on disclosure operations. As a member of the office overseeing real estate (including equity REITs and mortgage REITs) and commodity pool disclosures, Sara analysed complex disclosure issues that arose in filings made pursuant to the Securities Act of 1933 and the Securities Exchange Act of 1934, including in the context of IPOs, secondary offerings, mergers, spin-offs and other transactional filings, as well as annual reports, proxy statements and other ongoing disclosure obligations. She interfaced with issuers, their counsel and specialty offices within Corporation Finance and other divisions of the SEC, regarding legal issues and process, as well as business, timing and market concerns, affecting the transactions and filings that were the subject of her reviews. Sara also spent one year as counsel to the Corporation Finance associate directors, focusing on implementation of the expanded draft registration statement review programme, internal legal guidance for the disclosure review programme and rulemaking matters.

Prior to joining the SEC in 2014, Sara spent an aggregate of six years working as an associate in the corporate and capital markets groups of two national law firms, with a focus on real estate capital markets.

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