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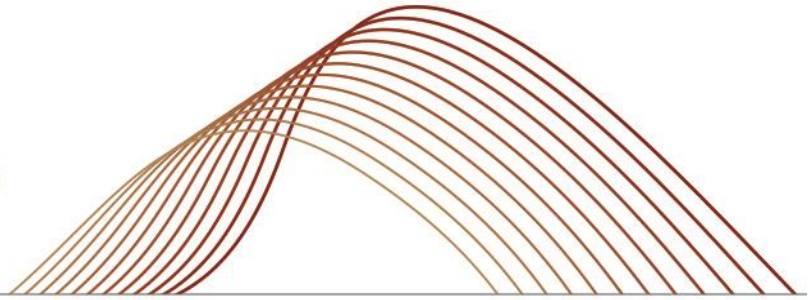

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# *PH COVID-19 Client Alert Series: Regulatory and Corporate Governance Implications*

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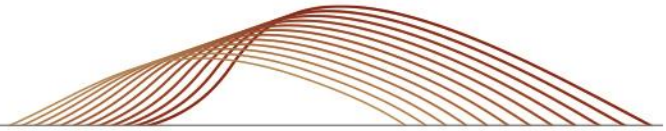
This communication constitutes the next installment of our Client Alert series considering the legal and business impacts of the 2019 Novel Coronavirus ("COVID-19"), commonly referred to as the "Coronavirus." This communication focuses on the implications of the Coronavirus upon regulatory and corporate governance issues, particularly with respect to entities subject to the jurisdiction of the Securities and Exchange Commission ("SEC") and the Commodity Futures Trading Commission ("CFTC").

## I. SEC and CFTC Statements on the Coronavirus

With the spread of the Coronavirus comes the specter of disrupted markets, volatile trading activity, and regulatory and governance implications extending far beyond the recent market corrections attributable to the epidemic. Both the SEC and the CFTC have issued statements on the Coronavirus; the SEC has instructed agency personnel to "monitor" and "provide guidance and other assistance to" market participants and issuers in connection with their disclosures related to the current and potential future effects of the Coronavirus, urging issuers to work together with their auditors and audit committees to "ensure that their financial reporting, auditing and review processes are as robust as practicable in light of the circumstances."[1] For its part, the CFTC is "closely monitoring" market volatility attributable to the Coronavirus, which recently sank the global equities and wheat and corn markets and pushed oil futures to their lowest prices in a year.[2]

Of particular importance for SEC- and CFTC-regulated entities, investors, and other market participants is how the uncertainty surrounding the Coronavirus will impact federal regulatory oversight and enforcement approaches. The SEC has indicated that regulated entities may need to make specific risk-related disclosures about the Coronavirus in their public filings, including proactively updating their filings (via Forms 8-K or otherwise) as new information develops.[3] To that end, the SEC has emphasized "(1) the need to consider potential disclosure of subsequent events in the notes to the financial statements in accordance with guidance included in Accounting Standards Codification 855, *Subsequent Events* and (2) [its] general policy to grant appropriate relief from filing deadlines in situations where, in light of circumstances beyond the control of the issuer, filings cannot be completed on time with appropriate review and attention."[4] Accordingly, the SEC has stated that issuers should consider making appropriate disclosures (or updating existing disclosures) related to the Coronavirus, including but not limited to disclosures regarding:



1. Potential disruptions the virus may have upon operations and supply chains, and consequently, continuity of operations and associated revenues;

2. Potential impact of the Coronavirus on earnings; and

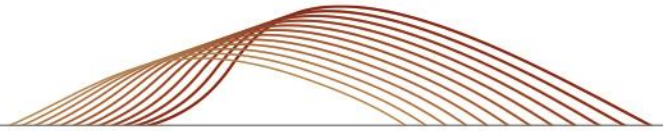
3. Plans to address the crisis, including any risk management plans in place or in progress, both internally and potentially with respect to key third-party vendors who may encounter similar difficulties related to the Coronavirus.

More generally, SEC rules mandate that public companies "warn investors of plausible business or legal risks," including those attributable to the Coronavirus, and failure to do so may subject a company to SEC oversight and enforcement, as well as shareholder scrutiny and potential investor litigation in the event of a drop in stock price.[5] More than 600 public companies have heeded the SEC's admonition to date, referencing the Coronavirus in the "risk factors" sections of their required periodic reports and prospectuses.[6]

The Coronavirus also has the potential to impact trading operations themselves; indeed, if the Coronavirus prompts market closures, then market participants holding open positions may encounter settlement risks (though *force majeure* clauses in some contracts may include contingency plans for how to address such risks). This would not be the first time that the markets close for emergencies, however; the U.S. stock markets remained closed for the rest of the week following the September 11, 2001 terrorist attacks, for example.[7] With that said, a potential Coronavirus epidemic could contemplate market closures for far longer durations, and if the markets remain closed for extended periods of time, market participants could encounter increased settlement and other risks beyond those encountered in the past. Moreover, a Coronavirus epidemic could traverse international boundaries, thereby prompting the closures of not only U.S. markets, but international markets as well. Cybercrime also is a potential risk, as cyber criminals may take advantage of the distraction occasioned by fears and uncertainty in the markets to hack into company systems and steal proprietary information. Market participants thus should take steps to ensure that their electronic systems are well protected and able to continue to function in the event of a workplace or market shutdown.

In addition, many participants in the securities, commodities, and derivatives markets have ongoing reporting obligations to the SEC or CFTC, including in some instances real-time or near-real-time reporting requirements following the execution of a trade.[8] Market participants thus should have risk management plans in place to ensure that they remain able to not only transact in the relevant markets in the event of a Coronavirus outbreak or mandated quarantine, but also properly and timely report those transactions to the appropriate regulator, to ensure the continued functioning of the markets.

Further, given that many market participants require their traders or brokers to trade or broker from the company's physical office (as opposed to remotely), using company devices and on recorded telephone lines or instant messages (and under the oversight of compliance personnel), these market participants should consider whether and how to shift trading or brokerage operations from a centralized facility to a remote workplace while maintaining compliance with the SEC's or CFTC's various reporting, recordkeeping, oversight, and other risk management obligations, in the event that a Coronavirus outbreak requires extensive office closures or incapacitates a significant portion of a company's workforce. A number of regulated entities already have begun "testing their ability to work remotely," including via potential recording of remote telephone lines, should traders need to work



remotely.[9] Adequate planning and testing at this juncture is vital, as the Coronavirus brings with it the possibility of regulatory examination and potential enforcement actions against regulated entities for failure to properly manage or report associated risks.[10]

## II. What Regulated Entities Can Do

To the extent Coronavirus-related disruptions create risks to operations, continuity of operations, revenue reductions, or other similar issues, management should consult with counsel regarding disclosure obligations and the timing of any required disclosures. Regulated entities also should consider putting in place the following controls to ease operational stress:

- Ensure a regular supply of up-to-date medical supplies (e.g., alcohol-based hand sanitizer), and maintain sanitized facilities;
- Encourage telecommuting, minimizing unneeded inter-jurisdictional travel. Where face-time is required, a company must have sufficient medical resources and an emergency management system in place, in the event the virus spreads to the workplace;
- Formulate a risk management plan outlining contingency operations in the event that a Coronavirus outbreak cripples a significant portion of a company's workforce and/or trading, brokering, or reporting operations, to ensure the continuity of mandatory risk management, reporting, and related obligations and functioning of remote electronic systems;
- Evaluate the sufficiency of current insurance coverage and whether any updates or upgrades may be necessary to cover events associated with the Coronavirus outbreak or similar future issues;
- Contact key third-party providers and vendors to ensure that they have similarly appropriate risk management and contingency plans in place; and
- Prepare to address these issues with regulators or self-regulatory organizations ("SROs"), as appropriate, including in connection with regular examinations or audits.

Businesses should recognize their obligations to plan for continuity and to address identified risks in the current crisis but also keep in mind that the Coronavirus is not a unique event or even the first one in this realm; we already have seen epidemics or fears of epidemics related to Severe Acute Respiratory Syndrome ("SARS"), Middle East Respiratory Syndrome ("MERS"), Ebola, and the Swine Flu, for example. The Coronavirus is only the latest in this series. Consequently, businesses also should consider longer-term plans to introduce flexibility and advance planning to address likely future events that would affect supply chains, operating hours, or arrangements and availability or quarantine of staff, and reduce travel and meeting time to minimize the possibility of an in-office outbreak.

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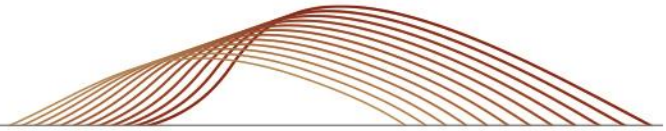

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[1] SEC, Public Statement on Continued Dialogue with Audit Firm Representatives on Audit Quality in China and Other Emerging Markets; Coronavirus—Reporting Considerations and Potential Relief (Feb. 19, 2020), https://www.sec.gov/news/public-statement/statement-audit-quality-china-2020-02-19; *see also* Press Release, SEC, SEC Provides Conditional Regulatory Relief and Assistance for Companies Affected by the Coronavirus Disease 2019 (COVID-19) (Mar. 4, 2020), https://www.sec.gov/news/press-release/2020-53 (noting the SEC's issuance of an order providing publicly traded companies an additional 45 days to file certain disclosure reports that otherwise would be due between March 1 and April 30, 2020, subject to certain conditions).

[2] Chris Prentice, *U.S. CFTC is 'closely' monitoring markets as pandemic fears mount: spokesman*, REUTERS (Feb. 27, 2020), https://www.reuters.com/article/us-china-health-cftc/u-s-cftc-is-closely-monitoring-markets-as-pandemic-fears-mount-spokesman-idUSKCN20L2SA.

[3] SEC, *supra* note 1.

[4] *Id.*

[5] Tom Zanki, *Coronavirus Abounds In Risk Disclosures As Disease Spreads*, LAW360 (Feb. 28, 2020), https://www.law360.com/securities/articles/1248475/coronavirus-abounds-in-risk-disclosures-as-disease-spreads.

[6] *Id.*

[7] *5 Worst Disasters—How Did the Stock Market React?*, NASDAQ (Mar. 25, 2011), https://www.nasdaq.com/articles/5-worst-disasters-how-did-stock-market-react-2011-03-25.

[8] *See, e.g.*, 17 C.F.R. Part 43.

[9] *See* Jenny Surane, *Split Trading Desks, Clorox May Follow Banks' Travel Bans (1)*, BLOOMBERG (Feb. 28, 2020), https://news.bloomberglaw.com/banking-law/split-trading-desks-hourly-clorox-may-follow-banks-travel-bans.

[10] The SEC's or CFTC's pursuit of regulated entities for inadequate reporting or risk management related to the Coronavirus would not mark the first time either agency has taken or threatened to take action for failure to properly manage risk; as we previously reported, the CFTC recently ordered several financial institutions to pay significant fines for reporting and risk management failures. *See also, e.g.*, Press Release, CFTC, CFTC Orders Six Financial Institutions to Pay Total of More Than $6 Million for Reporting Failures, Release No. 8033-19 (Oct. 1, 2019), https://www.cftc.gov/PressRoom/PressReleases/8033-19. The SEC also recently issued an alert to "warn investors about investment frauds involving claims that a company's products or services will be used to help stop the coronavirus outbreak," via potential "pump and dump" schemes through which unscrupulous actors circulate rumors of a public company's medical breakthroughs to prevent, detect, or cure the Coronavirus, thereby catalyzing stock price increases, then quickly sell their own shares before the hype ends and stock prices drop. SEC, Investor Alert, Look Out for Coronavirus-Related Investment Scams (Feb. 4, 2020), https://www.sec.gov/oiea/investor-alerts-and-bulletins/ia_coronavirus. The CFTC issued a similar statement: "Beware of promises of easy profits from commodity futures and options based on well-known public information such as the coronavirus. When salespeople contact you claiming to be able to profit from breaking news, their claims are most likely fraudulent." CFTC (@CFTC), TWITTER (Feb. 28, 2020, 10:47 AM), https://twitter.com/CFTC/status/1233418338476462086. The SEC's and CFTC's admonitions are not unfounded; Coronavirus-related concerns already have precipitated two two-week SEC suspensions of trading in the securities of medical companies stemming from this type of conduct. *See* Aethlon Medical, Inc., Suspension of Trading Order, Exchange Act Release No. 88142 (Feb. 7, 2020), https://www.sec.gov/litigation/suspensions/2020/34-88142-o.pdf; Eastgate Biotech Corp., Suspension of Trading Order, Exchange Act Release No. 88265 (Feb. 24, 2020), https://www.sec.gov/litigation/suspensions/2020/34-88265-o.pdf.