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## WHITE PAPER

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### Litigation and Regulatory Considerations and Risks for Financial Market Participants in a Post-Pandemic Society

More than a year ago the world fell victim to a global pandemic that would change life in ways that could never have been predicted. In the early stages of the pandemic, we published a [White Paper](#) directed at financial markets and market participants setting forth our views on issues to consider in crisis response and post-pandemic planning. Now, one tumultuous year later, with a waning pandemic and a new administration in the United States, we again assess issues of concern and focus for financial market participants in the United States and abroad.

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## LITIGATION RISKS

### Litigation Risk Associated with Elevated Delinquency and Default Rates

Over the past year, businesses continued to borrow money and issue high-yield corporate debt at a strong pace. Although the U.S. economy appears well positioned for a robust second half of 2021, rising interest rates and inflation, as well as the potential for corrections in the financial markets, may create risk to paying back that corporate debt. In addition, outstanding corporate and household debt continues to be at or near all-time highs. Many individuals find themselves in difficult financial circumstances with respect to repayment of housing and education loans or with other personal debts. Though foreclosure moratoriums in states including New York provided borrowers with some relief in 2020, disputes and workouts may increase in 2021 as these moratoriums expire. And even if moratoriums are extended, commercial lenders may be more inclined to seek relief on guarantees and mezzanine financing. As a result, some financial institutions and other market participants can expect to remain under increased risk of litigation due to elevated default rates and product-specific losses.

In the leveraged finance market, deterioration of corporate performance may lead to further disputes among lenders seeking priority. Efforts by some borrowers and lenders to provide incoming capital with a repayment super-priority, reducing the value of existing debt, has emerged as a focus for participants in the collateralized loan obligation (“CLO”) market. Last year’s pandemic-related market stress has contributed to bringing these disputes to the fore.

At the same time, commercial real estate loan performance has suffered, particularly in sectors hit especially hard by the pandemic. Although data indicates that delinquency rates have receded from their COVID-era peak, the durability of this recovery remains to be seen in some respects, and delinquency rates remain elevated in obvious categories such as lodging and retail. While commercial mortgage backed securities (“CMBS”) transactions differ in important ways from the type of residential mortgage backed securities (“RMBS”) transactions that remain subject to litigation more than a decade after the onset of the 2008-09 recession, litigation involving commercial loans and CMBS trusts may well continue to increase over the coming months. These lawsuits may involve direct claims by certificate holders against deal

parties, investor-directed actions against obligated parties similar to those that became prominent with respect to RMBS in the wake of the last financial crisis, and claims among certificate holders in different tranches. There is also a possibility of federal and state regulatory scrutiny concerning lending and servicing practices, the ratings assigned to CMBS certificates by rating agencies, and the trading of CMBS. Already, in February 2021, the U.S. Securities and Exchange Commission (“SEC”) filed a complaint against Morningstar over allegedly inflated CMBS ratings. In addition, investors have started bringing securities claims against financial institutions alleging improper origination and underwriting practices involving CMBS and CRE CLOs. It is likely similar lawsuits will follow against other financial institutions.

Consumer debt faces analogous challenges. Although there have been some bright spots in this area, such as falling credit card debt and increases in household savings, a sizable number of consumers are unable to pay their bills as they come due. Nearly three million mortgage borrowers are in some form of payment forbearance, and borrowers have taken advantage of similar programs for student, auto, and credit card debt. These programs have been buttressed by state and federal foreclosure moratoriums, as well as certain restrictions on debt collection. It remains to be seen whether consumers will be able to resume debt payments when the pandemic ends and relief is no longer available, or whether significant charge-offs are looming in the future. Substantial losses would likely have knock-on effects throughout the financial sector and could be destabilizing in many ways. In particular, consumer debt securitizations could face defaults or other stresses, leading to potential disputes among investors and transaction parties, and parties responsible for servicing consumer debt could face increased disputes with borrowers and pressure from state and federal regulators. The potential stress on any particular securitization transaction will likely be driven, at least in part, by the underlying asset class, with unsecured consumer loans or other unsecured debt potentially facing downward pressure before secured asset classes such as mortgage or auto loans.

### Environmental Social and Governance (“ESG”) Related Litigation Risks for Financial Institutions

ESG issues have dominated recent headlines in the financial markets, with investors seeking more ESG investment options. As a consequence, market participants are devoting

ever-greater resources and assets to ESG lending and investing. ESG investing grew to more than \$30 trillion in 2018, and some estimates say it could reach \$50 trillion over the next two decades.

Financial institutions will be at the forefront of this change, taking on a variety of roles in the process. Indeed, they will be active as public companies themselves, as intermediaries and facilitators on financial markets transactions with other companies, and as arrangers of the ESG-compliant investment opportunities demanded by institutional and retail investors.

As we discussed in our [Commentary](#) earlier this year, ESG-related risks for financial institutions generally fall into three high-level categories: (i) risks based on their own actions and ESG-related statements and disclosures; (ii) vendor and customer operational risks, including supply chain activities; and (iii) risks based on activities as a lender, underwriter, or investment adviser.

It is worth noting here, though the issue is explored in greater detail in the next section, that financial institutions must balance dueling needs relating to disclosures: (i) demonstrating to stakeholders a commitment to ESG principles; and (ii) minimizing the risk associated with that commitment. That risk is heightened when, in keeping with investor or market demands, companies move from disclosing aspirational ESG principles to more specific and seemingly objective targets or accomplishments. Banks may also face risks as more regulators incorporate ESG issues into bank stress tests; in the United Kingdom, for example, the Bank of England is rolling out its first-ever climate-related stress test for banks and insurers following a consultation period in 2019.

Litigation and regulatory risks related to ESG are not limited to a financial institution's own operations. Financial institutions must also consider customers and third-party service providers in their supply chain; that is, whether the vendors supporting them are ESG-aligned or meeting ESG targets. For example, the Alien Tort Statute and the Trafficking Victims Protection Act could subject companies to liability for human rights violations committed abroad by customers or entities in a financial institution's supply chain. Financial institutions may also face risks from customers or their own supply chain relating to environmental pollution, human trafficking, labor disputes, and corruption.

The growth in transaction documents referencing ESG has elevated ESG as a source of risk for financial market participants in their roles as lenders, investors, underwriters, fiduciaries, and contractual counterparties, and has likewise increased the need for ESG-related due diligence. Furthermore, the developing ESG credit market has spawned the still-evolving role of Sustainability Agent—or Sustainability Coordinator—which brings with it new duties and risks. Counterparties in the new but growing market for sustainability-linked financial derivatives should take care in negotiating, defining, and agreeing to the sustainability targets that trigger various credits, discounts, or penalties in those derivative transactions. In addition, cryptocurrencies are facing heavy scrutiny and public censure for the energy consumption and greenhouse gas emissions associated with generating their tokens and implementing their protocols.

Financial institutions will also need to closely monitor the rapid increase in ESG-related pronouncements by regulators to ensure preparedness and compliance with rules that could impose new obligations on clients, counterparties, and investors alike. In this regard, the new EU Sustainable Finance Disclosure Regulation (“SFDR”) came into force on March 1, 2021, and applies to asset managers, pension funds, and financial advisors. Numerous regulators in the United States have shown similar interest in addressing ESG and climate-change issues. For example, the SEC announced an Enforcement Task Force Focused on Climate and ESG Issues, the CFTC announced The Climate Risk Unit, and the Federal Reserve Board announced the Financial Stability Climate Committee. New York's Department of Financial Services, often seen as an innovator among U.S. state regulators, appointed its first-ever Sustainability and Climate Change Director in May 2020. Since then, it has continued to move quickly, providing guidance to its supervised insurers and financial entities regarding climate change and financial risk.

With increased scrutiny by regulators and investors, often supported by plaintiffs' firms, it is likely we will see an increase in fiduciary duty, derivative and disclosure-based ESG claims.

### **Corporate Disclosure and Duties to Update or Disclose**

Disclosures by financial market participants are always ripe for scrutiny by regulators and private litigants—both with respect to private deals and public filings. To mitigate exposure to undue litigation in the current environment, issuers of

securities and financial institutions should be aware of two rapidly evolving areas of corporate disclosure risk: COVID-19 and, as noted above, ESG.

**COVID-19.** Public companies should evaluate and ensure that they understand the full impact that COVID-19 has had on their business operations and financial conditions. It is important that disclosures of material pandemic-related impacts be robust, be provided in a timely manner, and take into account securities law obligations under Regulation FD. These disclosures should focus on the ways in which the pandemic has disrupted the business, known trends and uncertainties that have arisen during the course of the pandemic, and any ongoing or anticipated risks the company faces. On the regulatory front, we anticipate the SEC will continue to focus on COVID-19-related statements as the new agency leadership continues to emphasize protecting investors from inadequate disclosure. The SEC has issued guidance<sup>1</sup> encouraging companies to provide COVID-19-related disclosures that are forward-looking, tailored to the company's circumstances and industry, and detailed enough to allow investors to evaluate both the current and expected impacts of COVID-19. Companies should expect the SEC to scrutinize their historical and current pandemic-related disclosures, and to do so with the benefit of hindsight. Thus, a company's prior disclosures should be carefully considered when determining whether revisions or updates are warranted in light of changing facts and circumstances.

Public financial institutions contemplating securities offerings should anticipate comprehensive pandemic-related due diligence by transaction parties evaluating their public disclosure. Fulsome and transparent due diligence protects against undue litigation risk and offers opportunities to identify potential disclosure improvements.

Further, public companies should maintain consistent messaging in their communications with investors and with private contractual counterparties, while remaining vigilant regarding Regulation FD obligations. Disclosures to contractual counterparties should take into account context, addressing both the impact on the business and the potential impacts to the deal in question.

**ESG.** As noted above, the financial markets have seen an increased demand for ESG investment opportunities and, as a consequence, there is pressure to allocate more resources

to ESG lending and investing. At the same time, investors are both calling for enhanced ESG-related disclosure and more rigorously scrutinizing ESG-related disclosures. For financial institutions, there has been a particular emphasis on—and therefore enhanced risk from—social justice-related disclosures. Thus, companies face the challenge of informing their stakeholders of their ESG targets, while also protecting themselves from undue litigation risk.

Financial market participants also face regulatory risks related to their ESG-related disclosure. As with COVID-19-related disclosures, accuracy and consistency are key in this area. While there is currently no U.S. federal securities law that requires disclosure of ESG data (except in limited circumstances), existing disclosure requirements for nonfinancial information apply to material ESG topics. Regulatory review of ESG-related disclosures is therefore inevitable, and potential liability could arise from making false or misleading statements or from omitting material information from disclosure to investors.

#### **LIBOR Transition Plans and Implementation**

Following a two-month consultation period, on March 5, 2021, the ICE Benchmark Administration confirmed its intention to cease the publication of most USD LIBOR settings on June 30, 2023. The UK's Financial Conduct Authority ("FCA") also confirmed the dates for cessation of all LIBOR benchmark settings currently published by IBA. Although the March 5 announcements delayed the cessation of most tenors of USD LIBOR, risk remains for those legacy USD LIBOR transactions that are not scheduled to mature until after June 30, 2023. This universe of legacy transactions includes hundreds of billions of dollars of "tough legacy" deals, including securitizations and other structured finance transactions where there may be a LIBOR impact at the securities level, the collateral level, as a result of an associated derivative, or some combination of the three. Risks also remain for transactions tied to other IBORs and LIBOR currencies, including multi-currency transactions and transactions that permit funding in the one-week or two-month LIBOR tenor that are still scheduled to cease being published on December 31, 2021.

Trustees, securities administrators, calculation agents, and servicers must remain cognizant of the legal and regulatory risks as they consider potential remediation strategies—designed to facilitate the transition from LIBOR to alternative rates—including affirmative litigation strategies. Asset managers must

consider their fiduciary responsibilities and potential conflicts of interest as they evaluate portfolios, implement remediation plans, and develop strategies for responding to potential litigation that may result in the selection of new rates that will be applied to hundreds of billions of dollars in securities held by the funds they manage. The emergence of credit-sensitive alternatives to SOFR may exacerbate these risks in the United States, as there will be more options to choose from and the potential for more second-guessing once an alternative rate is chosen.

On April 6, 2021, New York enacted LIBOR legislation addressing the cessation of USD LIBOR. Under the law, contracts governed by New York law convert by operation of law to replace LIBOR with the “recommended benchmark replacement” if that contract references USD LIBOR as the benchmark rate of interest and either contains (i) no fallback provision, or (ii) fallback provisions that would result in a benchmark replacement that is based in any way on any LIBOR value. Federal legislation that would preempt the New York law is being considered. On April 15, 2021, the Subcommittee on Investor Protection, Entrepreneurship and Capital Markets of the House of Representatives held a hearing to discuss the proposed legislation. Lawmakers supporting the legislation are hopeful that something can be enacted by the end of October 2021, with rulemaking by the Board of Governors of the Federal Reserve implementing the statute being completed by July 1, 2022.

In all events, legislation is unlikely to be a panacea for all transactions, even if it comes at the federal level. Some contracts will fall into a gray area (i.e., are they impacted by the statute and how are they to be treated if they are) depending on, inter alia, the terms of the contract. This raises the prospect of litigation. Other transactions will clearly fall outside the legislation’s scope and will remain subject to litigation risks arising from latent ambiguities in their fallback language, such as whether the parties intended for the Prime rate to be used as a replacement rate in the context of the permanent cessation of LIBOR (as opposed to only if USD LIBOR was temporarily unavailable). For those that fall squarely within the scope of the legislation, there still will be thorny legal questions to consider (e.g., constitutional issues and, for the NY state statute, the interplay between state law and the Trust Indenture Act), as well issues related to conforming changes that will have to be implemented, particularly for more complex transactions. In addition, when seeking to avail themselves of any

“safe harbor” built into the statute to protect those who may exercise discretion to select new recommended SOFR-based rates, lenders and other market participants will have to be mindful of the timing requirements for making such selections to avoid losing the statutory protections.

In the United Kingdom, publication of GDP LIBOR is still scheduled to cease on December 31, 2021. That the UK is pressing ahead all but ensures that conduct risks, legal risks, and operational risks will come to the fore as financial institutions and market participants navigate the complexities of the LIBOR transition in a relatively compressed time period with multi-currency transactions and hedging arrangements giving rise to particular risks. Recognizing that there is no practical way to amend certain “tough legacy” contracts, including those underlying most securitization and structured finance vehicles, the UK government also is finalizing legislation that would allow the FCA to compel IBA to use a different methodology for calculating LIBOR values that would not be representative of what LIBOR is supposed to measure. For this “fix” to work, this so-called “synthetic LIBOR” (which many in the market believe will be Term SONIA for GBP LIBOR) will presumably have to be published on the same exact screens that are currently referenced in the governing agreements for the tough legacy contracts. Whether the FCA will use a similar approach for “tough legacy” contracts tied to USD LIBOR remains to be seen. But compelling IBA to calculate “USD LIBOR” the way one would calculate Term SOFR, for example, would give rise to numerous legal, regulatory, and operational risks. What do you do if your contract narrowly defines the information appearing on the referenced screen in a manner that would theoretically preclude the use of such a “synthetic LIBOR”? What happens if the information service providers are unwilling to publish synthetic, non-representative “LIBOR” on the specific screens currently referenced in the governing agreements? What will the interplay be between this UK approach to “synthetic LIBOR” and any legislation in the United States?

There are numerous other legal and regulatory risks associated with the LIBOR transition that remain in 2021—too many to identify and discuss here. But in addition to those noted above, there are a few other material issues worth putting on the reader’s radar. Asset managers should be particularly mindful of risks related to asset valuations that are impacted by the transition, including ensuring that their valuation methodologies account for alternative rates when necessary. They



also should take care to balance their support for particular replacement rates with what may be in the best interests of their investors, while also being mindful of potential conflicts of interest across fund platforms where certain funds may benefit from a particular legal position on replacement rates that adversely impacts other funds they manage. Industry participants that are eager to keep up with an ever-evolving market also should be cognizant of antitrust risks, including those that may arise from relationship managers and bankers sharing rate-related information with peer lenders.

### **COFI Transition Plans and Implementation**

COFI is the acronym for the 11th District Monthly Weighted Average Cost of Funds Index, which is administered by the Federal Home Loan Bank of San Francisco. Technically, COFI is not an interest rate. It reflects the interest expenses reported for a given month by COFI-reporting members, which come from Arizona, California, and Nevada. When the monthly COFI was originally developed in 1981, there were over 200 COFI-reporting members. Today there are only nine. As a result, much like GDP LIBOR, COFI will stop being published early in 2022.

The legal and regulatory risks associated with COFI termination are, in substance, the same as those associated with the termination of GDP LIBOR. This is because COFI serves as the reference rate for securities issued in connection with certain securitizations. In addition, COFI is also the index for consumer mortgages that are held on balance sheets as well as those used as collateral in both LIBOR-linked and COFI-linked securitizations. Indeed, the number of private label LIBOR-linked securitizations that involve COFI collateral far exceeds the number of COFI-linked securitizations. All of these COFI-indexed mortgages will have to be transitioned once publication of COFI ceases. And, like LIBOR-linked mortgages, COFI-linked mortgages typically require the selection of a new index based on comparable information.

Despite this, COFI has not received nearly as much attention as LIBOR. There is no legislative solution in the works to address legacy COFI transactions. Industry groups have not studied alternative rates, much less made recommendations. This raises potential legal and regulatory risks for parties who may have to select a new index. However, on April 27, 2021, Freddie Mac issued guidance, stating that it anticipates the replacement index for COFI will be a newly created

index administered by Freddie Mac called the Enterprise 11th District COFI Replacement Index. That rate will be based on the Federal Cost of Funds Index (“Federal COFI”), already published by Freddie Mac, with a spread adjustment intended to minimize or eliminate any value transfer for investors or payment shock for consumers as a result of the transition from COFI to Federal COFI. Although Freddie Mac’s guidance applies only to legacy GSE deals, it could, nonetheless be helpful for transitioning other securitizations and loans in the industry. The terms of each agreement tied to COFI should be analyzed to determine appropriate next steps.

### **Data Privacy and Cybersecurity**

Cybersecurity and data privacy risks closely followed ESG as being among the top concerns of financial institution risk managers in a recent survey conducted by Deloitte. Over the last decade in the United States, the civil plaintiffs’ bar has been increasingly active in filing consumer class actions against financial services companies related to the data privacy and security of customer information. Some of these cases have resulted in settlements from defendant financial services companies in the hundreds of millions of dollars.

In addition, various states have started enacting specific data privacy legislation with a private right of action. For example, the California Consumer Privacy Act (“CCPA”), which went effect on January 1, 2020, permits a private right of action and statutory damages against businesses for the “unauthorized access and exfiltration, theft, or disclosure” of certain types of personal information as a result of the businesses’ failure to implement and maintain reasonable security procedures. Plaintiffs already have filed over 100 private actions under the CCPA, including at least 12 complaints against four financial institutions alleging a cause of action under the CCPA. The California Privacy Rights Act (“CPRA”), which will go into effect on January 1, 2023, will expand the CCPA’s private right of action to incidents involving a broader range of personal information.

Further, numerous other states, including, importantly, New York, have introduced CCPA-copycat legislation with a private right of action similar to the CCPA.

In addition to the growing risk of private civil litigation, there has also been increased enforcement activity by financial regulators in connection with customer data privacy and security. For example, the New York Department of Financial Services (“NYDFS”)

Cybersecurity Regulation, which went into effect on March 1, 2017, was enforced for the first time in July 2020 by the NYDFS' newly created Cybersecurity Division. In that first enforcement action, the NYDFS alleged that an insurance company exposed millions of documents containing its customers' sensitive personal information through a known website vulnerability.

Finally, in December 2020, U.S. federal banking regulators jointly announced a proposed banking cyber incident notification rule. If adopted, this rule would require banking organizations to notify primary federal regulators within 36 hours of any "computer-security incident" that materially disrupts, degrades, or impairs certain important business operations. The proposal would also require third-party bank service providers to notify at least two individuals at the affected banking organization customer immediately after experiencing a computer-security incident that it believes in good faith could disrupt, degrade, or impair services for four or more hours. To mitigate the rapidly increasing legal and regulatory risks across multiple jurisdictions, financial institutions and their third-party service providers should proactively assess their risk management, information security, technology and vendor management compliance programs, and business continuity and incident response plans.

### **Anticipated Areas of State Attorney General Activity in the Financial Industry**

Over the last decade, state attorneys general have become significant players in the financial markets. Their involvement spans as far as the markets reach, and is bolstered by numerous investigative and enforcement tools at their disposal, such as "Blue Sky" laws, state consumer protection and Unfair and Deceptive Acts and Practices ("UDAP") statutes, and federal statutes that expressly grant state attorneys general parallel enforcement authority (such as the Fair Credit Reporting Act and the Consumer Financial Protection Act). With the help of these broad investigative and enforcement powers, state attorneys general have experienced recent success in treading into financial enforcement and litigation that were traditionally handled by other state and federal regulators.

Multistate actions, including multistate investigations and settlements, have become the norm and pose considerable risk to financial market participants. For instance, last year, a large international bank agreed to a \$550 million settlement with 35 state attorneys general related to its subprime auto loans.

These joint efforts to investigate and prosecute financial market issues are likely to continue, and are likely—particularly in the consumer protection space—to cross partisan lines. State attorneys general are more willing to team up in bipartisan fashion on issues of common concern, enabling their offices to conserve resources in order to pursue more partisan activity, such as lawsuits against the incoming administration. In addition to traditional areas of financial market investigations and lawsuits, financial market participants should expect coordinated, bipartisan attorney general scrutiny into lending and debt collection practices during the COVID-19 pandemic, particularly with respect to loans made during the pandemic and actions with respect to loans that defaulted during the pandemic.

In addition to multistate actions by state attorneys general, coordinated actions among attorneys general and state and federal agencies have increased in recent years and are likely to gain further traction under the Biden administration. State attorneys general are expected to coordinate with the Consumer Financial Protection Bureau ("CFPB") and FTC, among others, in part due to the perceived lack of enforcement by those agencies under the prior administration. In addition, CFPB Acting Director Dave Uejio has made clear that the agency will take "aggressive action" to ensure that financial services companies are meeting their obligations to assist consumers during the COVID-19 pandemic. Uejio's statement that the CFPB will be looking "more broadly, beyond fair lending, to identify and root out unlawful conduct that disproportionately impacts communities of color and other vulnerable populations" is one that has been echoed by other incoming members of the Biden administration, and is expected to be a top priority at all of the agencies under the new administration. It can be expected that these agencies, in coordination with state attorneys general, will take an expansive view of unfair or unlawful conduct. It remains to be seen the extent to which companies will be held responsible for disparities in outcomes alleged to have been caused by a failure to take affirmative steps to ensure minority outcomes are equal to their representation in the overall population.

### **Jurisdictional Issues Based on U.S. Supreme Court Decisions**

We saw several important personal jurisdiction developments in 2020, and we expect to see that trend continue in 2021. The two hot issues are whether a company in a post-*Daimler* world consents to general jurisdiction by dint of complying with a



state's registration statute, and separately, defining the contours of specific personal jurisdiction.

**Does Compliance with Registration Statutes Confer General Jurisdiction in a Post-Daimler World?** Since the U.S. Supreme Court's seminal decision in *Daimler AG v. Bauman*, 571 U.S. 117 (2014), courts have grappled with whether general jurisdiction exists over an entity that complies with a state's registration statute by registering to do business in business in that state. In *Daimler*, the Court held that a corporation may be subject to general jurisdiction in a state only if its contacts are so "continuous and systematic" that it is "essentially at home in the State." Aside from the rare "exceptional case," the Court explained that a corporation is "at home"—and therefore subject to general personal jurisdiction—only in the state of the company's place of incorporation or its principal place of business. The Court noted that general jurisdiction defines the scope of a court's jurisdiction when an entity "has not consented to suit in the forum."

That left open the issue of whether a company, consistent with notions of due process, could consent to a court's general jurisdiction simply by dint of registering to do business in that state. In a closely watched New York state case, an intermediate appellate court held that "asserting jurisdiction over a foreign corporation based on the mere registration and the accompanying appointment of an in-state agent by the foreign corporation, without the express consent of the foreign corporation to general jurisdiction, would be 'unacceptably grasping' under *Daimler*..." *Aybar v. Aybar*, 169 A.D.3d 137, 152 (2d Dep't 2019). The Second Department's decision in *Aybar* is on appeal to New York's highest court—New York Court of Appeals—and we expect it to hear oral argument in the autumn.

**Can There Be Specific Personal Jurisdiction When In-State Conduct Did Not Cause Injuries At-Issue?** After *Daimler* clarified the relatively narrow scope of general personal jurisdiction, courts increasingly focus on whether they can exercise specific personal jurisdiction over litigants.

On March 25, 2021, the U.S. Supreme Court issued its newest ruling on personal jurisdiction in the consolidated cases of *Ford Motor Company v. Montana Eighth Judicial District Court* and *Ford Motor Company v. Bandemer*. There, the Court held that Ford could be sued in Montana and Minnesota (respectively) after its cars were involved in accidents in those states.

The Court rejected Ford's argument that personal jurisdiction was lacking because the specific cars in question were neither designed, nor manufactured, nor sold within the forum state—meaning there was no direct causal link between Ford's in-state activities and the plaintiffs' claims. It was enough, the Court explained, that Ford cultivated and served a market in both states for the car models involved in the accidents, and that the plaintiffs' claims were closely "related to" those in-state activities.

Plaintiffs will surely attempt to spin Ford as a relaxation of the Due Process Clause's limits on personal jurisdiction. The opinion is best read, however, as an application of the U.S. Supreme Court's longstanding precedents—not as new authorization for suits in states with scant connection to the dispute. For starters, the decision addresses only "specific jurisdiction," which concerns claims connected to the forum state. The Due Process Clause's strict limits on all-purpose "general jurisdiction" remain fully intact—a corporation can be sued for any and all claims only where it is "essentially at home," usually just the state(s) where it is incorporated or has its headquarters. And the Court did not sketch new standards that departed from its existing precedent; it emphasized that it was simply resolving the cases at hand, not other questions like the extent to which internet commerce might give rise to personal jurisdiction. Moreover, several aspects of the Court's analysis underscore that Ford should not be read to meaningfully expand the number of states in which corporate defendants can be sued. These issues nonetheless are likely to be the subject of much discussion and litigation in the months and years ahead.

## REGULATORY RISKS

### Potential Increased U.S. Regulatory Enforcement Based on the New Administration

Although legislative reforms will be difficult to achieve given the closely divided Senate, President Biden's appointees will have a significant impact on the enforcement agenda at each agency. In all likelihood, these appointees will focus on consumer protection, fair lending, and prudential oversight. The Federal Reserve, OCC, and FDIC will likely continue emphasizing financial oversight, while also addressing racial and economic disparities in the financial industry.<sup>2</sup> Rohit Chopra, a former CFPB official and staffer to Elizabeth Warren, has been nominated as Director of the CFPB. Accordingly, it is expected

that the CFPB will take a more aggressive approach against predatory lending and emphasize discriminatory credit underwriting practices where artificial intelligence and machine learning are used.

It is also likely that certain financial services regulators will focus more on enforcement efforts and prescriptive rulemaking relevant to public companies, retail investors, and general soundness issues. The industry view is that the newly confirmed chairman of the SEC, Gary Gensler, will enhance enforcement efforts, as he did at the CFTC during the Obama administration. In addition, the SEC is expected to concentrate on public company disclosures, including those related to ESG issues, while also emphasizing retail investors, transparency, and maintenance of fair and efficient markets. The administration has not yet nominated a chair for the CFTC, but the agency also will likely focus on enforcement efforts, with an emphasis on digital assets regulation, compliance controls and procedures for regulated firms, and trading misconduct by all market participants.

In light of the passage of the Anti-Money Laundering Act of 2020 (“AMLA”), all financial services regulators and FinCEN will have a significant anti-money laundering and Bank Secrecy Act enforcement agenda. As we have reported previously,<sup>3</sup> AMLA will enhance the enforcement authority of FinCEN and the Department of Justice by virtue of an expanded set of subpoena powers associated with non-U.S. bank records located abroad. Thus, regulated entities as well as European financial institutions need to ensure they have current and effective AML policies when doing U.S.-related business. In that same vein, cryptocurrency-related enforcement actions involving anti-money laundering and other criminal matters are likely to increase given the Department of Justice’s recent publication of its Cryptocurrency Enforcement Framework.<sup>4</sup>

The expectation of increased regulatory enforcement also extends across borders, as the new administration’s priorities shift to financial and corporate fraud and ESG issues. The SEC’s expected focus on COVID-19 in its investigations will likely include an emphasis on the quality of financial reporting, particularly in those industries that have been severely impacted by the pandemic. Issuers, including foreign private issuers, need to remain cognizant that the SEC will pay particular attention to material non-public information disclosures and potential insider trading violations. Finally, it is expected

that the European Commission will deepen cooperation with its U.S. counterparts. In January 2021, it adopted an equivalence decision determining that the SEC regime for U.S. central counterparties is equivalent to EU rules.

### **Post-Brexit Compliance in Financial Activities and Cross-Border Business**

The United Kingdom departed from the European Union (following the end of the transitional period on December 31, 2020) without any substantive agreement being reached relating to financial services. In particular, there is currently no general “equivalence” decision in place, pursuant to which the UK and EU would agree to recognize the broad similarities between their respective regulatory and supervisory financial services regimes, as it has been the case for data protection.

While certain items were integrated in the Trade and Cooperation Agreement (“TCA”), such as provisions regarding anti-money laundering and countering terrorist financing, absent an equivalence decision, post-Brexit cooperation between UK, EU, and national EU Member State authorities is limited to those matters covered by bilateral Memoranda of Understanding (“MoUs”). The execution of an MoU regarding the establishment of a framework for financial services regulatory cooperation (the “MoU for Financial Services”) is currently pending. Once signed, it will establish the “Joint UK-EU Financial Regulatory Forum,” which will serve as a platform to facilitate dialogue on financial services issues.

Although the MoU for Financial Services will reduce uncertainty and identify potential cross-border implementation issues, as well as result in a more harmonized regulatory approach, financial services companies operating in both the EU and the UK will continue to face new compliance burdens. The MoU for Financial Services does not constitute an “equivalence” decision, and, as such, UK financial services companies willing to operate in the EU area have to ensure compliance at the level of each EU Member State, with no passporting. And the ESMA’s January 2021 communication on the limits of the reverse solicitation exemption shows how critical it is for institutions to carefully assess to which extent they may cross borders when just remotely contacting foreign incorporated or residing clients. Conversely, EU companies must generally adhere to the rules established in the post-Brexit UK, although the UK authorities have waived certain requirements temporarily to ease the transition process.

This fluid situation will require companies to regularly review compliance requirements applicable to them, and potential equivalence or exemption regimes that may be applicable to them. But it increases in parallel the risk of enforcement action by either UK or EU Member State regulators for non-compliance.

### **Delisting Chinese Companies—Prohibition on Transacting in Certain Securities/Derivatives of Communist China Military Companies**

There have been several recent actions taken by Congress, the prior administration, and stock exchanges relating to Chinese issuers accessing the U.S. capital markets. These actions not only will negatively impact some of those issuers but also will affect investors holding the securities of those companies, persons seeking to invest in those companies, broker-dealers facilitating trades in the securities of those entities, and investment banks providing or seeking to provide services to those companies. These new requirements may pose regulatory, compliance, and litigation risk.

**Legislation.** The “Holding Foreign Companies Accountable Act” (“HFCAA”), which was passed by unanimous vote by both the Senate and House and signed into law by President Trump on December 18, 2020, could remove certain foreign issuers from U.S. exchanges if U.S. regulators are not allowed to review their financial audits. The law requires enhanced disclosure to the SEC and the public by SEC-reporting issuers that have retained a registered public accounting firm that has a branch or office located in a foreign jurisdiction that prevents the U.S. Public Company Accounting Oversight Board (“PCAOB”) from performing inspections on that branch or office. This required disclosure includes, among others, the percentage of shares of the issuer owned by governmental entities in the foreign jurisdiction in which the issuer is incorporated and the names of each official of the Chinese Communist Party who is a member of the board of directors of the issuer or any operating entity with respect to the issuer. Covered issuers also are required to submit documentation to the SEC that establishes that they are not owned or controlled by a governmental entity in a foreign jurisdiction that does not allow for inspection by the PCAOB. Furthermore, if the PCAOB is unable to perform these inspections for a period of three consecutive years, then the issuer’s securities will be banned from trading on all national securities exchanges in the U.S. as well as through the U.S. over-the-counter market. Although the HFCAA applies

to companies from any country outside of the United States, it clearly is intended to target Chinese companies.

**Executive Order.** On November 12, 2020, President Trump issued an executive order (the “EO”) titled “Addressing the Threat from Securities Investments That Finance Communist Chinese Military Companies” that prohibits any transactions by U.S. persons in “publicly traded securities, or any securities that are derivative of, or are designed to provide investment exposure to such securities” of certain companies identified as Communist Chinese military companies (“CCMCs”). The EO applies this prohibition to CCMCs that are identified by the U.S. Department of Defense (“DOD”) and the Department of the Treasury. In addition, in Frequently Asked Questions on its website, Treasury’s Office of Foreign Assets Control (“OFAC”) noted that the prohibitions also apply to entities with names that “closely match” the names on the CCMC lists. At least one Chinese issuer has challenged its designation as a CCMC in federal court.

Under the EO, U.S. persons are not permitted to enter into “transactions” (i.e., the purchase or sale) for the securities of the listed CCMCs. The EO contains multiple start dates and grace periods for the prohibitions, depending on when and how a company is added to the CCMC list and whether the prohibition applies due to a “close match” in names. The EO implements exceptions to the prohibition to allow transactions solely to divest from these securities within certain grace periods. As amended, however, the EO makes clear that a U.S. person may not hold a security that meets the definitions in the EO following one year from the designation of the related CCMC.

Compliance with the EO will be fact-specific. It is unknown at this point whether President Biden will take any action regarding the EO. We note, however, that OFAC issued a new General License and additional FAQs following inauguration, suggesting that current plans are to leave the EO in place. In addition, the NYSE has delisted shares of several Chinese issuers in response to the EO.

### **Increased Antitrust Scrutiny for Financial Institutions**

The financial sector continues to face significant regulatory scrutiny and litigation risk around conduct that can be perceived as anti-competitive. Antitrust class actions are particularly appealing to litigious plaintiffs because alleged violations of U.S. antitrust law carry joint and several liability and treble

damages, exposing a single defendant to damages significantly greater than any harm associated with their own alleged market share or conduct. In volatile markets like the current environment, new theories of alleged antitrust violations in the financial sector have begun popping up and should be expected to continue appearing.

Over the past decade, antitrust class action litigation against banks has centered on the over-the-counter (“OTC”) fixed income and derivatives markets, with two primary theories underlying those cases. The first set of cases allege competitors conspired to fix financial benchmarks off of which certain securities are priced. The second set of cases allege competitors conspired in their roles as middlemen in certain OTC markets, including (i) allegedly conspiring to boycott platforms that would make those OTC markets more transparent and competitive; (ii) conspiring not to compete with each other in certain markets; and (iii) conspiring to fix fees. What’s more, other markets have shown susceptibility to antitrust challenges of their own. The recent wave of antitrust litigation around the trading halt in certain stock names such as GameStop, for instance, implicate the equities market.

Changes in the market and volatility due to the pandemic also could give rise to new antitrust exposure for the financial sector. While the pandemic has hit certain sectors harder than others, virtually all sectors have suffered significant economic disruption. This disruption includes changes in business as usual, not just because business is largely being conducted remotely, but also because the “usual” may no longer be an option. For instance, as access to capital through traditional financings structures has been more constrained over the past year, there has been an increase in the number of PIPE transactions—private investments in public equity as a means to raise capital—which could trigger Hart-Scott-Rodino filings and antitrust attention from regulators. Additionally, uncertainty in the market due to the pandemic can make business decisions challenging and increase the temptation to reduce market volatility by seeking to obtain non-public, commercially sensitive information from competitors.

Financial market participants should consider the content of their antitrust guidance, including whether it adequately addresses changes in the market, and the frequency in which that guidance should be issued to reinforce the importance of remaining compliant with antitrust laws in volatile markets.

## Crypto and Digital Assets

The last year has seen a significant upturn of activity in, and acceptance of, digital and crypto assets by financial market participants of all sizes and business models. At the same time, there remains significant divergence between global regulatory frameworks which may apply to any uses or applications.

These new technologies and uses offer exciting opportunities for financial market participants, but also carry a range of potential litigation and enforcement risks:

**Varying Licensing and Regulatory Requirements.** Digital and crypto assets are, by their nature, cross border in application, making it essential to ensure that all activities are permitted in each jurisdiction in which they take place and/or that any required licenses are in place (for example under the recent EU Markets in Crypto Assets regulation); new services, such as crypto custody shall also be carefully assessed to avoid any unexpected claims from clients, increased by the volatility and liquidity risks embedded with these asset classes.

As digital assets heavily rely on technology (being proprietary, public, or a mix), participants and investors are exposed to all sort of cyber risks. Insider threat issues, where an employee or third-party service provider may be involved in fraudulent activity to the detriment of the asset holder, are likely to be higher with this asset class (in the short term). This results in the need for proper monitoring and procedures to avoid any enforcement action from supervisors in this area, especially in the remote-working environment.

**Business Terms and Client Disclosures.** Financial market participants will need to review their relevant product terms and ensure customer disclosures take account of not only the new technology being used to support crypto and digital assets, but also the different risk factors, some of which are described above.

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## ENDNOTES

- 1 "Coronavirus (COVID-19)" (Mar. 25, 2020), <https://www.sec.gov/corpfin/coronavirus-covid-19>; "Coronavirus (COVID-19) — Disclosure Considerations Regarding Operations, Liquidity, and Capital Resources" (June 23, 2020), <https://www.sec.gov/corpfin/covid-19-disclosure-considerations>.
- 2 See Community Reinvestment Act Regulations, 85 Fed. Reg. 83747 (Dec. 23, 2020) and Community Reinvestment Act Regulations, 85 Fed. Reg. 34734 (Jun. 5, 2020).
- 3 See [Congress Passes Major U.S. Anti-Money Laundering Reforms](#) (Dec. 2020) and [Major Shift: U.S. Anti-Money Laundering Reforms Become Law](#) (Jan. 2021).
- 4 Department of Justice, [Report of the Attorney General's Cyber Digital Task Force; Cryptocurrency Enforcement Framework](#) (Oct. 2020).

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