

Foreign Private Issuers: Qualifying for Valuable Exemptions from SEC Reporting Requirements

Analyzing the Shareholder Test and Business Contacts Test,
Maintaining FPI Status, New SEC Guidance

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Foreign Private Issuers: Qualifying for Valuable Exemptions from SEC Reporting Requirements

ANALYZING THE SHAREHOLDER TEST AND BUSINESS CONTACTS TEST, MAINTAINING FPI STATUS, AND NEW SEC GUIDANCE

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Wednesday, May 10, 2017



TROUTMAN SANDERS

I. Definition of Foreign Private Issuer – Rule 405 under the Securities Act of 1933 and Rule 3b-4 under the Securities Exchange Act of 1934

Mutually Beneficial Relationship

- United States capital markets are attractive to foreign companies seeking to (a) raise capital and/or (b) establish a trading market for their securities
 - Reasons include, but are not limited to, volume and liquidity
- The U.S., and particularly the Securities and Exchange Commission (the “**SEC**”), establishes and maintains regulations and policies encouraging and facilitating foreign companies’ access to U.S. markets
 - Reasons include, but are not limited to, capital inflow

Main Regulatory Considerations

When a foreign company wishes to access U.S. capital markets, the two main bodies of law to be considered are:

1. The Securities Act of 1933, and related rules and regulations (the “**Securities Act**”); and
2. The Securities Exchange Act of 1934, and related rules and regulations (the “**Exchange Act**”)

The Securities Act

- Generally governs the initial offer and sale of securities in the U.S.
 - Transactions include public offerings in the U.S. (including initial public offerings, follow-on offerings, and secondary offerings by selling security holders)
- Requires the foreign company to either (a) register the offered securities with the SEC, in the case of a public offering, or (b) qualify for an exemption from registration, in the case of a private placement

The Exchange Act

- Generally governs trading of already issued securities on a national securities exchange in the U.S., activities of U.S. broker-dealers, ongoing reporting of U.S. public companies, and M&A activities of U.S. public companies (mergers, tender offers, exchange offers)
- Requires a foreign company to register a class of securities

FPI Accommodations

- Compliance with the registration and reporting requirements of the Securities Act and the Exchange Act can be costly and time-consuming, especially if foreign companies have parallel home country requirements
- To balance the burdens of increased time and cost requirements with encouraging access to U.S. capital markets, the SEC provides certain accommodations to companies that qualify as foreign private issuers

Foreign Private Issuer Qualification

- “Foreign Private Issuer” (“*FPI*”) is defined in (1) Rule 405 under the Securities Act and (2) Rule 3b-4 under the Exchange Act
- If a foreign company meets the definition, it is entitled to certain accommodations in its registration and reporting with the SEC
- If foreign company does not meet the definition, it is subject to the registration and reporting requirements of the Securities Act and the Exchange Act as if it were any other U.S. company

What is a Foreign Private Issuer?

Any foreign issuer (other than a foreign government) incorporated or organized under the laws of a foreign country (*i.e.*, not the U.S.), except an issuer that meets both of the following conditions as of the last business day of its most recently completed second fiscal quarter:

1. More than 50% of the issuer's outstanding voting securities are directly or indirectly owned of record by residents of the U.S.; and
2. any one of the following:
 - a. majority of the issuer's directors or executive officers are U.S. citizens or residents;
 - b. more than 50% of the issuer's assets are located in the U.S.; or
 - c. business of the issuer administered principally in the U.S.

To fail to qualify as a foreign private issuer, an issuer must be both majority owned by U.S. residents and meet one of the three tests in 2 above. An issuer with more than 50% U.S. ownership can still be a foreign private issuer.

“Foreign Issuer” and “Foreign Private Issuer”

- Not to be confused with a foreign private issuer
- A foreign issuer is defined as “any issuer that is a foreign government, a foreign national of any foreign country, or a corporation or other organization incorporated or organized under the laws of any foreign country”
- As a result, every foreign private issuer is a foreign issuer, but not every foreign issuer is an foreign private issuer .

II. The Shareholder Test

The Shareholder Test

Any foreign issuer (other than a foreign government) incorporated or organized under the laws of a foreign country (i.e., not the U.S.), except an issuer that meets both of the following conditions as of the last business day of its most recently completed second fiscal quarter:

- 1. more than 50% of the issuer's outstanding voting securities are directly or indirectly owned of record by residents of the U.S.; and**
2. any one of the following:
 - a. majority of the issuer's directors or executive officers are U.S. citizens or residents;
 - b. more than 50% of the issuer's assets are located in the U.S.; or
 - c. business of the issuer administered principally in the U.S.

How Shareholder Test is Calculated

1. Look at addresses of holders in the issuer's records
2. Must "look through" the ownership of the securities held by custodians, brokers, dealers, banks, and nominees
3. For example, look through DTC and its nominee, Cede & Co., at the participants (such as brokers, dealers, banks and nominees). Then look through brokers, dealers, banks and nominees at the separate accounts held by them
4. May limit inquiry to three (3) jurisdictions:
 - i. U.S.
 - ii. Foreign company's home jurisdiction
 - iii. Primary trading market for foreign company's securities
5. Good faith reliance on information provided by brokers, dealers, banks and nominees. If an issuer cannot obtain the information after reasonable inquiry, it may assume the accounts are resident in the jurisdiction where the broker, dealer, bank or nominee has its principal place of business.

Calculation using Shareholder Test

Shares held directly or indirectly of record by resident(s) of the U.S.

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Issuer's outstanding voting securities

> 50% = **Fail** test 1; move to second inquiry (test 2, the “Business Contacts Test”)

≤ 50% = **Pass**; qualifies as FPI (no need to proceed to the Business Contacts Test)

III. The Business Contacts Test (Part 2 of the FPI Definition)

The Business Contacts Test

Any foreign issuer (other than a foreign government) incorporated or organized under the laws of a foreign country (*i.e.*, not the U.S.), except an issuer that meets both of the following as at the last business day of its most recently completed second fiscal quarter:

- 1.** more than 50% of the issuer's outstanding voting securities are directly or indirectly owner of record by residents of the U.S.; and

- 2.** any one of the following:
 - a.** majority of the issuer's directors or executive officers are U.S. citizens or residents; or
 - b.** more than 50% of the issuer's assets are located in the U.S.; or
 - c.** business of the issuer administered principally in the U.S.

Citizenship and Residency of Executive Officers and Directors

(Part 2(a) of the Test)

1. Identify executive officers and directors
 - “Executive officer” means a president, any vice president in charge of a principal business unit, division or function, any other officer who performs a policy making function, or any other person who performs similar policy making functions
 - “Directors” means any director of a corporation, or any other person performing similar functions with respect to any organization whether incorporated or unincorporated
2. Assess citizenship of each executive officer and each director
3. Assess residency of each executive officer and each director

*If (i) a majority of executive officers are citizens or residents of the U.S., or (ii) If a majority of directors are citizens or residents of the U.S., the foreign company **fails this part of the test.***

Location of Assets

(Part 2(b) of the Test)

1. Assess the foreign company's assets, both tangible and intangible
2. Assess the location of the foreign company's assets, both tangible and intangible
 - Determination must be rationally based and consistently applied and not intentionally designed to vary the outcome (i.e., constructed to avoid the loss of FPI status)
 - Accounting approach – apply methodology in financial statements under U.S. GAAP, IFRS or home country GAAP;
 - Fair value approach – compare fair value of assets inside and outside the U.S.; and
 - Historical cost basis approach – if fair value measurement method is used under the applicable accounting standard, the historical cost basis permitted by that standard may be used

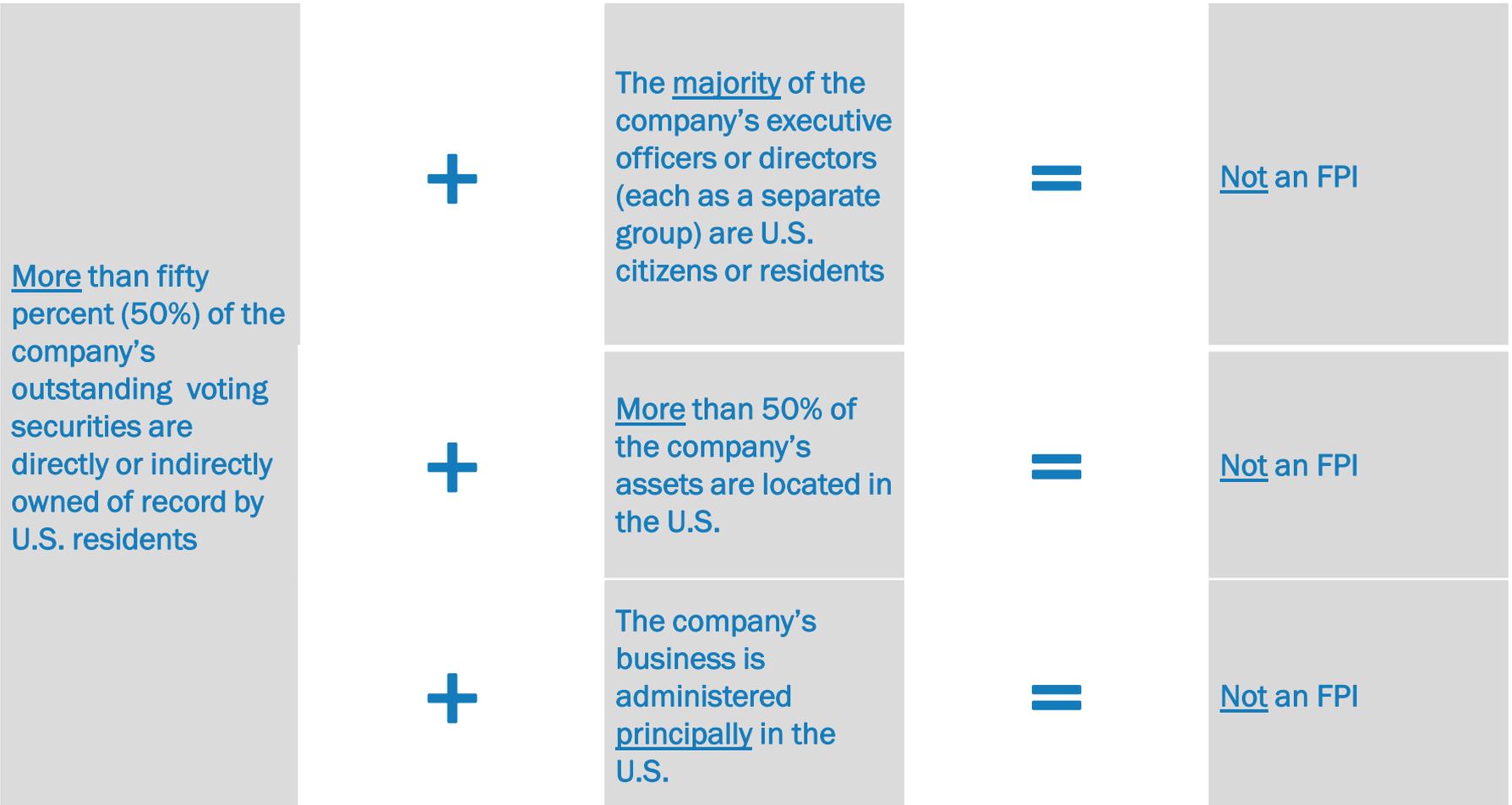
*If a majority of the foreign company's assets are located in the U.S., the foreign company **fails this part of the test.***

Administration of Business (Part 2(c) of the Test)

1. Assess the location of the foreign company's various business functions (including from where annual revenues are derived)
 - Can use the geographic segment information determined in the preparation of the company's financial statements
1. Assess the location of the foreign company's board and shareholders' meetings
2. Assess the location of the foreign company's headquarters
3. Assess the location of the company's most influential executives officers and how many days spent in the U.S.

*After considering the above, if the business of the foreign company is administered principally in the U.S., the foreign company **fails this part of the test.***

Application of The Business Contacts Test



IV. Recent SEC Guidance

Compliance and Disclosure Interpretations

- On December 8, 2016, the SEC released certain Compliance and Disclosure Interpretations (“**C&DIs**”)
- Generally speaking, C&DIs are interpretations of the rules and regulations as viewed by the staff of the SEC
- These particular C&DIs provided additional clarity to the definition of and determination of a foreign company’s status as an FPI

Determining Residency of “Green Card Holders”

- For individuals with permanent residence status, or “Green Card Holders,” there is now a presumption that they are residents of the U.S.
- For individuals who do not have permanent residence status, residency requires a facts-and-circumstances analysis, including, but not limited to:
 - Tax residency
 - Nationality
 - Mailing address
 - Physical presence
 - Financial and legal relationships
 - Immigration status



However the assessment is made, the foreign company must assess each individual’s residency consistently, not changing to achieve a desired result

Multiple Classes of Voting Stock AND Different Voting Rights

- Two methods available to determine whether fifty percent (50%) of foreign company's outstanding voting securities are directly or indirectly owned by U.S. residents

1. Consider whether U.S. residents own more than fifty percent (50%) of the voting power of the classes on a combined basis

2. Consider whether U.S. residents own more than fifty percent (50%) of the number of outstanding voting securities

SEC has no stated preference, but consistency is key

Determining Citizenship / Residency of Executive Officers and Directors

Four (4)-part inquiry —

1. Citizenship status of each executive officer
2. Citizenship status of each director
3. Residency status of each executive officer
4. Residency status of each director

Multiple Boards

- If the foreign company has multiple boards, the FPI analysis should focus most closely on the board that performs the functions of those undertaken by a U.S.-styled board of directors
- BUT – if those functions are divided between both boards, the directors can be aggregated.

Location of Assets

- Foreign companies may now use the geographic segment information from financial statements
- OR – foreign companies can apply any other “reasonable methodology”

SEC has no stated preference, but consistency is key

Where business is principally administered?

- In assessing where the officers, partners or managers primarily direct, control and coordinate the foreign company's activities on a consolidated basis, there is no single factor or group of factors that is determinative of whether the company's business is administered principally in the U.S.
- For example, holding an annual or special meeting of shareholders or occasional board meetings in the U.S. would not result in the determination that the company's business is administered principally in the U.S.

V. Process and Timing

Determination Date for FPI Status – New Registrants

For new registrants (those filings a registration statement under the Securities Act or the Exchange Act for the first time), determination of FPI status is made as of a date within 30 days prior to the filing of initial registration statement under the Securities Act or Exchange Act

Determination Date for FPI Status – Existing Registrants

- Thereafter, FPI status is required to be assessed once a year on the last business day of its second fiscal quarter

Fiscal Year End	Most Recent Determination Date	Next Determination Date
March 31 st	September 30 th , 2016	September 30 th , 2017
June 30 th	December 31 st , 2016	December 31 st , 2017
September 30 th	March 31 st , 2017	March 31 st , 2018
December 31 st	June 30 th , 2017	June 30 th , 2018

Consequences of Change in FPI Status

- If an FPI on this date, the company can access the FPI accommodations immediately (foreign forms under the Securities Act, reporting accommodations under the Exchange Act)
- If not an FPI on this date, the company can continue to use (non-MJDS) foreign forms under the Securities Act, reporting accommodations under the Exchange Act until the end of that fiscal year
- If not an FPI on this date, the foreign company would have U.S. domestic issuer status as of the first day of the next fiscal year
- Treated as a U.S. domestic issuer until it next qualifies as an FPI on a future assessment date (including reporting financial statement in U.S. GAAP)

VI. Maintaining the FPI Accommodations

Maintaining the FPI Accommodations

- FPIs must assess status annually (*i.e.*, assess each year, at the end of the most recently completed second fiscal quarter of the foreign company's fiscal year)
- Same analysis previously discussed applies (e.g., the Shareholder Test and the Business Contacts Test)

VII. Benefits Afforded FPIs

Quarterly Reporting Accommodations

- FPIs are not required to file Quarterly Reports on Form 10-Q or Current Reports on Form 8-K
- FPIs must, however, furnish (not file) Form 6-Ks with any other information material to an investment decision (including quarterly financial information filed in the company's home jurisdiction) that the company
 - Makes or is required to make public pursuant to the law of the jurisdiction of its domicile
 - Files or is required to file with a stock exchange on which its securities are traded
 - Distributes or is required to distribute to its security holders

Later Filing Deadlines for Annual Reports

- Annual reports for FPIs must be filed on Form 20-F (or Form 40-F for certain Canadian issuers)
- U.S. domestic issuers are required to file annual reports on Form 10-K within 60, 75 or 90 days after end of fiscal year (depending on filer status)
- FPIs must file an annual report on Form 20-F within 4 months of end of the fiscal year (or an annual report on Form 40-F on the same day as information is filed in Canada, for certain Canadian issuers)

Exemption from U.S. Proxy Rules

- FPIs exempt from much of Section 14 of the Exchange Act and proxy solicitation and shareholder proposal requirements under Regulations 14A and 14C relating to annual and special meetings of shareholders
- FPIs that voluntarily file on domestic forms are not permitted to file a proxy or information statement under Section 14 of the Exchange Act

Exemption from Insider Trading Reports

- Officers, directors and ten percent (10%) shareholders of U.S. domestic companies are required to file reports of beneficial ownership under Section 16(a) of the Exchange Act
- Officers, directors and ten percent (10%) shareholders of FPIs are not required to do so

Continued Application of Certain Section 13 and Section 14 Requirements

- FPIs listed on a U.S. national securities exchange must still comply with the going private rules and issuer tender offer rules under Section 13(e) of the Exchange Act
- Section 13(d) filings (Schedules 13D and 13G) for reporting the acquisition of a registered company's securities may be required if ownership thresholds are reached
- Persons acquiring the securities of FPIs listed on a U.S. national securities exchange may also need to comply with the third party tender offer rules under Section 14(d) of the Exchange Act and the general anti-fraud rules under Section 14(e) of the Exchange Act applicable to all tender offers.

Exemption from Short-Swing Profit Recovery Rules

- Officers, directors and 10%+ shareholders of U.S. domestic companies are subject to beneficial ownership reporting and complex short-swing profit recovery rules under Section 16 of the Exchange Act
- Exemption for officers, directors and 10%+ shareholders of FPIs

Exemption from Regulation FD

- Regulation FD (Fair Disclosure) prohibits “selective disclosure” of material non-public information by companies to certain persons
- FPIs are exempt from Regulation FD by being excluded from the definition of “issuer”

Exemption from Regulation BTR

- Regulation BTR sets forth certain “black-out trading restrictions” for executive officers and directors of U.S. domestic issuers and FPIs during pension fund blackout periods if the securities were acquired for service or employment with the issuer
- For FPIs no blackout period will be deemed to have occurred unless the general requirements in Regulation BTR are met, and either:
 - i. the number of plan participants or beneficiaries located in the United States that are subject to the suspension exceeds 15% of the issuer’s worldwide workforce or
 - ii. more than 50,000 participants and beneficiaries located in the United States are subject to the suspension

Exemption from Regulation G

- Regulation G governs the use of non-GAAP financial measures
- Certain FPIs are exempt from Regulation G under certain circumstances
 - Regulation G does not apply to public disclosure by (or on behalf of) an FPI with securities are listed outside the United States, if the non-GAAP financial measure is not derived from or based on a measure calculated and presented in accordance with U.S. GAAP and the disclosure is made by (or on behalf of) the FPI outside the United States, or is included in a written communication that is released by (or on behalf of) the FPI outside the United States

Reduced Executive Compensation Disclosures

- Exempt from many of the detailed compensation disclosures in Regulation S-K for U.S. domestic companies
- Certain individual compensation disclosure is not required unless it is required under its otherwise publicly disclosed

Use of IFRS or Local GAAP

- Financial statements of FPIs may be prepared using IFRS or local GAAP
- No reconciliation to U.S. GAAP required if the FPI uses IFRS issued by International Accounting Standards Board
- Reconciliation to U.S. GAAP required if the FPI uses local GAAP or IFRS not issued by International Accounting Standards Board
- FPIs that fail the FPI test must begin reporting financial statements in accordance with U.S. GAAP for all periods presented

Financial Statements Go “Stale” Later

- FPIs can file registration statements that include financial statements that are of an earlier date than those required for U.S. domestic issuers
- FPIs can omit interim financial statements if a registration statement becomes effective sooner than 9 months after the end of the most recent fiscal year end (except if the interim financial statements have been made public)

Confidential Submissions to SEC

- Certain FPIs registering for the first time with the SEC may submit draft registration statements to SEC confidentially in a similar way to EGCs
- FPI may submit IPO registration statements confidentially if
 - FPI is an emerging growth company
 - Is listed or listing on a foreign exchange
 - Is being privatized by a foreign government
 - Public filing would be against home country law
- The initial registration statement and amendments must be made public before a road show or selling securities
- U.S. domestic company must file publicly unless its is an emerging growth company

Termination of Reporting

- FPIs may terminate their registration and reporting under the Exchange Act (rather than suspending it) using Form 15F
- Form 15F – Equity Securities
 - Average daily trading volume test
 - 300 holder test
- Form 15F – Debt Securities
 - 300 holder test
- FPIs may also file Form 15 to deregister and suspend (generally based on record holders and/or value of assets)

Access to MJDS for Certain Canadian issuers

- FPIs that are Canadian companies that meet certain requirements may access the U.S.-Canada Multijurisdictional Disclosure System (MJDS)
- MJDS permits such Canadian issuers to file Canadian disclosure with the SEC, with certain additional U.S. disclosure included, to satisfy their U.S. reporting obligations under the Exchange Act or to register securities under the Securities Act

Other FPI Accommodations

- Regulation S for offshore transactions
- Exemptions from certain tender offer requirements (Tier I and Tier II Exemptions)
- Exemptions from certain rights offering requirements (Rule 801)
- Exemptions from certain requirements in connection with exchange offers and business combinations (Rule 802)
- Rule 12g3-2(a) and Rule 12g3-2(b) exemptions from Exchange Act registration
- Certain exemptions from independence requirements of Rule 10A-3 for audit committees
- Alternative listing standards on NYSE
- Ability to follow home country corporate governance standards and shareholder approval requirements on U.S. stock exchanges

VIII. XBRL Data Tagging Rules

eXtensible Business Reporting Language (“XBRL”)

- Interactive data format
- When used, data is “machine-readable”
- Allows for easier access, analysis and comparison of financial information across reporting periods and across companies

XBRL and FPIs

- FPIs using U.S. GAAP previously subject to XBRL requirements
- SEC Notice March 1, 2017 – FPIs using IFRS required to file financial statements in XBRL for fiscal periods ending on or after December 15, 2017
- Such FPIs may elect to file financial statements in XBRL prior to that time

Thank You

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