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TOP 10

PRACTICE TIPS BY EXPERTS: FOREIGN PRIVATE ISSUERS

by Marcelo A. Mottesi, Sam Badawi and Elizabeth McNichol, Milbank, Tweed, Hadley & McCloy LLP

Foreign Private Issuers, or FPIs, require a significant amount of guidance from experienced outside counsel. FPIs can benefit from the status and increased visibility that comes with being a Securities and Exchange Commission (SEC) registered company, while enjoying accommodations with respect to U.S. securities laws and stock exchange regulations not available to U.S. domestic public companies. However, FPIs need to be cognizant of the regulatory landscape applicable to them, which still imposes certain costs and burdens. Below are 10 practice tips that can help you handle foreign private issuers without panicking.

1. DISCUSS AND ASSIST WITH ONGOING REPORTING OBLIGATIONS

FPIs are required to comply with three major disclosure requirements:

- **Filing an annual report on Form 20-F.** An FPI must file a Form 20-F (containing audited financial statements) with the SEC within four months of the end of the issuer's fiscal year. In preparing the annual report, outside counsel should review the requirements of Form 20-F, Regulations S-K and S-X, and any recently released SEC guidance or updates. Many departments at the issuer, as well as their outside auditors, will help prepare the 20-F together with outside counsel.
- **Furnishing reports on Form 6-K for material information.** FPIs must file a Form 6-K with the SEC promptly following the public release of material information that the issuer (i) makes or is required to make public under local law (jurisdiction of domicile or organization), (ii) files or is required to file with a stock exchange, which are made public by such exchange, or (iii) distributes or is required to distribute to its security holders.
- **Furnishing reports on Form 6-K for interim financial statements (if listed on the New York Stock Exchange (NYSE) or the Nasdaq Stock Market (NASDAQ)).** To the extent listed on the NYSE or the NASDAQ, FPIs must also furnish a Form 6-K to the SEC within six months following the end of the second fiscal quarter, containing interim financial statements covering the first two fiscal quarters.

2. COORDINATE XBRL FILINGS WITH ISSUER AND PRINTER

Issuers preparing their financial statements in accordance with International Financial Reporting Standards (IFRS) will soon be required to submit their SEC reports using eXtensible Business Reporting Language (XBRL). This requirement becomes effective for fiscal periods ending on or after December 15, 2017. Given the requisite work needed to tag the financials, issuers should commence the preparatory work, including coordinating with their financial printer and performing test runs of tagging interim financials, as soon as possible to ensure timely filings. FPIs who prepare their financial statements in accordance with U.S. generally accepted accounting standards (GAAP) are already required to use XBRL.

3. ADVISE LARGE KNOWN SHAREHOLDERS ON BENEFICIAL OWNERSHIP REPORTING REQUIREMENTS

To the extent an FPI has equity securities that are registered under Section 12 (15 U.S.C.S. § 78l) of the Securities Exchange Act of 1934, as amended (Exchange Act), whether triggered due to the number of shareholders or a listing on a U.S. national stock exchange, holders of more than 5% of such equity securities are required to disclose their ownership in a filing with the SEC on Schedule 13D or, for passive or smaller investors, Schedule 13G. Such holders must update Schedules 13D and 13G, as applicable, following material changes, such as acquisitions or dispositions (generally triggered at 1% of the issuer's securities) or a change in control/investment intent by the holder. An FPI's securityholders should monitor their own compliance with these requirements. However, because many foreign companies have their founders (or family members thereof) as major shareholders and often also as directors and/or officers, FPIs should ensure these large known shareholders are advised of these requirements.

4. ENSURE ONGOING COMPLIANCE WITH DIRECTOR INDEPENDENCE AND CORPORATE GOVERNANCE REQUIREMENTS

FPIs may generally follow home-country practices with respect to corporate governance, subject to some important exceptions. For example, to the extent listed on a national securities exchange in the United States, an FPI must have an audit committee that satisfies the SEC's independence requirements. In addition, an FPI's Form 20-F annual report must summarize the ways in which its corporate governance practices differ from the listing standards of the exchange on which its securities are listed that are applicable to U.S. domestic issuers.

5. ENSURE ONGOING COMPLIANCE WITH SARBANES-OXLEY RULES

The Sarbanes-Oxley Act of 2002 (SOX) imposes rules on all issuers, including FPIs. Compliance with such rules and regulations is costly and burdensome, and can be particularly difficult for FPIs to navigate. This is especially true where SOX requirements conflict with applicable foreign laws or corporate governance practices. When advising FPIs on compliance with SOX, you should highlight the following notable provisions:

- **Section 404.** This requires management to file with the issuer's annual report on Form 20-F an internal control report that includes specific statements regarding the issuer's internal controls.
- **CEO and CFO certifications.** Chief executive officers (CEOs) and chief financial officers (CFOs) must make certain certifications that accompany the annual report filing.
- **Prohibition on loans.** There is a blanket prohibition on loans to executive officers.
- **Bonus clawbacks.** CEOs and CFOs must forfeit previously paid bonuses if the issuer is required to prepare an accounting restatement due to material non-compliance of the issuer.

6. MONITOR FPI STATUS

Issuers must assess their FPI status on a yearly basis in order to ensure that they can still operate under the FPI regulatory and compliance regime. An FPI must first determine if more than 50% of its outstanding voting securities are owned by U.S. residents. For this purpose, an FPI is required to look through the holders of record to the beneficial holders to determine residency. If the answer to the 50% inquiry is in the affirmative, the issuer must then determine whether any of the following are true:

- A majority of the executive officers or directors are U.S. citizens or residents
- More than 50% of its assets are located in the United States
- Its business is administered principally in the United States

To the extent an issuer triggers any of these three tests, and had answered affirmatively to the 50% inquiry, it would become unable to continue its qualification as an FPI, and would become subject to U.S. domestic company reporting requirements and related stock exchange regulations.

7. KEEP ISSUER AWARE OF APPLICABLE SECURITIES LAW LIABILITY ISSUES

FPIs should be aware that they are subject to liability under certain U.S. securities laws, including Section 11 (15 U.S.C.S. § 77k) and Section 12 (15 U.S.C.S. § 77l) under the Securities Act of 1933, as amended, and Section 10(b) (15 U.S.C.S. § 78j(b)) under the Exchange Act. Directors and officers who sign a registration statement, along with the issuer itself, are subject to civil liability for material misstatements or omissions in a registration statement. Liability also extends to any person who offers or sells a security without registration or a valid exemption therefrom, or by means of a prospectus or oral communication that includes a misstatement or omission of a material fact. Finally, Rule 10b-5 (17 C.F.R. § 240.10b-5) of the Exchange Act generally prohibits fraud in connection with the sale of any security.

8. REVIEW USAGE OF NON-GAAP FINANCIAL MEASURES

Similar to U.S. domestic issuers, FPIs are subject to both Regulation G (17 C.F.R. §§ 244.100-102) and Item 10(e) (17 C.F.R. § 229.10) of Regulation S-K. Where FPIs publicly disclose financial measures that deviate from their applicable accounting principles, they must provide a reconciliation to the most directly comparable U.S. GAAP, IFRS, or local GAAP measure, as applicable. Regulation G does not, however, apply to public disclosure of a non-GAAP/non-IFRS measure made by an FPI if the following are all true:

- The FPI's securities are quoted on an exchange outside the U.S.
- Such non-GAAP/non-IFRS measure is not derived from or based on a measure calculated and presented in accordance with U.S. GAAP/IFRS.
- Such disclosure is made outside the United States or included in a written communication released outside the United States.

In addition, Item 10(e) prohibitions do not apply where an FPI uses a non-GAAP financial measure if such measure:

- Relates to local GAAP or IFRS
- Is required or expressly permitted by the applicable regulator
- Is included in the annual report prepared by the FPI for use in its home jurisdiction

9. CONSIDER DELISTING/DEREGISTRATION WHEN COSTS OUTWEIGH THE BENEFITS

U.S. listing and SEC registration sometimes outlive their usefulness. Issuers may find themselves supporting a minimal U.S. float, or they may get comparable stature from listing on the local market given recent regulatory advances in many jurisdictions. Delisting from a U.S. stock exchange requires the filing of a Form 25, which must be preceded by notice to the stock exchange that includes certain required materials (e.g., certified translated board resolutions). The SEC also requires contemporaneous public announcement of such notification to a stock exchange.

To deregister, an FPI must have (i) less than 300 holders resident in the United States or worldwide, or (ii) a U.S. average daily trading volume (ADTV) over a recent 12-month period not greater than 5% of the worldwide ADTV. Once an FPI meets either of these tests, then, subject to certain conditions, it can file a Form 15F to terminate its SEC registration provided it first publicly announces such intent. In addition, an FPI relaying on the ADTV test cannot file a Form 15F for 12 months after it delisted its equity securities in the United States or terminated an American Depositary Receipt (ADR) facility.

10. BE MINDFUL OF THE RULE 12G3-2(B) EXEMPTION

FPIs that deregister from the SEC and have concerns about exceeding equity holder thresholds beyond which they would be required to re-register with the SEC (i.e., greater than 300 holders resident in the United States) can utilize Rule 12g3-2(b) (17 C.F.R. § 240.12g-3-2(b)) under the Exchange Act to maintain their exemption from registration. Specifically, this exemption requires that the issuer provide, in English, on its website or an electronic delivery system generally available to the public in its primary trading market, the same information it would have been required to furnish to the SEC on Form 6-K had it continued to be a reporting issuer. This would include, at a minimum, its annual report and annual financial statements, interim reports that include financial statements, press releases, and all other material communications and documents distributed directly to security holders of the class of securities to which the exemption relates.

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