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Foreign Private Issuer Annual Assessment

For foreign private issuers (FPIs) with a calendar year-end, now is the time of year to conduct the annual assessment to determine whether the company still qualifies as an FPI. SEC rules generally require that a company assess its FPI status annually as of the last business day of its second fiscal quarter to determine whether the company can continue to avail itself of the accommodations in the SEC's forms and rules applicable to FPIs. An FPI with a calendar year-end should therefore perform its annual assessment as of June 30, 2022, to determine whether it still qualifies as an FPI.

As summarized below, testing FPI status as of the last business day of an issuer's second fiscal quarter – which was June 30, 2022 this year for companies with a December 31 fiscal year end – is part of a web of annual status tests required by SEC rules that depend at least in part on facts that existed as of that date. Although the SEC intended that requiring issuers to perform these status tests as of the last business day of the issuer's second fiscal quarter would provide issuers whose status would change at the end of their fiscal year a period of six months to prepare for transitions that can require significant effort and expense, in some cases a loss of status is immediate.

For example, an FPI that reorganizes or reincorporates in a U.S. jurisdiction loses its FPI status and must comply with SEC rules applicable to domestic issuers immediately. As another example, an emerging growth company (EGC) that issues more than $1 billion of non-convertible debt in a rolling three-year period loses its EGC status and must comply with generally applicable SEC rules immediately. There are no transition provisions in these situations. In the case of an FPI, compliance with SEC rules that apply to domestic issuers begins on the date that FPI status is lost (January 1, in the case of a calendar-year-end company).

Testing FPI Status

Test Dates. As stated above, SEC rules generally requires an FPI to test its status annually as of the last business day of the second quarter of the issuer's fiscal year and to begin complying with the SEC rules that apply to domestic issuers on the first day of the next fiscal year if the issuer no longer qualifies as an FPI. There are two exceptions to the annual testing requirement.

First, if an FPI loses its FPI status as a result of reincorporating in a U.S. jurisdiction at any time during its fiscal year, the loss of FPI status is immediately effective. This is essentially a daily test, and the result is that the issuer must immediately begin filing reports under the Securities Exchange Act of 1934 (Exchange Act) on the SEC forms required for domestic issuers, as stated in Question 110.01 of the Exchange Act Rules Compliance and Disclosure Interpretations.

Because some of the factual conditions for FPI status, which are discussed in the next section, can change at any time without notice and result in a significant change in SEC compliance requirements at the end of the current fiscal year, and because reincorporating in a U.S. jurisdiction results in immediate loss of FPI status, FPIs may

wish to consider maintaining appropriate controls and procedures that have been designed to avoid untimely or unintended changes that could result in loss of FPI status.

Second, when a foreign issuer files a registration statement under the Securities Act of 1933 (Securities Act) or the Exchange Act for the first time, it can determine its FPI status as of a date up to 30 days before filing its initial registration statement. If the issuer satisfies the conditions for FPI status at that time, the FPI must test its status annually as of the last business day of its second fiscal quarter after its initial registration statement becomes effective.

Tests for FPI Status. An issuer that seeks to qualify as an FPI must satisfy one of two tests. These tests involve an element of judgment and knowledge about how the issuer's voting securities are owned. The SEC staff has issued an extensive body of interpretive guidance in an effort to provide some clarity and consistency for FPI determinations. These determinations can depend on a variety of factual nuances, which makes a detailed discussion of these tests and their application beyond the scope of this discussion. Because the consequences of qualifying as an FPI – and losing FPI status – are significant, issuers that are or wish to qualify as an FPI should analyze these issues closely.

The two tests for FPI status are:

- **U.S. Share Ownership.** The issuer is organized outside the U.S. and more than 50% of its voting securities are owned of record by non-US residents. An issuer organized outside the U.S. that does not satisfy this test can still qualify as an FPI if it satisfies each element of the U.S. business contacts test:

- **U.S. Business Contacts.** The issuer is organized outside the U.S. and none of the following conditions is true:

    - The majority of its executive officers or directors are U.S. citizens or residents

    - More than 50% of the issuer's assets are located in the United States; and

    - The issuer's business is administered principally in the United States.

As noted above, applying these tests involves a reasonable degree of judgment about certain facts and their legal significance. The tests can be found in Securities Act Rule 405 and Exchange Act Rule 3b-4.

U.S. Share Ownership

If 50% or less of a foreign company's outstanding voting securities are directly or indirectly held of record by U.S. residents as of June 30, the issuer qualifies as an FPI and no further analysis is required. If more than 50% of the company's outstanding voting

securities are held by U.S. residents, however, the company must apply the U.S. business contacts test to determine whether it can nevertheless qualify as an FPI.

The determination of share ownership is based on the methodology in Exchange Act Rule 12g3-2(a), which uses the definition of "held of record" in Exchange Act Section 12g5-1 but requires issuers to apply a "look through" approach to test beneficial ownership. SEC rules require issuers to "look through" the record ownership of certain nominee holders, such as brokers, dealers, and banks that hold securities for the accounts of their customers, to determine the residency of those customers. In order to reduce the burden to companies of applying this look-through approach, the SEC only requires foreign companies to examine voting securities held of record in the jurisdictions that should account for most of the company's trading volume and that are most likely to produce the greatest number of U.S. beneficial owners. These jurisdictions include the United States, the issuer's home jurisdiction, and the primary trading market for its securities.

If the issuer is unable to obtain information about the customer accounts of nominee holders after reasonable inquiry and having made a good faith effort, the issuer may rely on a presumption that those accounts are held in the principal place of business of the nominee holder. SEC rules do not require the company to make inquiries in cases where the costs for obtaining the requested information would be unreasonable. This inquiry also requires the issuer to consider any beneficial ownership reports, such as Schedules 13D or 13G, that have been publicly filed with the SEC or are otherwise provided to the issuer, as well as other information available to it, when determining U.S. ownership. The SEC staff has provided guidance on the factors to apply in determining U.S. residency for purposes of determining whether an issuer qualifies as an FPI. This guidance clarifies that a person who has permanent resident status in the United States is presumed a U.S. resident, and that even individuals without permanent resident status may be considered U.S. residents for purposes of the FPI definition based on numerous factors, such as tax residency, mailing address, physical presence, and location of a significant portion of their financial and legal relationships. SEC rules require issuers to decide what criteria they will use to determine residency, and apply the criteria consistently without changing them to achieve a desired outcome.

U.S. Business Contacts

If the U.S. ownership of a foreign company's voting securities exceeds 50%, the company may still qualify as an FPI if it satisfies a U.S. business contacts test that requires the company to assess three conditions. A foreign company will not qualify as an FPI if any of the three tests below are true.

a. ***Citizenship and Residency of Executive Officers and Directors.*** A foreign company will not qualify as an FPI if (i) a majority of its executive officers are U.S. citizens or residents; or (ii) a majority of its directors are U.S. citizens or residents.

   The determination must be made separately for each group, and must be true for each group. This requires the following evaluations: (1) the identity of the

issuer's directors and executive officers, as defined by SEC rules, whose citizenship and residency must be determined; (2) whether each of the issuer's executive officers and each of the issuer's directors is a U.S. citizen or resident; and (3) whether or not a majority of each group, evaluated separately, are U.S. citizens or residents**.** Under Exchange Act Rule 3b-7, the term "executive officer" means an issuer's president, any vice president in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy making function, or any other person who performs similar policy making functions for the issuer, which may include executive officers of subsidiaries. Some FPIs have board structures, such as a two-tier board, that may require the issuer to make judgments about which individuals should be treated as directors for purposes of testing FPI status.

b. ***Location of Assets***. If more than 50% of a foreign company's assets (tangible and intangible) are located in the U.S., the company will not qualify as an FPI. The issuer may use the geographic segment information determined in the preparation of its financial statements, or any other reasonable methodology, in assessing the location and amount of its assets.

c. ***Administration of Business***. If a foreign company's business is administered principally in the U.S., the company will not qualify as an FPI. No single factor is determinative for purposes of this test. The company must assess on a consolidated basis the location from which its officers, partners, or managers primarily direct, control and coordinate the company's activities.

Results of Loss of FPI Status

In most cases, an FPI that determines that it no longer qualifies as an FPI loses its status as an FPI and becomes subject to SEC reporting requirements for a domestic company beginning on the first day of the next fiscal year. For example, an issuer with a December 31 fiscal year end that no longer qualified as an FPI as of June 30, 2022 would file its annual report on Form 10-K, rather than Form 20-F, in 2023 for its 2022 fiscal year. The issuer would also become subject to the other SEC reporting and disclosure requirements that apply to domestic issuers on January 1, 2023. These include, among others, reporting on Form 10-Q and Form 8-K and complying with SEC proxy rules. As part of its transition to being treated as a domestic issuer under SEC rules, the FPI would be required to prepare and file financial statements in accordance with U.S. generally accepted accounting principles (GAAP).

The issuer's directors and executive officers would also become subject to the reporting and short-swing profits recapture provisions of Section 16 of the Exchange Act. The due date of the Form 3 initial beneficial ownership report varies depending on the circumstances in which the issuer lost its FPI status, but could be as early as the day on which the issuer loses FPI status and would generally be no later than 10 days after loss of FPI status. The circumstances of the loss of FPI status can also affect whether the directors and executive officers are subject to reporting obligations and potential short-swing profits recapture for transactions involving the issuer's securities during the six month period before the loss of FPI status.

FPIs as EGCs and SRCs

An issuer that is an FPI can also be an emerging growth company (EGC) or a smaller reporting company (SRC), and an FPI can also meet the tests for both an EGC and an SRC concurrently. Like FPIs, both EGCs and SRCs can rely on scaled disclosure accommodations that are intended to be less burdensome than those that apply to other domestic issuers, although the disclosure requirements and transition provisions that apply to EGCs and SRCs differ from each other and from those available to FPIs in some significant ways.

SRC eligibility is tested annually, based in part on the issuer's public float as of the last business day of its second fiscal quarter. EGC status is not directly tested as of any specific date after an issuer first qualifies as an EGC, but EGCs must test their status as an accelerated filer or large accelerated filer annually, and these tests are based in part on the issuer's public float as of the last business day of its second fiscal quarter. If an EGC becomes a large accelerated filer, the definition of EGC in Securities Act Rule 405 and Exchange Act Rule 12b-2 provides that the issuer loses EGC status on the date on which it is deemed to be a large accelerated file, as defined in Rule 12b-2.

An FPI that also qualifies as an EGC can use the EGC disclosure accommodations for its Exchange Act filings, to the extent applicable. In contrast, an FPI can only qualify as an SRC if it files its Exchange Act reports on the forms required for U.S. issuers and presents its financial statements in accordance with U.S. GAAP.

Unlike domestic issuers, which can take an *a la carte* approach to the scaled disclosure accommodations available to EGCs and SRCs, foreign issuers that qualify as an FPI and an SRC must select either the FPI disclosure accommodations or the SRC disclosure accommodations.

Auditor Attestation on ICFR

For FPIs, one of the most important practical impacts of annual tests for status as an EGC, an SRC, an accelerated filer and a large accelerated filer is whether or not the FPI will be required to file an auditor's attestation on the FPI's internal control over financial reporting (ICFR), as required by Section 404(b) of the Sarbanes-Oxley Act of 2002.

An FPI is exempt from this requirement if it is neither an accelerated filer or a large accelerated filer, as defined in Exchange Act Rule 12b-2 and briefly summarized below.

An FPI that qualifies as an EGC is exempt from this requirement even if it is an accelerated filer. Note that under SEC rules a large accelerated filer cannot be an EGC.

An SRC is only exempt from this requirement if it is a non-accelerated filer. As stated earlier, an FPI can only qualify as an SRC if it files its Exchange Act reports on domestic forms and presents its financial statements in accordance with U.S. GAAP.

FPI Filer Status: Large Accelerated, Accelerated and Non-Accelerated Filers

SEC rules require companies to determine whether they are an accelerated filer or a large accelerated filer, as defined in Exchange Act Rule 12b-2. An issuer that is not an accelerated or a large accelerated filer is by default a non-accelerated filer, which is a term not defined in SEC rules.

As mentioned earlier, accelerated filer status and large accelerated filer status is determined annually as of the last fiscal day of the issuer's second fiscal quarter, and both of these tests are based in part on the issuer's public float as of that date.

The Bottom Line

June 30, 2022 was a very important date for reporting companies, and for FPIs especially. The transition from the forms and disclosure requirements for FPIs to those required by SEC rules for domestic issuers is particularly significant. Six months is not too much time to prepare for this transition. FPIs – and all issuers with SEC reporting obligations that have a December 31 fiscal year-end – should perform all of the relevant status tests promptly after the last business day of their second fiscal quarter. This is especially important for FPIs because some of the conditions of the FPI tests will require the FPI to ascertain facts that may require some time and effort to collect and evaluate. Carpe diem!