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SEC Proposes Foreign Issuer Reporting Enhancements

In 1979 the Securities and Exchange Commission ("SEC") adopted Form 20-F for use by foreign private issuers ("FPIs") when registering a class of securities and filing annual reports in accordance with the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The principles guiding the implementation of this form was that investors should have access to information concerning foreign private issuers that is equal, "as nearly possibly and practicable", to the information available regarding domestic issuers while improving the accessibility of public markets to foreign private issuers. Even at the time, however, the development of foreign issuer disclosure requirements was acknowledged to be an evolutionary and iterative process. On February 29, 2008, the SEC proposed a series of amendments pertaining to Form 20-F and a variety of related rules that the SEC believes would further both of these objectives "in light of market developments, new technologies and other matters in a manner that promotes investor protection, cross-border capital flows and the elimination of unnecessary barriers to [U.S.] capital markets."[1] The SEC has indicated that comments on the proposed amendments should be received on or before May 12, 2008. A summary of the proposals follows.

1. Annual Test for Foreign Private Issuer Status

The determination of whether a company qualifies as a "foreign private issuer" is important because SEC regulations provide a variety of accommodations and exemptions for these entities.[2] Current rules require foreign private issuers to monitor their status continuously

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1 SEC Release Nos. 33-8900; 34-57409; International Series Release No. 1308; File No. S7-05-08, Foreign Issuer Reporting Enhancements (February 29, 2008), available at, http://www.sec.gov/rules/proposed/2008/33-8900.pdf.

2 The definition of "foreign private issuer" is contained in Exchange Act Rule 3b-4(c). A foreign private issuer is any foreign issuer other than a foreign government, except for an issuer that (1) has more than 50% of its outstanding voting securities held of record by U.S. residents and (2) any of the following: (i) a majority of its officers and directors are citizens or residents of the

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in relation to the various factors used to determine FPI status and to adjust their accounting accordingly, regardless of when in the fiscal year a change in status occurs. In addition to being costly, the current need to reevaluate FPI status on a continuous basis results in uncertainty for not just the issuer, but also, in the view of the SEC, for investors who may have to examine both foreign and domestic reporting forms in order to evaluate the performance of a company in a single fiscal year.

In order to address these difficulties, the SEC is proposing that FPIs be allowed to assess their status once a year, on the last business day of their second fiscal quarter. Canadian issuers currently filing registration statements using the multijurisdictional disclosure system ("MJDS") would also be required to test their FPI status at the end of their second fiscal quarter, as opposed to at the end of the fiscal year as is currently required. The choice of this date is partly an attempt to achieve internal consistency within the reporting rules, as determination of accelerated filer and smaller reporting company status occurs on the same benchmark date. Further, since the determination of FPI status would occur at the end of the second fiscal quarter, companies that did not qualify would have six months' advance notice that they will be required to file as a domestic company. Of course during that six-month period, investors would not have the benefit of the additional disclosures required by the domestic Forms 8-K and 10-Q.

2. Accelerating the Reporting Deadline for Form 20-F Annual Reports

Presently, an FPI must file its annual report on Form 20-F within six months of its fiscal year-end. This extended filing period was intended to acknowledge the additional challenges faced by foreign filers, including the necessity of reconciling their financial statements with U.S. GAAP and the obligation to comply with the filing requirements of their home jurisdiction. However, since the adoption of Form 20-F, the SEC has implemented rule amendments that relieve foreign private issuers using International Financial Reporting Standards ("IFRS") of the responsibility of conforming to U.S. GAAP,[3] and many foreign jurisdictions have significantly shortened the timetables for foreign issuers' filings with their home securities regulator.

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United States, (ii) more than 50 percent of its assets are located in the United States, or (iii) its business is principally administered in the United States.

3 SEC Release Nos. 33-8879; 34-57026; International Series Release No. 1306; File no. S7-13-07, Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance with International Reporting Standards Without Reconciliation to U.S. GAAP (December 21, 2007), available at, http://www.sec.gov/rules/final/2007/33-8879.pdf; see our Firm Memorandum, *SEC Publishes Final Rules for Financial Disclosures of U.S.-Registered Foreign Companies*, December 26, 2007.

The SEC believes that these developments, together with technological advancements that make it easier for companies to process and disseminate information, permit a shortened filing period for FPIs. Accordingly, the SEC is proposing to change the due date for annual reports filed on Form 20-F to 90 days after an issuer's fiscal year-end for accelerated filers and 120 days for all others (after a two year transition period). These deadlines are still more lenient than those for domestic companies (60 and 75 days, respectively); however, this expedited filing schedule should still provide investors with more timely access to crucial information, thus improving the efficiency of the markets. Moreover, the SEC expects that in the next several years the majority of foreign filers will have independent incentives to use either U.S. GAAP or IFRS, thus mitigating concerns of some commentators that the additional costs and burdens of this rule change might discourage foreign issuers from accessing American capital markets or impair the ability of FPIs to file annual reports with their home regulators on a timely basis.

3. Segment Data Disclosure

Currently, FPIs that present financial statements that are otherwise in full compliance with U.S. GAAP are permitted to omit segment data from their statements. The SEC estimates that fewer than 10 FPIs currently avail themselves of this accommodation. This exemption is inconsistent with the recent decision to accept IFRS-compliant statements (which require segment data) without reconciliation to U.S. GAAP. Accordingly, the SEC is proposing to amend Form 20-F to eliminate this exception.

4. Exchange Act Rule 13e-3

Exchange Act Rule 13e-3 is triggered when an issuer engages in a transaction or series of transactions that have the effect of causing a class of equity securities to be held by less than 300 persons or to be neither listed on any national securities exchange nor authorized to be quoted on an inter-dealer quotation system; the rule is usually implicated when a public company is being taken private. The company is then required to make a number of disclosures — whether alternative means were considered, the reasons for the structure of the transaction, the effects on unaffiliated security holders, etc.

Recently, the SEC adopted amendments to the Exchange Act deregistration provisions in Rules 12g-4 and 12h-6 (applicable to both foreign and domestic issuers) that tie reporting obligations under the Exchange Act to a quantitative benchmark designed to measure U.S. market interest in the security.[4] The SEC believes it makes sense to link the rules governing go-

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[4] See our Firm Memorandum, SEC Eases De-registration Rules for Foreign Private Issuers**,** March 30, 2007. Rules 12g-4 and 12h-6 permit an FPI to delist its securities from trading on U.S. markets if its number of shareholders is less than 500 and its assets are less than $10 million for the last three fiscal years, or if the average daily trading volume of the subject class of securities has

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ing private transactions explicitly to the deregistration provisions found elsewhere in the Exchange Act and is proposing that Rule 13e-3 disclosures will be required if an FPI elects to deregister under Rule 12g-4 or 12h-6. The SEC believes that this rule proposal is consistent with the original objective of Rule 13e-3, which was to provide security holders a final opportunity to obtain information about a company which is going private, and consider their alternatives.

In soliciting comments on this particular aspect of the proposed amendments the SEC appears to recognize that amending Rule 13e-3 in this fashion might result in unintended consequences. Among the comments solicited, the SEC has asked whether this proposed amendment would result in more registrants being required to comply with Rule 13e-3 than intended. For example, the SEC asks whether the proposal would unnecessarily trigger Rule 13e-3 disclosures if FPIs engage in ordinary course securities transactions (such as buybacks or repurchases) which result in their becoming eligible to delist their securities under Rule 12g-4 or 12h-6. Because the criteria for delisting would seem to be indicative of FPIs with little U.S. investor interest, it would seem to be a burdensome expense to require such an FPI to make the disclosures required by Rule 13e-3 when balanced against whatever investor protections might be achieved with a respect to a company that is not being followed by many U.S. investors. We expect that this proposal will be commented on extensively.

5. Requiring Item 18 Reconciliation in Annual Reports and Registration Statements Filed on Form 20-F

Currently, the disclosures required for FPIs that have not conducted a public offering (Form 20-F, Item 17) are less comprehensive than those otherwise required (Item 18). In short, Item 18 requires a series of footnote disclosures required by U.S. GAAP and Regulation S-X. The SEC is proposing to eliminate this distinction and require that all FPIs whose reports do not comply with U.S. GAAP or IFRS provide financial information pursuant to Item 18. The SEC notes that a majority of FPIs who do not comply with U.S. GAAP already choose to make the disclosures required in Item 18. Further, the SEC does not believe there is a clear conceptual reason as to why these disclosures would be required in one case but not another, given that all investors would benefit from the availability of this information, and the cost to FPIs would be minimal. The SEC is proposing that these rules not extend to Canadian MJDS filers (who currently have the option of utilizing Item 17). The SEC is also proposing a one year grace period to allow affected FPIs to transition to the new requirements.

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not been greater than 5% of the average daily trading volume of that class of securities in the FPI's primary trading market during a recent 12 month period, regardless of the size of its U.S. public float.

6. Disclosure about Changes in a Registrant's Certifying Accountant

Domestic companies are required to report any changes in, and disagreements with, their certifying accountant in a current report on Form 8-K, and in registration statements filed under the Exchange Act (Form 10) and the Securities Act of 1933 (the "Securities Act") (Forms S-1 and S-4). The SEC states that the primary benefit of this requirement is to reduce the potential for opinion shopping; that is, searching for an auditor that is willing to support a particular accounting approach. In spite of the fact that the need for this type of disclosure should be equally compelling for both foreign and domestic issuers, FPIs are not subject to such a requirement.

The SEC is proposing changes that would bring the requirements for FPI disclosures about changes in certifying accountants in line with those for domestic companies. The proposal would amend Form 20-F (and initial registration Forms F-1 and F-4) by adding an Item 16F that would require a variety of disclosures, including: whether a previously engaged independent accountant has resigned, declined to stand for re-election, or was dismissed; whether during the fiscal year during which the change of accountant took place there were material transactions which led to disagreements with the former accountants; and, if there were such material transactions, what the effect on the financial statements would have been had the previous accountant's method been followed. Item 16F would be virtually identical to the provisions covering domestic companies,[5] with the exception of a number of date modifications necessary because the disclosures will be made on an annual basis, rather than on a current basis.

7. Annual Disclosure about American Depositary Receipt Fees and Payments

Foreign private issuers are required to disclose fees paid to depositaries with respect to American Depositary Receipts ("ADRs") on Form 20-F when used for Exchange Act registration, but not when such Form is used for an annual report. The SEC is proposing to revise Form 20-F to require disclosure of these fees (or other payments made to depositaries) on an annual basis. The SEC believes that these fees are likely to be passed along to ADR holders; moreover, many depositaries are now charging an annual fee for general depositary services, a practice which until recently was prohibited by some exchanges.

8. Disclosure about Differences in Corporate Governance Practices

As a consequence of being subject to different legal and regulatory requirements in their home jurisdiction, foreign companies can be expected to follow different corporate gov-

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5 These types of disclosures by domestic issuers are required by Item 4.01 of Form 8-K and Item 304(a) of Regulation S-K.

ernance practices than their domestic counterparts. Acknowledging this, some American securities exchanges exempt FPIs from many of their corporate governance requirements. In lieu of complying with these obligations, FPIs delineate the significant differences between their corporate practices and those of domestic companies on their website and/or in their annual report. It is not uncommon for FPIs to disclose this information only on their website.

In the interest of protecting the ability of investors to monitor the corporate governance practices of a given issuer, the SEC is proposing to require disclosure of corporate governance policies in all Form 20-F annual reports filed by FPIs. The amendment would require a concise summary of the significant ways in which the FPIs' corporate governance practices differ from those of domestic companies listed on the same exchange.

9. Financial Information for Significant Completed Acquisitions

Currently, the Exchange Act and Securities Act only require that financial information for significant completed acquisitions be disclosed by an FPI in its registration statements. Domestic companies, on the other hand, are required to disclose data about significant business acquisitions no later than 71 calendar days after an initial Form 8-K filing reporting such a transaction.

The SEC is proposing to require that FPIs provide this information on a more consistent basis. As proposed, FPIs would provide financial information in their annual report on Form 20-F about highly significant acquisitions. This proposed rule differs in a number of ways from the regulations governing domestic companies. First, domestic companies are required to report such information currently on Form 8-K; FPIs will only report this information annually. Second, domestic companies are required to report financial information with respect to acquisitions at the 20% or greater level; FPIs will be required to report acquisitions at the 50% or greater level of significance. In addition, the SEC is not proposing to require financial information about probable acquisitions, or financial information for the aggregation of individually insignificant acquisitions.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or e-mail Jon Mark at (212) 701-3100 or jmark@cahill.com; or John Schuster at (212) 701-3323 or jschuster@cahill.com; Tafari Mbadiwe at (212) 701-3342 or tmbadiwe@cahill.com