FREQUENTLY ASKED QUESTIONS ABOUT FOREIGN PRIVATE ISSUERS

General

What are some benefits of becoming a public company in the United States?

Foreign companies realize a number of benefits by being a public company in the United States. These benefits include:

- increased visibility and prestige;
- ready access to the U.S. capital markets, which are still the largest and most liquid in the world;
- an enhanced ability to attract and retain key employees by offering them a share in the company's growth and success through equity-based compensation structures; and
- the ability to send credible signals to the market that the company will protect minority shareholder interests.

However, even with the renewed vigor of capital markets in the United States and to a lesser extent, globally, all companies face substantial obstacles to accessing capital in the United States. Even if a foreign company is able to raise capital publicly in the United States, becoming and remaining a U.S. public company is an expensive, time-consuming project that may require foreign companies to reorganize their operations and corporate governance in ways that such companies would not necessarily choose absent U.S. requirements.

What is a "foreign issuer"?

The federal securities laws define a "foreign issuer" 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.

Source: *See* Rule 405 ("Rule 405") of the Securities Act of 1933, as amended (the "Securities Act"), and Rule 3b-4(b) of the Securities Exchange Act of 1934, as amended (the "Exchange Act").

What is a "foreign private issuer"?

A "foreign private issuer" ("FPI") is any foreign issuer (other than a foreign government), unless:

- more than 50% of the issuer's outstanding voting securities are held directly or indirectly of record by residents of the United States; and
- any of the following applies:
  - the majority of the issuer's executive officers or directors are U.S. citizens or residents;

- more than 50% of the issuer's assets are located in the United States; <u>or</u>
- the issuer's business is administered principally in the United States.

A foreign company that obtains FPI status can avail itself of the benefits of FPI status immediately.

Source: Rule 405 under the Securities Act and Rule 3b-4(c) ("Rule 3b-4(c)") under the Exchange Act.

How is the percentage of an FPI's outstanding voting securities calculated for purposes of determining whether 50% or more are held of record by U.S. residents?

Methodology for Calculating Voting Securities. Securities held of record by a broker, dealer, bank, or nominee for the accounts of customers residing in the United States are counted as held in the United States by the number of separate accounts for which the securities are held. In addition, a foreign issuer also must treat as owned of record by U.S. residents any shares reported as beneficially owned by a U.S. resident in a filing made under Section 13(d) of the Exchange Act or any comparable reporting provision of another country. This method of calculating record ownership differs from the method a U.S. domestic issuer is permitted to use in its determination of the number of record owners for purposes of Section 12(g) of the Exchange Act, which counts only record owners and not beneficial owners holding securities in street name.

Source: Rule 12g3-2(a) under the Exchange Act.

A foreign issuer that maintains multiple voting classes may use one of two methods to determine whether more than 50% of its voting stock is held by U.S. residents by assessing: (1) whether 50% of the voting power of those classes on a combined basis is directly or indirectly owned of record by residents of the United States; or (2) the number of voting securities. While the Securities and Exchange Commission's (the "SEC") Division of Corporation Finance (the "SEC Staff") has not expressed a preference for either methodology, it has affirmed that a foreign issuer must apply a determination methodology on a consistent basis.

Source: Securities Act Rules C&DIs, Question No. 203.17; Exchange Act Rules C&DIs, Question No. 110.02.

Evaluating U.S. Residency. While a person who has permanent resident status (*i.e.*, a Green Card holder) is presumed to be a U.S. resident, the SEC Staff has explained that individuals without permanent resident status may also be deemed U.S. residents (for purposes of Rule 405 and Rule 3b-4(c)) based on the following criteria:

- tax residency;
- nationality;
- mailing address;
- physical presence;
- the location of a significant portion of the person's financial and legal relationships; or
- immigration status.

While the SEC Staff has not mandated use of any one of these criteria, it has asserted that a foreign issuer must nevertheless decide which criteria it will use to determine residency and apply them consistently.

Source: Securities Act Rules C&DIs, Question No. 203.18; Exchange Act Rules C&DIs, Question No. 110.03.

How can a foreign issuer assess whether its executive officers or directors are U.S. citizens or residents?

For purposes of determining whether a majority of a foreign issuer's executive officers or directors are U.S.

residents or citizens under Rule 405 and Rule 3b-4(c), the SEC Staff has clarified that the calculation must be made separately for each of its directors and officers. Accordingly, a foreign issuer must make the following four determinations under Rule 405 and Rule 3b-4(c):

- the citizenship status of its executive officers;
- the residency status of its executive officers;
- the citizenship status of its directors; and
- the residency status of its directors.

In the case of a foreign issuer that maintains two boards of directors, the foreign issuer must make the "majority" analysis with respect to the board of directors that performs functions that most closely resemble those undertaken by a U.S.-style board of directors. If such functions are allocated to both boards, then the foreign issuer may aggregate the members of both boards for purposes of the calculation.

Source: Securities Act Rules C&DIs, Question Nos. 203.19 and 203.20; Exchange Act Rules C&DIs, Question Nos. 110.04 and 110.05.

How can a foreign issuer determine whether a majority of its assets are located in the United States?

To determine whether more than 50% of a foreign issuer's assets are located in the United States, the SEC Staff has clarified that a foreign issuer may either:

- use the geographic segment information determined in the preparation of its financial statements; or
- apply on a consistent basis any other reasonable methodology in assessing the location and amount of its assets.

Source: Securities Act Rules C&DIs, Question No. 203.21; Exchange Act Rules C&DIs, Question No. 110.06.

How can a foreign issuer determine whether its business is administered principally in the United States?

There is no particular factor that is determinative for evaluating whether a foreign issuer's business is administered principally in the United States under Rule 405 and Rule 3b-4(c). Instead, a foreign issuer must assess on a consolidated basis the location from which its officers, partners or managers primarily direct, control and coordinate its activities.

For example, absent any other factors, an issuer that holds an annual (or special) meeting of its shareholders or occasional meetings of its board of directors in the United States would not be deemed to be administering its business principally in the United States.

Source: Securities Act Rules C&DIs, Question Nos. 203.22 and 203.23; Exchange Act Rules C&DIs, Question Nos. 110.07 and 110.08.

How often must a foreign issuer review its status as an FPI?

An FPI must determine its status on the last business day of its most recently completed second fiscal quarter. If an FPI no longer satisfies the FPI requirements, it will become subject to U.S. domestic reporting requirements on the first day of its fiscal year immediately succeeding such determination. This allows an FPI about six months' advance notice to prepare the necessary materials to comply with these domestic reporting requirements.

Source: Rule 3b-4(c) under the Exchange Act.

Can an FPI qualify as an emerging growth company?

Yes. Title I of the Jumpstart Our Business Startups Act (the "JOBS Act"), adopted in April 2012, establishes a new category of issuer called an emerging growth company ("EGC"). An EGC is defined as an issuer with total gross revenues of under $1.07 billion (adjusted from $1 billion in March 2017, and subject to inflationary adjustment by the SEC every five years) during its most recently completed fiscal year. A company remains an EGC until the earlier of five years or:

- the last day of the fiscal year during which the issuer has total annual gross revenues in excess of $1.07 billion (subject to inflationary indexing);
- the last day of the issuer's fiscal year following the fifth anniversary of the date of the first sale of common equity securities of the issuer pursuant to an effective registration statement under the Securities Act;
- the date on which such issuer has, during the prior three-year period, issued more than $1 billion in nonconvertible debt; or
- the date on which the issuer is deemed a "large accelerated filer."

How is gross revenue calculated for purposes of determining whether an FPI qualifies as an EGC?

As noted above, an FPI can qualify to be treated as an EGC if it has total gross revenues of under $1.07 billion during its most recently completed fiscal year. The phrase "total annual gross revenues" means total revenues as presented on the income statement under U.S. Generally Accepted Accounting Principles ("U.S. GAAP") or IFRS as issued by the IASB (each as defined below), if used as the basis of reporting by an FPI). If the financial statements of an FPI are presented in a currency other than U.S. dollars, total annual gross revenues for purposes of determining whether an FPI is an EGC should be calculated in U.S. dollars using the exchange rate as of the last day of the most recently completed fiscal year.

May an already public FPI qualify to be treated as an EGC?

Under Title I of the JOBS Act, an FPI may not qualify as an EGC "if the first sale of common equity securities of such issuer pursuant to an effective registration statement under the Securities Act occurred on or before December 8, 2011." According to the SEC, the phrase "first sale of common equity securities" in the JOBS Act is not limited to a company's initial primary offering of common equity securities for cash, and may also include offering common equity pursuant to an employee benefit plan (for example, pursuant to Form S-8), as well as a selling shareholder's secondary offering on a resale registration statement.

If an FPI had a registration statement declared effective on or before December 8, 2011, it can qualify as an EGC (provided the other requirements of the definition are satisfied) so long as the first *sale* of common equity securities occurs *after* December 8, 2011. An FPI that is a public company outside of the United States may also qualify as an EGC provided it meets the EGC requirements set forth above.

How does an FPI become subject to U.S. reporting requirements?

An FPI will be subject to the reporting requirements under U.S. federal securities laws if:

- it registers with the SEC the public offer and sale of its securities under the Securities Act;
- it lists a class of its securities, either equity or debt, on a U.S. national securities exchange, *e.g.*, the Nasdaq Stock Market ("Nasdaq") or the New York Stock Exchange (the "NYSE"); or
- within 120 days after the last day of its first fiscal year in which the issuer had total assets that exceed $10 million and a class of equity securities held of record by either: (1) 2,000 or more persons or (2) 500 persons who are not accredited investors in the United States (or, in the case of an FPI that is a bank holding company or a savings and loan holding company, if it had total assets that exceeded $10 million and a class of equity securities held of record by either 2,000 or more persons). However, an FPI may also deregister more easily than a domestic issuer. *See "How can an FPI deregister a particular class of securities?"*

Source: Section 12(g) of the Securities Act.

What accommodations under the federal securities laws and the rules of U.S. national securities exchanges are available to an FPI that are not available to U.S. domestic issuers?

An FPI receives certain regulatory concessions compared to those received by U.S. domestic issuers, including:

- *Annual Report Filings*: An FPI must file an Annual Report on Form 20-F within four months after the fiscal year covered by the report. By contrast, a domestic issuer must file an Annual Report on Form 10-K between 60 and 90 days following the end of its fiscal year, depending on its capitalization and other factors. However, *see "What are the requirements for the age of financial statements in connection with an offering or listing?"*
- *Quarterly Financial Reports*: An FPI is not required under U.S. federal securities laws to file or make public quarterly financial information, subject to certain exceptions. Companies with a class of securities listed on the NYSE must submit semi-annual unaudited financial information under cover of a Form 6-K within six months following the end of the second fiscal quarter. By contrast, U.S. domestic issuers are required to file unaudited financial information on Quarterly Reports on Form 10-Q.
- *Proxy Solicitations*: An FPI is not required under U.S. federal securities laws or the rules of the U.S. national securities exchanges to file proxy solicitation materials on Schedule 14A or 14C in connection with annual or special meetings of its securityholders.
- *Audit Committee:* There are numerous accommodations to the nature and composition of an FPI's audit committee or permitted alternative. *See "Under what circumstances may an FPI follow its home-country rules regarding corporate governance practices?—*Audit Committees."
- *Internal Control Reporting*: Both an FPI and a U.S. domestic issuer must annually assess their internal control over financial reporting and in many instances provide an independent auditor's audit of such internal control. However, U.S. domestic issuers are also

obligated on a quarterly basis to, among other matters, assess changes in their internal control over financial reporting.

- *Executive Compensation*: An FPI is exempt from the detailed disclosure requirements regarding individual executive compensation and compensation philosophy and analysis now required by the SEC. An FPI is required to make certain disclosures regarding executive compensation on an individual basis unless it is not required to do so under home-country laws and the information is not otherwise publicly disclosed by the FPI. In addition, an FPI must file as exhibits to its public filings individual management contracts and compensatory plans if required by its home-country regulations or if it previously disclosed such documents.
- *Directors/Officers Equity Holdings*: Directors and officers of an FPI do not have to report their equity holdings and transactions under Section 16 of the Exchange Act, subject to certain exceptions. However, shareholders, including directors and officers, may have filing obligations under Section 13(d) of the Exchange Act. *See* "*Are officers, directors and shareholders of an FPI subject to the short-swing provisions of Section 16 of the Exchange Act?*" and "*Are directors, officers and beneficial owners of an FPI subject to the disclosure requirements of Section 13 of the Exchange Act?*"
- *IFRS-No U.S. GAAP Reconciliation*: An FPI may prepare its financial statements in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") without reconciliation to U.S. GAAP.
- *Confidential Submissions for Certain Foreign Issuers*: Certain foreign issuers that are registering for the first time with the SEC may submit their registration statements on a confidential basis to the SEC Staff. *See* "*Under what circumstances may an FPI confidentially submit its initial registration statement?*"
- *Exemption from Exchange Act Reporting*: An FPI may be automatically exempt from Exchange Act reporting obligations if the FPI satisfies certain conditions.

Source: Rule 12g3-2(b) of the Exchange Act.

- *Easy Termination of Registration/Deregistration*: An FPI, regardless of the number of its U.S. securityholders, may terminate its registration of equity securities under the Exchange Act and cease filing reports with the SEC, subject to certain conditions. This rule allows a U.S.-listed FPI to exit the U.S. capital markets with relative ease and terminate its reporting duties under Section 15(d) of the Exchange Act.

Source: Rule 12h-6 of the Exchange Act.

Under what circumstances may an FPI confidentially submit its initial registration statement?

In its guidance from December 2011 that was updated in May 2012, the SEC Staff announced that it had revised its confidential filing policy afforded to FPIs and would review initial registration statements of a foreign issuer on a confidential basis only if such issuer is:

- a foreign government registering its debt securities;

- an FPI that is listed or is concurrently listing its securities on a non-U.S. securities exchange;
- an FPI that is being privatized by a foreign government; or
- an FPI that can demonstrate that the public filing of an initial registration statement would conflict with the laws of an applicable foreign jurisdiction.

Foreign issuers that are shell companies, blank-check companies and issuers with no, or substantially no, business operations are not permitted to confidentially submit their initial registration statements. In addition, the SEC Staff has stated that there may be circumstances in which the Staff will request that a foreign issuer publicly file its registration statement even though it comes within the general parameters of the policy. Examples of these circumstances include a competing bid in an acquisition transaction or publicity about a proposed offering or listing.

Throughout 2012, the SEC sought to harmonize the confidential submission process for FPIs and EGCs. Since October 2012, both FPIs and EGCs are required to submit draft registration statements and response letters to Staff comments through the SEC's Electronic Data-Gathering, Analysis, and Retrieval system, or EDGAR. When the FPI or EGC publicly files its registration statement, all previously submitted draft registration statements will become publicly available and all Staff comment letters and issuer response letters will be posted on EDGAR in accordance with Staff policy. However, unless the FPI is seeking to be treated as an EGC, it will not be required to publicly file its registration statement (and the prior confidential submissions) at least 15 days before commencement of the road show for the offering as that timing is only required for EGCs.

Source: Non-Public Submissions from Foreign Private Issuers, December 8, 2011, as amended May 30, 2012, available at https://www.sec.gov/divisions/corpfin/internatl/nonpublicsubmissions.htm and Draft Registration Statements Required to Be Submitted and Filed Using EDGAR Beginning October 15, 2012, available at https://www.sec.gov/divisions/corpfin/cfannouncements/drsfilingprocedures101512.htm. *See also* Jumpstart Our Business Startups Act Frequently Asked Questions, Generally Applicable Questions on Title I of the JOBS Act, available at https://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-title-i-general.htm (hereinafter, the "JOBS Act FAQs").

Can an FPI take advantage of the confidential filing policy, as well as the disclosure exemptions available to EGCs, under the JOBS Act?

No. An FPI may only avail itself of disclosure accommodations available under the JOBS Act if it elects to be treated as an EGC. If an FPI does not or cannot take advantage of the benefits afforded to EGCs, then an FPI must follow the SEC's revised limited confidential filing policy applicable to FPIs. *See "How does the JOBS Act affect an FPI engaged in a public offering?"* and *"Under what circumstances may an FPI confidentially submit its initial registration statement?"*

Source: JOBS Act FAQs, available at https://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-title-i-general.htm.

Are there other confidential submission alternatives for FPIs?

In June 2017, the SEC Staff announced a new policy to make the confidential submission process for registration statements more broadly available. Since July 10, 2017, all companies, including FPIs and Canadian issuers that rely on the Multijurisdictional Disclosure System, may submit draft IPO registration statements for confidential review. FPIs may elect to benefit from this new guidance, the procedures available to EGCs (if they so qualify) or the SEC Staff guidance issued in May 2012, which is discussed above.

As is the case for EGC IPO issuers, any issuer that avails itself of the confidential submission process for its IPO must publicly file its registration statement at least 15 days before the date on which the issuer conducts a road show. An FPI that relies on the accommodations available to EGCs or on this new policy will have to comply with the requirement to file publicly at least 15 days prior to commencement of its roadshow, which would not apply under the SEC Staff's May 2012 guidance. The SEC did not extend any of the other JOBS Act benefits (*i.e.*, the ability to test the waters or reduced disclosure requirements) to non-EGC IPO issuers. However, the new policy does permit an IPO issuer to omit financial information that the issuer reasonably believes will not be required at the time that the registration statement is publicly filed.

The SEC also extended the ability to make confidential submissions for EGCs and other issuers in connection with offerings undertaken within the first twelve months after the issuer has become an SEC-reporting company. In the case of a follow-on offering within the first twelve months following the effective date of the IPO or a Section 12(b) registration statement, the issuer must file publicly at least 48 hours prior to any requested effective time and date. An issuer relying on the confidential submission process for follow-on offerings cannot file amendments on a confidential basis, it can only make the first submission of the follow-on registration statement on a confidential basis.

Finally, the SEC Staff also will permit an issuer to submit for confidential review a registration statement filed to register a class of securities under the Exchange Act, such as a registration statement on Form 20-F for an FPI. An issuer must publicly file an Exchange Act registration statement at least 15 days prior to seeking its effectiveness.

Going Public in the United States

How does an FPI offer its securities publicly in the United States?

An FPI seeking to raise capital in the United States publicly for the first time must register its shares on Form F-1. A registration statement on Form F-1 is similar to a Form S-1 filed by U.S. domestic issuers and requires extensive disclosure about the FPI's business and operations. Certain Canadian issuers, on the other hand, may take advantage of the Multijurisdictional Disclosure System ("MJDS"), which allows a shorter form of disclosure and incorporation by reference to Canadian disclosures. These FAQs generally do not address MJDS concerns. *See* our Frequently Asked Questions About The Multijurisdictional Disclosure System ("MJDS"), available at

https://media2.mofo.com/documents/faqs-multijurisdictional-disclosure-system.pdf.

What kind of securities may an FPI register in the United States?

An FPI may offer any type of securities that a U.S. domestic issuer is permitted to offer. In addition, an FPI may offer its securities using American Depositary Receipts ("ADRs"). *See "What is an American Depositary Receipt?"*

Is a "short-form" registration statement available for a public offering by an FPI?

Yes. Once an FPI has been subject to the U.S. reporting requirements for at least 12 calendar months, it may use Form F-3 to offer securities publicly in the United States. Form F-3 is a short-form registration statement (analogous to Form S-3 for U.S. domestic issuers) and may be used by an FPI if the FPI meets both the form's registrant requirements and the applicable transaction requirements. Form F-3 permits an FPI to disclose minimal information in the prospectus included in the Form F-3 by incorporating by reference the more extensive disclosures already filed with the SEC under the Exchange Act, primarily in the FPI's most recent Annual Report on Form 20-F and its Forms 6-K. *See "Which Exchange Act filings are a registered FPI required to make with the SEC?"* The scope of the prospectus will generally depend on marketing needs as determined by the FPI and its investment bankers.

Under the registrant requirements of Form F-3, to be eligible to file a Form F-3, an FPI must:

- have filed at least one Annual Report on Form 20-F or Form 10-K under the Exchange Act, and either: (1) have a class of securities registered pursuant to Section 12(b) or Section 2(g) of the Exchange Act or (2) otherwise be required to file reports pursuant to Section 15(d) of the Exchange Act;
- have been subject to the requirements of Section 12 or Section 15(d) of the Exchange Act, have filed all the materials required to be filed pursuant to Sections 13, 14, or 15(d) of the Exchange Act for a period of at least 12 calendar months immediately prior to the filing of the Form F-3, and have filed in a timely manner all reports required to be filed during the 12 calendar months and any portion of a month prior to the filing of the Form F-3; and
- have not, nor may any of its subsidiaries have, since the end of its last fiscal year for which certified financial statements have been included in a report under the Exchange Act, failed to pay a dividend or sinking fund payment on preferred stock, or defaulted on any payment of indebtedness or on any rental on one or more long-term leases, which defaults in the aggregate are material to the financial position of the FPI and its subsidiaries, taken as a whole.

An FPI that meets the registrant requirements of Form F-3 must also satisfy at least one of the following transactional requirements with respect to the securities offered:

- The securities are offered for cash by or on behalf of the FPI, and the FPI's worldwide public float equals $75 million or more.
- The securities are nonconvertible securities, other than common equity, that are offered for cash by or on behalf of the FPI, provided that the FPI:

- has issued (as of a date within 60 days prior to the filing of the Form F-3) at least $1 billion in nonconvertible securities, other than common equity, in primary offerings for cash, not exchange, registered under the Securities Act, over the prior three years;
- has outstanding (as of a date within 60 days prior to the filing of the Form F-3) at least $750 million of nonconvertible securities, other than common equity, issued in primary offerings for cash, not exchange, registered under the Securities Act;
- is a wholly owned subsidiary of a well-known seasoned issuer ("WKSI");
- is a majority-owned operating partnership of a real estate investment trust that qualifies as a WKSI; or
- discloses in the registration statement that it has a reasonable belief that it would have been eligible to use Form F-3 as of September 1, 2011 because it is registering a primary offering of nonconvertible investment-grade securities, discloses the basis for such belief, and files a final prospectus for an offering pursuant to such registration statement on Form F-3 on or before September 2, 2014.

- The securities are offered for the account of any person other than the FPI.
- The securities are offered: (1) upon the exercise of outstanding rights granted by the issuer of the securities to be offered, subject to certain conditions; (2) pursuant to a dividend or interest reinvestment plan, or upon conversion of outstanding convertible securities; or (3) upon the conversion of outstanding convertible securities or upon the exercise of outstanding transferable warrants issued by the FPI, or an affiliate of the FPI.
- The securities are offered for cash by or on behalf of the FPI whose worldwide public float is less than $75 million, provided that: (1) the FPI does not sell more than the equivalent of one-third of its worldwide public float in primary offerings over a period of 12 calendar months; (2) the FPI is not a shell company and has not been a shell company for at least 12 calendar months prior to filing the registration statement; and (3) the FPI has at least one class of common equity securities listed and registered on a national securities exchange that is registered under the Exchange Act.

Source: Form F-3, General Instruction I.

What are the requirements for the age of financial statements in connection with an offering or listing?

An FPI has four months to file a Form 20-F as an annual report. However, if the Form 20-F is to be used as a registration statement in connection with a listing of an FPI's securities or if the financial statements in the Form 20-F are to be incorporated by reference in a Form F-3 for an offering, in most cases the last year of audited financial statement may not be older than

15 months at the time of the offering or listing (defined as the time when the registration statement is declared effective). The impact of this requirement is to push an FPI to file its Form 20-F within three months of the end of its fiscal year rather than four months, particularly if the FPI is engaged in frequent or continuous offerings of its securities, as it would be precluded from using its shelf registration statement for 30 days.[1] Further, for issuers with affiliated broker-dealers, market-making resales of the issuer's securities by those dealers would no longer be registered. In the view of the SEC, the Section 4(a)(3) exemption is not available for market-making resales of an issuer's securities by an affiliated broker-dealer.

In addition, if the relevant document (which excludes an annual report on Form 20-F) is dated more than nine months after the end of the last audited financial year, it should contain consolidated interim financial statements, which may be unaudited, covering at least the first six months of the financial year.

Source: Form 20-F, Items 8.A.4 and 8.A.5; Exchange Act Forms C&DIs, Question No. 110.05.

[1]For offerings of securities (a) upon the exercise of outstanding rights granted by the issuer of the securities to be offered, if the rights are granted pro rata to all existing securityholders of the class of securities to which the rights attach; or (b) pursuant to a dividend or interest reinvestment plan; or (c) upon the conversion of outstanding convertible securities or upon the exercise of outstanding transferable warrants issued by the issuer of the securities to be offered, or by an affiliate of that issuer, the 15-month period is extended to 18 months and the interim financial statements shall be as of a date within 12 months of the date of the document. The provisions of this paragraph are not applicable if securities are to be offered or sold in a standby underwriting in the United States or similar arrangement.

How does the JOBS Act affect an FPI engaged in a public offering?

The JOBS Act seeks to ease many of the regulatory burdens imposed on smaller companies that are considering, or are in the process of, going public through an IPO. For FPIs that are EGCs, the JOBS Act allows for a streamlined IPO "on-ramp" process in order to phase-in some of the more comprehensive and costly disclosure requirements. For instance, an EGC has the option to do the following:

- *Confidential Submissions*: An EGC is permitted to submit a draft registration statement on Form 20-F or Form F-1, as well as any amendments, to the SEC for confidential, nonpublic review prior to the public filing, provided that the initial confidential submissions and all amendments are filed with the SEC no later than 15 days prior to the issuer's commencement of the road show (note: this 15-day period is not required under the SEC's confidential filing policy solely applicable to FPIs).
- *Testing-the-Waters*: An EGC is permitted to engage in oral or written communications with qualified institutional buyers, or QIBs, and institutional accredited investors in order to gauge their interest in a proposed IPO, either prior to or following the initial filing of the IPO registration statement.
- *Research Report*: A broker-dealer is permitted to publish or distribute a research report about an EGC that it proposes to register or that is in registration. The research report will not be deemed an "offer" under the Securities Act regardless of whether the broker-dealer

intends on participating, or is currently participating, in the offering.

- *Audited Financials*: An EGC is required to present only two years of audited financial statements (as opposed to three years) in connection with its IPO registration statement. In any other registration statement or periodic report, an EGC need not include financial information within its selected financial data or in its Management Discussion and Analysis disclosure for periods prior to those presented in its IPO registration statement.
- *Auditor Attestation Report on Internal Control*: An EGC is exempt from the requirement to obtain an attestation report on internal control over financial reporting from its registered public accounting firm.

While the JOBS Act does not explicitly allow an FPI that is an EGC to take advantage of the disclosure accommodations, in the SEC Staff's JOBS Act FAQs, the Staff stated that it will not object to an FPI that opts to take advantage of such exemptions, provided that it qualifies as an EGC.

May an FPI and its non-FPI subsidiary use an F-Series registration statement to register an offering of securities by the non-FPI subsidiary where the FPI guarantees the securities?

Yes. Where an FPI guarantees securities of its non-FPI subsidiary, the parent FPI (as guarantor) and non-FPI subsidiary (as issuer) may use an F-Series registration statement to register the offering of the securities under the Securities Act and use Form 20-F with respect to any reporting obligations, as long as certain requirements are satisfied.

Where the parent-guarantor and subsidiary-issuer are eligible to present condensed consolidated financial information in the parent-guarantor's filings, and the parent qualifies as an FPI, the parent-guarantor and its subsidiaries may use:

- an F-Series registration statement to register an offering of guarantees and guaranteed securities that are issued by a subsidiary (either domestic or foreign) that does not itself qualify as an FPI; and
- a Form 20-F with respect to any reporting obligations associated with the F-Series registration statement.

The subsidiary-issuer would not be required to submit separate financial statements if any of Rules 3-10(b) through 3-10(d) under Regulation S-X apply and all other applicable conditions of the rule(s) are satisfied by the parent-FPI's filings (as guarantor). The SEC Staff has further explained that the same would apply in the case of a parent-guarantor and subsidiary-issuer that were eligible to present narrative disclosures (as opposed to condensed consolidating financial information) under Rule 3-10 under Regulation S-X.

Source: Securities Act Forms C&DIs, Question No. 102.03; Exchange Act Forms C&DIs, Question No. 110.03.

May an FPI and its non-FPI subsidiary use an F-Series registration statement to register an offering of securities by the FPI-parent, which are guaranteed (or co-issued) by one or more of the FPI's non-FPI subsidiaries?

Yes. Where a parent-FPI issues securities that are guaranteed (or co-issued) by one or more of its non-FPI subsidiaries, the parent FPI and subsidiary guarantor(s) (or co-issuers) may still use an F-Series registration statement to register the offering under the Securities Act and use Form 20-F with respect to reporting obligations. Separate financial statements will not be required to be filed for the parent's subsidiaries if:

- Rule 3-10(e) or 3-10(f) under Regulation S-X applies; and
- all applicable conditions of Rule 3-10 under Regulation S-X relied upon are satisfied in the parent's filings.

Source: Securities Act Forms C&DIs, Question No. 102.04; Exchange Act Forms C&DIs, Question No. 110.04.

Are there any state laws that may affect an FPI engaged in an offering in the United States?

Possibly. U.S. federal securities laws preempt the operation of individual state securities laws and regulations, known as "blue sky" laws, during the offer and sale of "covered securities." "Covered securities" include, but are not limited to, securities that are listed on a national securities exchange, such as the NYSE or Nasdaq, and securities offered in an offering exempt from the registration requirements under certain regulations under the Securities Act (as set forth under Section 18 of the Securities Act). Therefore, offerings of "covered securities" will generally not be subject to state blue sky laws. Public offerings of noncovered securities and certain private transactions by an FPI, however, may still be subject to one or more state's applicable blue sky laws and regulations.

"Blue sky" laws vary from state to state and may offer different interpretations of similar provisions. For example, California takes an expansive approach to transactions that fall within the reach of its securities laws. Under California's blue sky laws, unless the securities are "covered securities," California jurisdiction attaches in the three following transaction types and, therefore, offers and sales must either be exempt transactions under California's requirements or satisfy California requirements:

- when an offer to sell is made in California;
- when an offer to buy is accepted in California; and
- when a security is delivered to a buyer in California or both its seller and its buyer are domiciled in California.

The State of New York differs significantly from other states with respect to the sale of securities within the state. As a general note, in addition to compliance with the applicable blue sky laws, an FPI must also be in compliance with applicable U.S. federal securities laws.

Source: Section 18 of the Securities Act.

Ongoing Reporting Obligations

Which Exchange Act filings are a registered FPI required to make with the SEC?

An FPI that has registered securities under Section 12(b) or 12(g) of the Exchange Act or is required to file under Section 15(d) of the Exchange Act (because it has recently completed a registered offering) is obligated to file the following Exchange Act reports with the SEC:

Annual Report on Form 20-F. Form 20-F is unique to an FPI and can be used as an Annual Report similar to a Form 10-K, filed by U.S. domestic issuers. The information required to be disclosed in a Form 20-F includes, but is not limited to, the following:

- operating results;
- liquidity and capital resources;
- trend information;
- off-balance sheet arrangements;
- consolidated statements and other financial information;
- significant business changes;
- selected financial data;
- risk factors;
- history and development of the registrant;
- business overview; and
- organizational structure.

A Form 20-F is also required to contain a description of the FPI's corporate governance and a statement regarding those corporate governance practices that conform to its home-country requirements and not those of the U.S. national securities exchanges on which its securities are listed. An FPI must also disclose information relating to changes in, and disagreements with, the FPI's certifying accountant, including a letter, which must be filed as an exhibit, from the former accountant stating whether it agrees with the statements furnished by the FPI and, if not, stating the respects in which it does not agree. An FPI may also be required to disclose specialized information. For example, an FPI must provide specified information if it, or any of its subsidiaries, are engaged in oil and gas operations that are material to business operation or financial position.

Following the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), an FPI that either directly, or indirectly, operates a mine in the United States is required to disclose certain specified information in its Form 20-F about mine health and safety, including any violations or orders issued under the U.S. Federal Mine Safety and Health Act of 1977. An FPI that operates directly or indirectly mines outside of the United States is not subject to the disclosure requirements with respect to such mines. However, to the extent mine safety issues relating to non-U.S. mines are material, disclosure may otherwise be required under the SEC Rules.

The Dodd-Frank Act also requires disclosure by domestic issuers and FPIs regarding "conflict materials" originating from the Democratic Republic of Congo or an adjoining country, and disclosures regarding payment made to U.S. or non-U.S. governments in connection with commercial development of oil, natural gas or minerals. Companies are required to provide conflict minerals disclosure on new Form SD. All affected companies are required to file the new form for each calendar year, regardless of their fiscal year end, no later than May 31 of the following year.

A Form 20-F may also be filed as a registration statement when an FPI is not engaged in a public offering of its securities, but is still required to be or chooses to be registered under the Exchange Act (for example, when it reaches the holder of record threshold under Section 12(g) of the Exchange Act, and there is no other exemption available); it is similar in purpose to a Form 10 for a U.S. domestic issuer. As discussed above under "*Are there other confidential submission alternatives for FPIs?*," an FPI may undertake a direct listing and list a class of its securities on a securities exchange without raising capital by filing a Form 20-F and becoming subject to the Exchange Act. Given the new SEC policy permitting issuers, including FPIs, to submit for confidential review a Form 20-F, it is now easier to undertake a direct listing.

An FPI that elects to become an EGC is permitted to avail itself of the relevant selected disclosure accommodations under the JOBS Act. *See "How does the JOBS Act affect foreign private issuers engaged in a public offering?"*

Source: Form 20-F.

Reports on Form 6-K. In addition to an Annual Report, an FPI must furnish Forms 6-K to the SEC from time to time. Generally, a Form 6-K contains information that is material to an investment decision in the securities of an FPI, and may include press releases, securityholder reports and other materials that an FPI publishes in its home country in accordance with home-market law or custom, as well as any other information that the FPI may want to make publicly available.

Reports on Form 6-K generally take the place of Quarterly Reports on Form 10-Q (which include financial reports) and Current Reports on Form 8-K (which include disclosure on material events) that U.S. domestic issuers are required to file. Unlike Form 10-Q or Form 8-K, there are no specific disclosures required by Form 6-K. Instead, an FPI must furnish under cover of Form 6-K information that it:

- makes or is required to make public pursuant to the laws of the jurisdiction of its domicile or the laws in the jurisdiction in which it is incorporated or organized;
- files or is required to file with a stock exchange on which its securities are traded and which was made public by that exchange; or
- distributes or is required to distribute to its securityholders.

Reports on Form 6-K must be furnished to the SEC promptly after the information is made public by an FPI, as required by the country of its domicile or under the laws of which it was incorporated or organized, or by a foreign securities exchange with which the FPI has filed the information. For many of the larger FPIs, the Forms 6-K that are filed with the SEC generally include similar types of information and are filed with the same frequency as Forms 10-Q and 8-K that are filed by U.S. domestic issuers.

Source: Form 6-K.

May an FPI incorporate by reference into its Form 20-F annual report information previously filed with the SEC?

Yes. An FPI may, pursuant to Rule 12b-23 under the Exchange Act ("Rule 12b-23"), incorporate by reference information previously filed with the SEC into any item of its Form 20-F annual report, subject to certain limitations set forth under Rule 12b-23. An FPI that elects to incorporate such information by reference must, however, identify with specificity the information that is being incorporated by reference.

Source: Exchange Act Forms C&DIs, Question No. 110.07.

May an FPI's wholly owned subsidiary omit certain information from its Form 20-F annual report?

Yes. An FPI's wholly owned subsidiary may omit certain information under General Instruction I(2) (to Form 10-K) from its Form 20-F annual report, as long as the registrant includes a prominent statement on the Form 20-F's cover page:

- that it satisfies the conditions set forth under General Instruction I(1)(a) and (b) to Form 10-K; and
- is therefore filing the Form 20-F with a reduced disclosure format.

Source: Exchange Act Forms C&DIs, Question No. 110.06.

What is the difference between information that is "filed" and information that is "furnished" for purposes of U.S. federal securities laws?

Certain types of information can be either "filed" with or "furnished" to the SEC. Information that is "filed" is subject to the liability provisions under Section 18 of the Exchange Act and is automatically incorporated by reference into the issuer's registration statement. Information that is "furnished" is not subject to Section 18 liability and is not automatically incorporated by reference into the registration statement.

Information provided in an FPI's Form 6-K is deemed "furnished" for purposes of U.S. federal securities laws, and is not automatically incorporated by reference into an FPI's registration statement on Form F-3. If an FPI wants to incorporate a Form 6-K into its F-3, it must specifically provide for its incorporation by reference in the registration statement and in any subsequently submitted Forms 6-K.

What financial information must an FPI disclose in its public filings?

An FPI is required to make significant disclosures regarding its financial condition under Items 8 and 18 of its Annual Reports on Form 20-F. Item 8 of Form 20-F sets forth the financial information that must be included, as well as the periods covered and the age of the financial statements. In addition, Item 8 obligates an FPI to disclose any legal or arbitration proceedings involving a third party that may have, or have recently had, a significant impact on the FPI's financial position or profitability, as well as any significant changes since the date of the annual financial statements (or since the date of the most recent interim financial statements).

Item 18 of Form 20-F addresses the requirements for an FPI's financial statements and accountants' certificates that must be furnished with the Form 20-F. Under Item 18 of Form 20-F, an FPI that presents its financial information on a basis other than U.S. GAAP or IFRS as issued by IASB must nevertheless provide all of the information required by U.S. GAAP and Regulation S-X. *See "Must an FPI prepare its financial statements in accordance with U.S. GAAP?"*

Effective for fiscal years ending on or after December 15, 2011, the SEC eliminated certain reconciliation disclosure accommodations formerly afforded to FPIs under Item 17 of Form 20-F so that an FPI reporting under its home country GAAP, other than those preparing financial statements under IFRS, is required to provide a reconciliation that includes the footnote disclosures required by U.S. GAAP and Regulation S-X.

Source: Form 20-F, Items 8, 17 and 18.

Must an FPI prepare its financial statements in accordance with U.S. GAAP?

No. An FPI that prepares its financial statements in accordance with the English language version of IFRS as issued by IASB in its filings with the SEC does not have to reconcile those financial statements with U.S. GAAP. This exemption from reconciliation to U.S. GAAP applies only to IFRS as issued by IASB and not to any other accounting practices. If reconciliation is required, under Item 17, an FPI must either: (1) provide a statement of cash flows that is prepared in accordance with U.S. GAAP or IAS No. 7; or (2) furnish, in a note to the financial statements, a quantified description of the material differences between cash or fund flows reported in the primary financial statements and cash flows that would be reported in a statement of cash flows prepared in accordance with U.S. GAAP.

The above U.S. GAAP reconciliations may not be necessary where the financial statement information is for either:

- a business an FPI has acquired or plans to acquire;
- a less-than-majority-owned investee; or
- a joint venture.

If the target's or less-than-majority-owned investee's financial information is not prepared in accordance with U.S. GAAP, then such target or investee must account for less than 30% of an FPI's assets or income in order to avoid U.S. GAAP reconciliation. If, however, the target's or less-than-majority-owned investee's financial information is prepared in accordance with IFRS as issued by IASB (even if the issuer's financial statements are not prepared in accordance with U.S. GAAP or IFRS as issued by IASB), the FPI is not obligated to reconcile such financial statements with U.S. GAAP, regardless of the significance of the entity to the FPI's operations.

In the case of a joint venture, if an FPI prepares financial statements on a basis of accounting, other than U.S. GAAP, that allows proportionate consolidation for investments in joint ventures that would be accounted for under the equity method pursuant to U.S. GAAP, it may omit differences in classification or display that result from using proportionate consolidation in the reconciliation to U.S. GAAP. In order to avail itself of such omissions, the joint venture must be an operating entity, the significant financial operating policies of which are, by contractual arrangement, jointly controlled by all parties having an equity interest in the entity. Financial statements that are presented using proportionate consolidation must provide summarized balance sheet and income statement information and summarized cash flow information resulting from operating, financing and investing activities relating to its pro rata interest in the joint venture.

Item 18 of Form 20-F requires that an issuer provide all information required by U.S. GAAP and Regulation S-X, as well as the reconciling information for line items specified in Item 17(c) of Form 20-F. However, Item 18(b) of Form 20-F grants a limited exemption to the reconciliation requirement:

- for any period in which net income has not been presented on a basis as reconciled to U.S. GAAP;
- for the financial statements provided pursuant to Rule 3-05 of Regulation S-X in connection with a business acquired or to be acquired; or
- for the financial statements of a less-than-majority-owned investee.

Effective for fiscal years ending on or after December 15, 2011, compliance with Item 18 rather than Item 17 will be required for all issuer financial statements in all Securities Act registration statements, Exchange Act registration statements on Form 20-F, and Annual Reports on Form 20-F. Item 17 compliance will still be permitted for non-issuer financial statements such as those pursuant to Rules 3-05, 3-09, 3-10(i) and 3-14 of Regulation S-X, as well as non-issuer target company financial statements included in Forms F-4 and proxy statements. Item 17 will also continue to be permitted for pro forma information pursuant to Article 11 of Regulation S-X.

Source: Form 20-F, Items 17 and 18; SEC Release No. 33-8959.

What other financial disclosures must an FPI make in its Annual Report on Form 20-F?

Non-U.S filers reporting under U.S. GAAP are required to include in their Form 20-F their financial statements in an interactive data format based on eXtensible Business Reporting Language, or XBRL. In March 2017, the SEC made available an XBRL taxonomy for IFRS financial statements. As a result of the availability of the taxonomy, FPIs that prepare their financial statements under IFRS as issued by the IASB must file their financial statements in XBRL for fiscal years ending on or after December 15, 2017.

Source: Form 20-F, Instruction as to Exhibits Item 101 and Release Nos. 33-9002; 34-59324; 39-2461; IC-28609.

Must officers of an FPI certify reports filed with the SEC?

Yes. The principal executive officer(s) and the principal financial officer(s) (or persons performing similar functions) of an FPI are obligated to make certain certifications in a company's periodic reports. These certifications must be included in an FPI's Form 20-F. Other reports filed or furnished by an FPI, such as reports on Form 6-K, are not subject to the certification requirements because they are not considered "periodic" (unlike, for example, a Form 10-Q) and not made in connection with any securities offerings. Form 20-F requires the following certifications (although certain of the certifications with respect to internal control over financial reporting are not made until the issuer has been a reporting company for at least a year):

- the signing officer has reviewed the report of the issuer;
- based on the officer's knowledge, the report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by the report;
- based on the officer's knowledge, the financial statements, and other financial information included in the report, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in the report;
- the issuer's other certifying officer(s) and the signing officer are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the issuer and have:
  - designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under their supervision, to ensure that material information relating to the issuer, including its consolidated subsidiaries, is made

known to such officers by others within those entities, particularly during the period in which the report is being prepared;

  - designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - evaluated the effectiveness of the issuer's disclosure controls and procedures and presented in the report their conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by the report based on such evaluation; and
  - disclosed in the report any change in the issuer's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting; and

- the registrant's certifying officer(s) and the signing officer have disclosed, based on their most recent evaluation of internal control over financial reporting, to the issuer's auditors and the audit committee of the issuer's board of directors (or persons performing the equivalent functions):
  - all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting that are reasonably likely to adversely affect the issuer's ability to record, process, summarize and report financial information; and
  - any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal control over financial reporting.

Source: Form 20-F, Instruction 12; Rule 13a-14(a) of the Exchange Act.

Is an FPI subject to the internal control certification requirements of the Exchange Act?

Yes, but not immediately. An FPI's obligation to comply with the internal control certification requirements does not begin until it is either required to file an annual report pursuant to Section 13(a) or 15(d) of the Exchange Act for the prior fiscal year or had filed an annual report with the SEC for the prior fiscal year. An FPI that is not required to comply with Items 15(b) and (c) must include a statement in the first annual report that it files in substantially the following form:

> "This annual report does not include a report of management's assessment regarding internal control over financial reporting or an attestation report of the company's registered public accounting firm due to a transition period established

> by rules of the Securities and Exchange Commission for newly public companies."

The Exchange Act requires that each periodic report filed under the Exchange Act, including Form 20-F, must include the internal control certifications and must be signed by the issuer's chief executive officer and chief financial officer. Item 15 of Form 20-F contains the internal control certification requirements applicable to an FPI. Under Item 15(b), an FPI must disclose:

- a statement of management's responsibility for establishing and maintaining adequate internal control over financial reporting for the FPI;
- a statement identifying the framework used by management to evaluate the effectiveness of the FPI's internal control over financial reporting;
- management's assessment of the effectiveness of the FPI's internal control over financial reporting as of the end of its most recent fiscal year, including a statement as to whether or not internal control over financial reporting is effective; and
- a statement that the registered public accounting firm that audited the financial statements included in the annual report has issued an attestation report on management's assessment of the FPI's internal control over financial reporting.

Further, under Item 15(c) of Form 20-F, every registered public accounting firm that prepares or issues an audit report on an FPI's annual financial statements must attest to, and report on, the assessment made by management. Such attestation must be made in accordance with standards for attestation engagements issued or adopted by the Public Company Accounting Oversight Board ("PCAOB"), and cannot be the subject of a separate engagement of the registered public accounting firm. However, the universal practice is for the auditors to audit management's internal controls over financial reporting, and not actually attest to management's assessment.

An FPI that qualifies as an EGC is exempt from the requirement to obtain an auditor attestation report. *See* "*How does the JOBS Act affect foreign private issuers engaged in a public offering?*"

Source: Form 20-F, Items 15(c), (d) and Instructions to Item 15; PCAOB Auditing Standard No. 5.

Do the proxy rules of the Exchange Act apply to an FPI?

The proxy rules under Section 14 of the Exchange Act govern the solicitation of proxies from shareholders and require companies whose securities are registered pursuant to Section 12 of the Exchange Act to disclose information to their shareholders concerning matters for which proxies are being sought. An FPI with registered securities is exempt from the SEC's proxy rules (specifically, Sections 14(a), 14(b), 14(c), and 14(f) of the Exchange Act). However, an FPI that files proxy materials in accordance with its home country's rules and regulations may be required to furnish and distribute the same proxy materials to its U.S. securityholders under cover of Form 6-K.

Source: Section 14 of the Exchange Act; Rule 3a12–3(b) of the Exchange Act.

Do the tender offer provisions of Section 14 of the Exchange Act apply to an FPI?

Possibly. While an FPI may generally be exempt from the SEC's proxy rules under Section 14, it may still be subject to the cross-border tender offer provisions of

Sections 14(d) and 14(e) of the Exchange Act. The regulations regarding tender offers contain two tiers of exemptions based on the level of ownership by U.S. securityholders of the securities of the FPI. An FPI may apply the "Tier I" exemption rules if its U.S. securityholders of record own 10% or less of its securities involved in the tender offer. Tier I exemptions generally exempt the tender offer from most provisions of the Exchange Act and the rules governing tender offers and require only that the bidder must comply with any applicable rules of the foreign target company's home country relating to tender offers. An FPI may apply the "Tier II" exemption rules if its U.S. securityholders own more than 10% but less than 40% of its securities involved in the tender offer. Tier II exemptions offer limited exemptive relief from U.S. tender offer regulations and are intended to eliminate frequent areas of conflict between U.S. and foreign regulatory requirements. An FPI may not avail itself of the tender offer exemptions if its U.S. securityholders own more than 40% of the securities involved in the tender offer. However, the SEC may grant limited tender offer exemptions on a case-by-case basis if there is any direct conflict between the FPI's U.S. tender offer obligations and the requirements under its home-country rules.

Source: Sections 14(d) and (e) of the Exchange Act; Rules 14d-1(c) and (d) of the Exchange Act.

Corporate Governance

Under what circumstances may an FPI follow its home-country rules regarding corporate governance practices?

The SEC and the U.S. national securities exchanges, separately, through statutes, rules and regulations, govern corporate governance practices in the United States. However, an FPI registered in the United States may continue to follow certain corporate governance practices in accordance with its home-country rules and regulations. The SEC and the U.S. national securities exchanges acknowledge the disparities between domestic and foreign governance practices and the potential cost of conforming to U.S. standards. Accordingly, an FPI is granted exemptions from certain corporate governance requirements in the event that it chooses to follow its home-country governance practices (particularly with regard to audit committee and compensation committee requirements).

Audit Committees

The SEC provides exemptions to its independence requirement for Audit Committee members in order to accommodate the following global practices:

- *Employee representation*: If a nonmanagement employee is elected or named to the board of directors or audit committee of an FPI pursuant to the FPI's governing law or documents, an employee collective bargaining or similar agreement, or other home-country legal or listing requirement, he or she may serve as a committee member.
- *Two-tiered board systems*: A two-tiered system consists of a management board and a supervisory/nonmanagement board. The SEC

treats the supervisory/nonmanagement board as a "board of directors" for purposes of Rule 10A-3(b)(1) of the Exchange Act. As such, an FPI's supervisory/nonmanagement board can either form a separate audit committee or, if the supervisory/nonmanagement board is independent, the entire supervisory/nonmanagement board can be designated as the audit committee.

- *Controlling securityholder representation*: The SEC permits one member of an FPI's audit committee to be a shareholder, or representative of a shareholder or shareholder group, owning more than 50% of the FPI's voting securities, subject to certain conditions.
- *Foreign government representation*: In some instances, a foreign government may be a significant securityholder or own special shares that entitle the government to exercise certain rights related to an FPI. The SEC permits a representative of a foreign government or foreign governmental entity to be an audit committee member, subject to certain conditions.
- *Listed issuers that are foreign governments*: The SEC grants an exemption to the audit committee independence requirements to listed issuers that are foreign governments.
- *Board of auditors*: The SEC permits auditor oversight through a board of auditors, subject to certain conditions.

Source: Rule 10A-3(b)(iv) of the Exchange Act; SEC Release No. 33-8220.

The U.S. national securities exchanges, such as the NYSE and Nasdaq, also impose rules and regulations governing audit committee composition and disclosures for companies that list on their exchanges. Like the SEC, each exchange provides exemptions for an FPI that wants to follow its home-country practices in lieu of the national securities exchange rules. For example, under Nasdaq rules, an FPI opting to follow its home-country audit committee practices is required to submit a letter from home-country counsel certifying its practice is not prohibited by home-country law. An FPI is required to submit such a letter only once, either at the time of initial listing or prior to the time the FPI initiates a nonconforming audit committee practice. Similarly, under the NYSE Listed Companies Manual, an FPI may follow its home-country audit committee practice, provided it:

- discloses how its corporate governance differs from those of domestically listed companies;
- satisfies the independence requirements imposed by Section 10A-3 of the Exchange Act;
- certifies to the NYSE that the FPI is not aware of any violation of the NYSE corporate governance listing standards; and
- submits an executed written affirmation annually or an interim written affirmation each time a change occurs to the FPI's board or any of the committees of the board, and includes information, if applicable, indicating that a previously independent audit committee member is no longer independent, that a member has been added to the audit committee, or that the FPI is no longer eligible to rely on, or has chosen not to continue to rely on, a previously applicable exemption to the audit committee independence rules.

The SEC, Nasdaq and NYSE each require that an FPI disclose in its Annual Report on Form 20-F each exchange requirement that it does not follow and describe its alternative home-country practice.

Source: Nasdaq Marketplace Rule 5615(a)(3); Section 303A of the NYSE Listed Companies Manual.

Compensation Committees

Form 20-F requires an FPI to disclose information regarding its compensation committee, including the names of the committee members and a summary of the terms under which the committee operates. Similar to audit committees, both the NYSE and Nasdaq permit an FPI to follow home-country practices with regards to its compensation committee.

Source: Sections 303A.00 and 303A.05 of the NYSE Listed Companies Manual; Nasdaq Marketplace Rule 5605(j).

American Depository Receipts

What is an American Depositary Receipt?

An ADR is a negotiable instrument issued by a U.S. depository bank that represents an ownership interest in a specified number of securities that have been deposited with a custodian, typically in the issuer's country of origin. ADRs can represent one or more shares, or a fraction of a share, of an FPI, and are offered as either "unsponsored" or "sponsored" programs. "Unsponsored" ADR programs are issued by a depository bank without a formal agreement with the FPI whose shares underlie the ADR. Consequently, an unsponsored ADR program affords the FPI little to no control over the marketing or other terms of the offering. Unsponsored ADRs are only permitted to trade in over-the-counter markets.

In contrast, "sponsored" ADRs are depositary receipts that are issued pursuant to a formal agreement, known as a depository agreement, between the depository bank and an FPI. The depository agreement between the issuer and the depository bank will, among other matters, cover fees (including fees paid by investors), communications with investors and monitoring the U.S. trading activity to provide early warning of the possibility that U.S. registration will be required. Most ADR programs are sponsored programs.

There are three levels of sponsored ADR programs:

- *Level I ADRs*: A sponsored Level I ADR program is the simplest method for companies to access the U.S. capital markets, and is similar to an unsponsored ADR program. Unlike the other two levels of ADRs, Level I ADRs are traded in the U.S. over-the-counter market with prices published in the Pink Sheets. In order to establish a Level I ADR and register the ADRs under the Securities Act, an FPI must: (1) qualify for an exemption under Rule 12g3-2(b) of the Exchange Act; (2) execute a deposit agreement with the depository bank and the ADR holders, which detail the rights and responsibilities of each party; and (3) furnish Form F-6 to the SEC. Note that financial statements and a description of the FPI's business are not required to be included in a Form F-6 registration statement.
- *Level II ADRs*: Level II ADR programs enable an FPI to list its depositary receipts on a U.S. exchange, such as the NYSE or Nasdaq, but do not involve raising new capital. The

requirements of a Level II ADR program are significantly more burdensome than a Level I ADR. Under a Level II ADR, an FPI is obligated to file a registration statement on Form 20-F and comply with ongoing SEC reporting requirements, including filing annual reports on Form 20-F and reports on Form 6-K, as needed. In addition, an FPI must also satisfy any listing requirements of the relevant exchange.

- *Level III ADRs*: A Level III ADR program is used for capital-raising by an FPI. Under a Level III ADR program, the depository bank and the FPI must meet all of the Level II ADR program requirements. In addition, an FPI must file a registration statement on Form F-1 under the Securities Act in order to register the securities underlying the ADRs. After the offering, the FPI will be subject to disclosure obligations under Section 15(d) of the Exchange Act and may have additional disclosure obligations under Section 13(a) of the Exchange Act if the ADRs are listed on a securities exchange.

For each of the three types of sponsored ADR programs, the instructions on Form F-6 require that the depository bank, the issuer, its principal executive officer, financial officer, controller or principal accounting officer, at least a majority of the board of directors or persons performing similar functions and its authorized representative in the United States sign the registration statement on Form F-6.

What are the potential benefits and drawbacks of an ADR facility?

An ADR program has numerous advantages for an FPI:

- ADR facilities open U.S. markets to the FPI, and enhance the visibility and image of the FPI's products, services and financial instruments in a marketplace outside its home country.
- ADRs allow U.S. investors to diversify their investment portfolio without subjecting themselves to foreign securities laws.
- ADRs are "American" securities that are quoted in U.S. dollars, pay dividends (if any) in U.S. dollars and trade and settle according to U.S. market conventions.
- ADR facilities increase liquidity for an FPI's securities by providing a larger shareholder base and a strong acquisition currency.
- An FPI that is new to the U.S. capital markets can use a Level I or Level II ADR program to "test the waters."
- ADRs allow an FPI to bundle one or more shares or a fraction of a share of foreign stock.
- The underlying securities of an ADR may be accessible by the holder, either through the cancellation of the ADR facility or by request of the holder.

ADRs also have drawbacks. First, there are costs related to establishing a sponsored ADR program in addition to those associated with becoming a U.S. registrant. Second, since the depository bank is the record holder of the securities underlying the ADR, any rights that an ADR holder may have as the beneficial owner of the underlying securities must be exercised through the depository bank and are, consequently, subject to the depository bank's compliance with its obligations under the applicable depositary agreement. Third, courts may not recognize the ADR holder as a "shareholder" of the company. Finally, offers and sales of ADRs in the United States are subject to the liability provisions of federal securities laws.

What are the benefits and drawbacks of an unsponsored ADR facility?

An unsponsored ADR facility can be a useful way for an FPI to become visible in the U.S. markets. However, unsponsored ADR facilities can have the following adverse consequences:

- the issuer has no control over the timing or the nature of the trading of its securities in the United States;
- the issuer could at some point, not of its choosing, be required to register under the Exchange Act if its total assets exceed $10 million and a class of equity securities are held by 2,000 or more U.S. residents (or 500 or more U.S. residents who are not accredited investors), and there is no other available exemption from U.S. reporting requirements;
- the depository bank has no obligation to forward any shareholder materials to the ADR holders and communications between the issuer and its (indirect) shareholders could be adversely affected;
- the issuer has no involvement in the mechanics of the ADR program, including its fees and charges and any securities lending arrangements; and
- ADR investors may not be aware that the issuer has no involvement in the ADR facility and can attribute problems with the facility to the issuer.

Can there simultaneously be sponsored and unsponsored ADR facilities for an FPI's securities?

No. If an FPI elects to establish a sponsored ADR facility while an unsponsored facility is in effect, the issuer must cause the depository bank of the unsponsored facility to terminate the unsponsored facility and arrange for the bank to transfer the deposited securities and the related ADR holders to the sponsored facility. If the depository bank is not the same for both facilities, the FPI will likely be required to pay an additional fee to the depository bank to effect such transfers.

What is an "authorized representative in the United States" and what are its obligations?

The U.S. federal securities laws provide little guidance as to whom or what can qualify as an "authorized representative in the United States." When evaluating the sufficiency of an "authorized representative in the United States," the SEC has held that it "generally accepts the signature of an individual who is an employee of the registrant or an affiliate, or who is the registrant's counsel or underwriter in the United States for the offering, because the signature clearly identifies an individual that is connected with the offering as subject to the liability provisions of the Securities Act" and "generally has refused to accept the appointment of a newly formed or shell corporation in the United States as the authorized representative." Accordingly, because an authorized representative is obligated to sign the registration statement on behalf of the FPI, it provides the SEC with a potential U.S. defendant in the event that it must bring a claim under Section 11 of the Securities Act.

Is an FPI required to make any disclosures in connection with its ADR program?

Yes. An FPI with a sponsored ADR facility is obligated to disclose in its Form 20-F information about any fees or charges in connection with:

- depositing or substituting the underlying shares;
- receiving or distributing dividends;
- selling or exercising rights;
- withdrawing an underlying security;
- transferring, splitting, or grouping receipts; and
- general depositary services, particularly those charged on an annual basis.

In addition, an FPI must describe all fees and other direct and indirect payments made by the depositary to the issuer of the deposited securities.

Source: Form 20-F, Items 12.D.3 and 12.D.4.

Non-public Offerings in the U.S. Capital Markets

May an FPI raise capital through offerings not registered with the SEC?

There are a number of alternative strategies an FPI can use to raise capital, including private placements under Section 4(a)(2) of the Securities Act, Regulation D offerings, and Rule 144A offerings. Foreign companies that are registered in the United States may also raise capital through these means.

What are the requirements for a private placement under Section 4(a)(2) of the Securities Act?

Under Section 4(a)(2) of the Securities Act, the registration and related prospectus delivery requirements under Section 5 of the Securities Act do not apply to "transactions by an issuer not involving any public offering." The statute itself provides little guidance as to the types of transactions that fall within the scope of Section 4(a)(2). However, judicial and regulatory interpretations have produced a flexible, fact-specific analysis of the types of transactions that could be deemed a private offering, based on the following elements:

- a limited number;
- of financially sophisticated offerees;
- given access to information relevant to their investment position;
- that have some relationship to each other and to the issuer; and
- that are offered securities in a manner not involving any general advertising or solicitation.

It is important to note that the Section 4(a)(2) exemption is available only to the issuer of the securities. This exemption is not available for the resale of securities purchased by investors in a private placement. The issuer claiming the Section 4(a)(2) exemption has the burden of establishing that the exemption is available for the particular transaction. If securities are sold without a valid exemption from registration, Section 12(a)(1) of the Securities Act gives the purchaser the right to rescind the transaction for a period of one year after the sale. The rescissory right may be exercised against anyone that was involved in the sale of the security, including the issuer and any broker-dealer that may have acted as the financial intermediary or placement agent in connection with the offering. Further, transactions that are not deemed exempt under Section 4(a)(2) will be treated as an unregistered public offering, and the issuer may be subject to liability under U.S. federal securities laws.

Source: Section 4(a)(2) of the Securities Act; Section 12(a)(1) of the Securities Act.

What are Regulation D offerings?

Regulation D provides issuers with a safe harbor from the Securities Act registration requirements for certain private transactions, thereby providing greater certainty to specific transactions exempt from registration. Regulation D is comprised of eight rules—Rules 501 through 508—and provides two safe harbors from registration under two statutory provisions. Specifically, Rule 504 of Regulation D, promulgated under Section 3(b) of the Securities Act, provides an exemption for small offerings of up to $5 million by non-reporting issuers, subject to certain criteria. Rules 506(b) and 506(c) of Regulation D, which are promulgated under Section 4(a)(2) of the Securities Act and Section 201(a) of the JOBS Act, respectively, provide an exemption for offerings and sales without regard to the dollar amount, subject to satisfaction of certain conditions. Sales of an issuer's securities made pursuant to Rule 506(b) are limited to 35 "purchasers" and an unlimited number of "accredited investors" (as defined under Rule 501 of Regulation D), while sales made pursuant to Rule 506(c) may be made only to accredited investors.

Prior to the enactment of the JOBS Act, issuers utilizing Regulation D were prohibited from engaging in general solicitation or advertising of the offering. Effective September 23, 2013, offerings made pursuant to Rule 506(c) may use general solicitation, provided that the securities are sold only to accredited investors and the issuer takes "reasonable steps" to verify that all purchasers are accredited investors in connection with the offering. Issuers may also continue to conduct private offerings without general solicitation pursuant to Rule 506(b).

What are the general requirements for an offering under Rule 144A under the Securities Act?

Rule 144A provides a nonexclusive safe harbor from the registration and prospectus delivery requirements of Section 5 of the Securities Act for certain offers and sales of qualifying securities by certain persons other than the issuer of the securities. The safe harbor is based on two statutory exemptions from registration under Section 5 of the Securities Act, Section 4(a)(1) and Section 4(a)(3). In summary, Rule 144A provides that:

- for sales made under Rule 144A under the Securities Act by a reseller, other than the issuer, an underwriter, or a broker-dealer, the reseller is deemed not to be engaged in a "distribution" of those securities and, therefore, not to be an "underwriter" of those securities within the meaning of Section 2(a)(11) and Section 4(a)(1) of the Securities Act; and
- for sales made under Rule 144A under the Securities Act by a reseller that is a dealer, the dealer is deemed not to be a participant in a "distribution" of those securities within the meaning of Section 4(a)(3)(C) of the Securities Act and not to be an "underwriter" of

those securities within the meaning of Section 2(a)(11) of the Securities Act, and those securities are deemed not to have been "offered to the public" within the meaning of Section 4(a)(3)(A) of the Securities Act.

A Rule 144A offering usually is structured so that the issuer first sells the newly issued restricted securities to an "initial purchaser," typically a broker-dealer, in a private placement exempt from registration under Section 4(a)(2) or Regulation D. Rule 144A then permits the broker-dealer to immediately reoffer and resell the restricted securities to a category of the largest and most sophisticated investors known as qualified institutional buyers ("QIBs") or to persons and entities that the issuer reasonably believes are QIBs.

Previously, issuers engaged in a Rule 144A offering were prohibited from engaging in general solicitations or advertisements in connection with the sale of securities. The JOBS Act, and Rule 144A as amended to implement the JOBS Act provision, abolishes the prohibition against general solicitations and advertisements, provided securities are sold only to QIBs.

Source: Rule 144A of the Securities Act.

May an FPI engage in crowdfunding?

No. The exemption from the registration requirements of the Securities Act for certain "crowdfunding" activities is not available to an FPI.

Rule 12g3-2(b) and Other Exemptions from Exchange Act Reporting Requirements

How can an FPI obtain an exemption from the reporting requirements pursuant to Rule 12g3-2(b) under the Exchange Act?

Rule 12g3-2(b) under the Exchange Act exempts certain FPIs that have sold securities in the United States from the reporting obligations of the Exchange Act even if the FPI's equity securities are traded on a limited basis in the over-the-counter market in the United States. An FPI can claim an exemption under Rule 12g3-2(b) if:

- it is not required to file or furnish reports under Section 13(a) or Section 15(d) of the Exchange Act, which means that the FPI has neither registered securities under Section 12(b) (for exchange-listed securities) or Section 12(g) (for other trading systems) of the Exchange Act or completed a registered public offering in the United States in the prior 12 months;
- it currently maintains a listing of the relevant securities on at least one non-U.S. securities exchange that, on its own or combined with the trading of the same securities in another foreign jurisdiction, constitutes the primary trading market for those securities, as defined in the rule; and
- it has published specified non-U.S. disclosure documents in English on its website or through an electronic information delivery system generally available to the public in its primary trading market, since the first day of its most recently completed fiscal year.

An FPI that satisfies the Rule 12g3-2(b) exemption will also be permitted to have established an unlisted, sponsored, or unsponsored depositary facility for its ADRs.

Source: Rule 12g3-2(b) under the Exchange Act.

What type of information must be disclosed by an FPI to take advantage of the Rule 12g3-2(b) exemption?

The types of information required to be published electronically under Rule 12g3-2(b) include information material to an investment decision, such as:

- results of operations or financial condition;
- changes in business;
- acquisitions or dispositions of assets;
- issuance, redemption, or acquisitions of securities;
- changes in management or control;
- granting of options or the payment of other compensation to directors or officers; and
- transactions with directors, officers, or principal securityholders.

At a minimum, Rule 12g3-2(b) requires that the FPI electronically publish English translations of the following documents if originally published in a foreign language:

- an annual report, including or accompanied by annual financial statements (the SEC appears to assume, without comment, that the annual financial statements will be audited);
- interim reports that include financial statements;
- press releases; and
- all other communications and documents distributed directly to securityholders of each class of securities to which the exemption relates.

Source: Rule 12g3-2(b) under the Exchange Act.

In what circumstances will a Rule 12g3-2(b) exemption be unavailable to an FPI?

The Rule 12g3-2(b) exemption is <u>not</u> available if an FPI:

- no longer satisfies the electronic publication conditions, as indicated above;
- no longer maintains a listing of the subject class of securities on one or more exchanges in a primary trading market; or
- registers a class of securities under Section 12 of the Exchange Act or incurs reporting obligations under Section 15 of the Exchange Act.

Source: Rule 12g3-2(b) under the Exchange Act.

Can an FPI with securities registered under Section 12 of the Exchange Act or subject to the reporting requirements under Section 15 of the Exchange Act take advantage of the Rule 12g3-2(b) exemption?

No. The exemptions from reporting requirements under Rule 12g3-2(b) are only afforded to an FPI that maintains the requirements under Rule 12g3-2(b). The exemption is lost once an FPI registers a class of securities under Section 12 of the Exchange Act or is subject to the reporting obligations under Section 15 of the Exchange Act. However, an FPI may immediately claim a Rule 12g3-2(b) exemption once the FPI deregisters its securities or suspends its reporting obligations, provided that it still meets the requirements set forth under Rule12g3-2(b).

Source: Rule 12g3-2(b) under the Exchange Act.

Can others take advantage of the benefits of Rule 12g3-2(b)?

Yes. Rule 12g3-2(b) may be used by any depository bank to establish an unsponsored ADR facility as long as there is no sponsored ADR facility relating to the same securities. With respect to an FPI's securities, once a depository bank establishes an unsponsored ADR facility, the ADRs may trade in the over-the-counter market, thus establishing a trading market in the United States for the issuer's securities. Form F-6, the registration statement for ADRs (not the underlying securities), provides that in the case of an unsponsored ADR facility, the bank depositary may base its representation about the availability of information regarding the issuer of the securities underlying the ADRs, as required by Rule 12g3-2(b), upon its "reasonable, good faith belief after exercising reasonable diligence."

Source: Rule 12g3-2(b) under the Exchange Act.

What happens if an FPI relying on the Rule 12g3-2(b) exemption ceases to meet its foreign listing requirements?

The foreign listing/primary trading market requirement under Rule 12g3-2(b), which is founded on a respectful recognition of foreign securities markets and practices, is designed to ensure that an eligible FPI is subject to reporting and disclosure requirements of the overseas regulator in the jurisdiction in which the FPI's securities are listed. If an FPI ceases to meet its foreign listing requirements, it will immediately lose the Rule 12g3-2(b) exemption. Rule 12g3-2(b) does not provide a cure period during which an FPI can correct any deficiency resulting in delisting of its securities in its primary trading market. Accordingly, an FPI that loses the Rule 12g-2(b) exemption must either reestablish compliance with the rule in a reasonably prompt manner, find another exemption, such as its securities being held of record by less than 500 persons in the United States, or register under the Exchange Act.

Source: Rule 12g3-2(b) under the Exchange Act.

Liability under U.S. Securities Laws

Are directors and officers of an FPI who sign a registration statement subject to liability under U.S. federal securities law?

Directors and officers of an FPI who sign a registration statement filed in connection with a securities offering are subject to the liability provisions of Section 11 of the Securities Act. Section 11 of the Securities Act creates civil liability for misstatements or omissions in a registration statement at the time it became effective. Any person that acquired a security registered under a registration statement, and did not have knowledge of the misstatement or omission at the time of the acquisition of the security, can bring suit against: (1) every person who signed the registration statement, including the issuer; (2) every director of the issuer at the time of the filing of the registration statement, whether or not such director signed the registration statement; (3) experts who consent to such status, but only with respect to those sections of the registration statement which they have "expertized;" and (4) underwriters. In addition, Section 15 of the Securities Act permits a plaintiff in an action for damages under Section 11 to assert claims against any person who controls any of the foregoing persons, including controlling securityholders who are not also officers and directors of the issuer, by or through the ownership of stock or an agency relationship.

Source: Section 11 of the Securities Act.

What are the elements of a Section 11 cause of action?

Section 11 of the Securities Act is a strict liability provision. Therefore, a plaintiff is not required to prove intent or knowledge with respect to a misstatement or omission in a registration statement. In addition, a plaintiff bringing a cause of action under Section 11 does not have to show reliance on a misstatement or omission. However, reliance must be established if the plaintiff purchased the securities after the publication of an earnings statement covering a 12-month period after the effective date of the registration statement.

Source: Section 11 of the Securities Act.

What are some defenses available to a defendant in a claim under Section 11 of the Securities Act?

There are a number of defenses to a Section 11 claim. A defendant can argue that there was no material misrepresentation or omission. A defendant can also argue that the plaintiff's damages were not attributable to false, misleading, or omitted information or that the plaintiff was aware at the time of purchase that the representations were false or misleading or that the required information was not included. Additionally, under the "due diligence" defense, most defendants (with the exception of the issuer) may not be liable for the portions of the registration statement that were not prepared by an expert if "he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading . . . ." Alternatively, under the "reliance" defense, the defendant may not be liable for portions of the registration statement that were prepared on the authority of an expert, if "he had no reasonable ground to believe and did not believe, at the time such part of the registration statement became effective, that the statements therein were untrue or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading . . . ." Finally, a defendant in a Section 11 claim can bring a statute of limitations defense under Section 13 of the Securities Act. Under Section 13, claims initiated pursuant to Section 11 must be brought within one year of discovery of the misleading statement or omission, or after the discovery of such misleading statement or omission should have been made through the exercise of reasonable diligence. Note that no action under Section 11 may be brought more than three years after the bona fide public offering of the security in question.

Source: Section 11 of the Securities Act.

How are damages measured once a plaintiff successfully brings a cause of action under Section 11 of the Securities Act?

Section 11(e) limits the amount of recoverable damages to the difference between the price paid (not to exceed the public offering price) and (1) the value of the security as of the time the suit was brought, (2) the price at which the security would have been disposed of in the open market before the suit, or (3) the price at which the security would have been disposed of after the suit but before judgment if the damages would be less than the damages representing the difference between the amount paid for the security (not to exceed the public offering price) and the value of the security at the time the suit was brought, subject to certain exceptions. Section 11, however, also provides that defendants may reduce the amount of damages by proving that the market depreciation of the securities was due to factors other than the misstatement or omission.

Source: Section 11 of the Securities Act.

What are other causes of action under U.S. federal securities laws that a plaintiff may have against an FPI?

In addition to Section 11 of the Exchange Act, an FPI may assert claims under several other provisions of U.S. federal securities laws, some of which are discussed below.

Liability Under the Securities Act. Section 12 of the Securities Act assigns liability to any person who offers or sells a security in violation of Section 5 of the Securities Act (pursuant to Section 12(a)(1)), or by means of a prospectus or oral communication that includes a misstatement or omission of material fact (pursuant to Section 12(a)(2)). Plaintiffs bringing a claim under Section 12 are afforded rescissory relief, if they still have ownership of the securities, or damages, if they no longer own the security.

There are a number of defenses available to a person subject to a claim under Section 12. Under Section 12(a)(2), a person may not be liable for a misstatement or omission in connection with selling the security if he or she "did not know, and in the exercise of reasonable care could not have known, of such untruth or omission." In addition, claims under Section 12 are subject to the statute of limitations defense under Section 13 of the Securities Act. Under Section 13, a claim brought under Section 12(a)(2) must be brought within one year of discovery of the misleading statement or omission or after the discovery of such misleading statement or omission should have been made by the exercise of reasonable diligence. In the case of a claim brought under Section 12(a)(1), the action must be brought within one year of the violation of Section 5. Note that no action under Section 11 or Section 12(a)(1) may be brought more than three years after the bona fide public offering of a security, or, in the case of Section 12(a)(2), more than three years after the actual sale of a security.

Source: Sections 12 and Section 13 of the Securities Act.

Liability Under the Exchange Act. Rule 10b-5 of the Exchange Act prohibits: (1) the use of any device, scheme, or artifice to defraud; (2) the making of any untrue statement of a material fact or the omission of a material fact necessary to make the statements made not misleading; or (3) the engaging in any act, practice, or course of business that would operate to deceive any person in connection with the purchase or sale of any securities. To bring a successful cause of action under Rule 10b-5, the plaintiff must prove (i) that there was a misrepresentation or failure to disclose a material fact, (ii) that was made in connection with plaintiffs' purchase or sale of a security, (iii) that defendants acted with "scienter," or the intent or knowledge of the violation, (iv) that plaintiffs "relied" on defendants' misrepresentation or omission, and (v) that such misrepresentation or omission caused plaintiffs' damages.

In 2010, the U.S. Supreme Court limited the territorial application of Rule 10b-5 by holding that Section 10(b) of the Exchange Act covers only: 1) transactions in securities listed on domestic exchanges, and 2) domestic transactions in other securities.[2] "Foreign-cubed" cases – foreign issuers, foreign plaintiffs and foreign transactions – may no longer be brought in the U.S. courts. One federal appeals court has held that to be liable for "domestic transactions in other securities," a "plaintiff must allege facts suggesting that irrevocable liability was incurred or title was transferred within the United States."[3] One federal district court has held that sponsored, but unlisted, ADRs in the United States could nevertheless constitute a "domestic transaction" under *Morrison*.[4]

However, there continue to be cases exploring the limitations of *Morrison*. For example, the status of *Morrison's* "transactional test" has been called into question in light of the passage of Section 929p(b) of the Dodd-Frank Act.[5] Several federal district courts have also assumed through dicta that Section 929p(b) does in fact supersede *Morrison*.[6] Section 929p(b) of the Dodd-Frank Act directly addresses the issue of transnational securities fraud brought by the SEC or the U.S. Department of Justice.[7] More importantly, one federal district court has even affirmatively held that Section 929P(b) supersedes *Morrison*, which serves as a warning to issuers that their foreign activities may nevertheless be subject to liability under U.S. securities laws even if other federal district courts continue to use *Morrison*'s transactional test.[8]

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[2] *See Morrison v. National Australia Bank Ltd*., 130 S. Ct. 2869 (2010) (emphasis added).

[3] *See Absolute Activist Value Master Fund Ltd. v. Ficeto,* No. 11-0221-cv, Slip. Op. (2d Cir. Mar. 1, 2012).

[4] *See In re Volkswagen "Clean Diesel" Marketing, Sales Practices and Products Liability Litigation*, MDL No. 2672 CRB (JSC) (Jan. 4, 2017).

[5] *See SEC v. A Chicago Convention Center, LLC*, 961 F. Supp. 2d 905 (N.D. Ill. 2013). While the Court in *Chicago Convention Center* acknowledged that the passage of Section 929p(b) may raise questions over whether the "transactional test" under *Morrison* is still controlling, it did not feel a "need [to] . . . resolve this complex interpretive issue" because the SEC's complaint at issue would survive under either the "transactional" or "conduct and effects" tests. *Id.* at 911.

[6] *See, e.g., SEC v. Tourre,* No. 10. Civ. 3229(KBF), 2013 WL 2407172 *1 n.4 (S.D.N.Y. 2013) ("Because the Dodd–Frank Act effectively reversed *Morrison* in the context of SEC enforcement actions, the primary holdings of this opinion affect only pre-Dodd Frank conduct."); *In re Optimal U.S. Litigation*, 865 F. Supp. 2d 451, 456 n.28 (S.D.N.Y. 2012) ("To the extent that a broad reading of *Morrison* may raise policy concerns that parties will engage in foreign transactions to avoid the reach of the Exchange Act, Congress has attempted to remedy that problem by restoring the conducts and effects test for SEC enforcement actions."); and *Cornwell v. Credit Suisse Group*, 729 F. Supp. 2d 620, 627 n.3 (S.D.N.Y. 2010) (". . . the Court notes that in legislation recently enacted, Congress explicitly granted federal courts extraterritorial jurisdiction under the conduct or effect test for proceedings brought by the SEC, and called for further SEC study and report on the issue in regard to extraterritorial private rights of action").

[7] *See A Chicago Convention Center*, *supra*, note 5 at 911. Section 929p(b) amends Section 22 of the Securities Act and Section 27 of the Exchange Act by providing that "the district courts of the United States and the United States courts of any Territory shall have jurisdiction of an action or proceeding brought or instituted by the [SEC] or the United States alleging a violation of [U.S. securities laws] involving—(1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or (2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States."

[8] *See SEC v. Traffic Monsoon, LLC,* Case No. 2:16-cv-00832-JNP (Mar. 28, 2017). In *Traffic Monsoon*, the U.S. District Court for the District of Salt Lake City granted the SEC's request for a preliminary injunction in connection with Traffic Monsoon's operation as a web traffic exchange, in which it sold several different products designed to deliver "clicks" or "visits" to the websites of its customers. The SEC alleged that such activity as a web traffic exchange violated Exchange Act Section 10(b) and Rule 10b-5. Traffic Monsoon relied on *Morrison* to assert that Exchange Act Sections 10(b) and Section 17 do not authorize a federal district court to enjoin activity related to foreign transactions, claiming that approximately 90% of Traffic Monsoon's customers purchased products over the internet while located outside the United States. Traffic Monsoon claimed that notwithstanding the passage of Section 929P(b), the SEC lacked jurisdiction in accordance with *Morrison*'s transactional test. However, the Court disagreed with the Traffic Monsoon's claim, holding that the legal context in

In addition, an FPI is subject to Regulation M under the Exchange Act. Regulation M prohibits any participant in a distribution of securities from purchasing any security or securities of the same class or series until the participant has completed its participation in the distribution. Regulation M is designed to prevent market priming or stock price manipulation in a distribution of securities. Potential participants covered under Regulation M include the issuer, underwriters, placement agents, brokers, dealers, control persons, selling securityholders and officers and directors. Regulation M does allow for certain exemptions and the SEC may grant additional exemptions upon request.

Source: Section 10(b) and Rule 10b-5 of the Exchange Act; Regulation M of the Exchange Act.

Is there liability under Section 11 and Section 12 of the Securities Act for private offerings?

Possibly, if the court determines that the "private placement" was actually a public offering and that the registration requirements of the Securities Act were not satisfied. There would still be liability under the general anti-fraud provisions of the Securities Act and under Section 10b-5 of the Exchange Act for material misstatements and omissions.

which Section 929P(b) was drafted, legislative history and express purpose of Section 929P(b) all point to a congressional intent that Section 10(b) and Section 17(a) should be applied to extraterritorial transactions to the extent that the conduct and effects test can be satisfied. Using the conducts and effects test, the Court found that the SEC had jurisdiction to bring an injunction against Traffic Monsoon, given that Traffic Monsoon was conceived and created in the United States, along with the promotion of its products.

Deregistering Securities

Why deregister securities?

It is expensive and time-consuming to comply with the ongoing reporting obligations of the Exchange Act and the continued listing requirements of an exchange, and an FPI may not even have significant U.S. holders or the intent to raise additional capital publicly in the United States. Deregistration can save an FPI both time and money by alleviating the stringent requirements imposed by the Exchange Act and Sarbanes-Oxley. However, maintaining registration generally provides exposure to the U.S. markets and allows for easier access to capital in the United States and abroad.

How can an FPI deregister a particular class of securities?

An FPI may terminate (and not merely suspend) both the registration of a class of equity securities (registered pursuant to Section 12(g) of the Exchange Act), and the consequent Section 15(d) reporting obligations, by filing a Form 15F with the SEC. However, if the securities are listed on an exchange, then an FPI must first delist such securities. *See "How does an FPI delist or deregister securities listed on a U.S. national securities exchange?"* To be eligible for deregistration, the FPI must certify the following in a Form 15F:

- the FPI was subject to the reporting obligations under Section 13(a) or Section 15(d) of the Exchange Act for at least the 12 months preceding the filing of the Form 15F, has filed or furnished all reports required for this period, and has filed at least one Annual Report pursuant to Section 13(a) of the Exchange Act;

- the FPI's securities have not been sold in the United States in a registered offering under the Securities Act during the 12 months preceding the filing of the Form 15F, subject to certain exceptions; and
- the FPI has maintained a listing of the subject class of securities for at least the 12 months preceding the filing of the Form 15F on one or more exchanges in a foreign jurisdiction that, either singly or together with the trading of the same class of the issuer's securities in another foreign jurisdiction, constitute the primary trading market for those securities (a primary trading market means that at least 55% of the trading in the securities to be deregistered took place in a single foreign jurisdiction or in no more than two foreign jurisdictions during a recent 12-month period), and either:
    - the FPI's daily U.S. trading volume over a recent 12-month period has been 5% or less of the average daily trading volume ("ADTV") of that class of securities on a worldwide basis for the same period; or
    - on a date within 120 days before the filing date of the Form 15F, the FPI's securities must be held of record by no more than 300 shareholders worldwide or no more than 300 persons resident in the United States (or in the case of a bank holding company, if the securities are held of record by less than 1,200 persons). With respect to the number of holders of record of ADRs, the trading volume is calculated in terms of the number of securities represented by the ADRs.

An FPI must certify on a Form 15F that it meets the conditions under Rule 12h-6 and that there are no classes of securities other than those that are subject to Form 15F for which the FPI has reporting obligations. In most cases, upon filing a Form 15F, all reporting obligations are suspended immediately for 90 days while the SEC approves deregistration. If the SEC does not object to the filing of the Form 15F within 90 days or such shorter period as determined by the SEC, the effectiveness of any of the following shall occur: (1) the termination of registration of a class of the FPI's securities under Section 12(g) of the Exchange Act; or (2) the termination of an FPI's duty to file reports under Section 13(a); or (3) Section 15(d) of the Exchange Act.

Source: Rule 12h-6 of the Exchange Act.

Are there any time limitations with respect to deregistration of securities?

Yes. An FPI must wait at least 12 months before it files a Form 15F to terminate its reporting obligations in reliance on the ADTV criterion discussed above if the FPI has: (a) delisted a class of equity securities from a national securities exchange or inter-dealer quotation system in the United States, and at the time of delisting, the ADTV of that class of securities in the United States exceeded 5% of the ADTV of that class of securities on a worldwide basis for the preceding 12 months; or (b) terminated a sponsored ADR facility, and at the time of termination the U.S. ADTV of the ADRs exceeded 5% of the ADTV of the underlying class of securities on a worldwide basis for the preceding 12 months.

Source: Rule 12h-6 of the Exchange Act; SEC Release No. 34-55540.

How does an FPI delist or deregister securities listed on a U.S. national securities exchange?

Rule 12d2-2 of the Exchange Act permits an FPI to withdraw a class of securities from being listed on a national securities exchange and/or from registration under Section 12(b) of the Exchange Act. An FPI must file an application on Form 25, notifying the SEC of its intent to withdraw its securities from listing on such national securities exchange and/or its intention to withdraw securities from registration under Section 12(b). An application to withdraw from listing on a national securities exchange on Form 25 will become effective 10 days after the form is filed with the SEC. An application to withdraw registration of a class of securities under Section 12(b) will become effective within 90 days after the form is filed.

In addition to the filing of Form 25, an FPI must satisfy and certify in its Form 25 that:

- it is in compliance with all applicable laws in effect in the state in which it is incorporated and with the applicable national securities exchange's rules governing an issuer's voluntary withdrawal of a class of securities from listing and/or registration; and
- no fewer than 10 days before the issuer files an application on Form 25 with the SEC, an FPI will provide written notice to the national securities exchange of its determination to withdraw the class of securities from listing and/or registration on such exchange. Such written notice must set forth a description of the security involved, together with a statement of all material facts relating to the reasons for withdrawal from listing and/or registration.
- Contemporaneous with providing written notice to the exchange of its intent to withdraw a class of securities from listing and/or registration, an FPI must publish notice of such intention, along with its reasons for such withdrawal, via a press release and, if it has a publicly accessible website, posting such notice on that website. Any notice provided on the FPI's website must remain available until the delisting on Form 25 has become effective. If the FPI has not arranged for listing and/or registration on another national securities exchange or for quotation of its security in a quotation medium, then the press release and posting on the website must contain this information.

Once the applicable national securities exchange in which the FPI's securities are listed receives written notice of the FPI's intention to withdraw a class of securities from listing and/or registration on such exchange, the exchange must provide notice on its website of the FPI's intent to delist and/or withdraw from registration its securities by the next business day. Such notice must remain posted on the exchange's website until the delisting on Form 25 is effective.

Source: Rule 12d2-2(c) of the Exchange Act; Form 25.

How does deregistering equity securities differ from deregistering debt securities?

The deregistration of debt securities is subject to less extensive regulations than the deregistration of equity securities. Under Rule 12h-6, an FPI must certify, under

Form 15F, that it has furnished all reports required by the Exchange Act, including at least one Annual Report (pursuant to Section 13(a) of the Exchange Act), and that its class of equity securities is held of record, on a date within 120 days before the filing of the Form 15F, by either fewer than 300 persons globally or 300 persons resident in the United States.

Source: Rule 12h-6(c) of the Exchange Act.

Does an FPI have to provide notice of its intention to deregister?

Yes. Either before or on the date it files a Form 15F, an FPI must publish a notice to the U.S. markets that it intends to terminate its registration of a class of securities. Notice must be published "through a means reasonably designed to provide broad dissemination of the information to the public in the United States." The FPI must also submit a copy of the notice to the SEC, either under cover of a Form 6-K before or at the time of filing of the Form 15F, or as an exhibit to the Form 15F.

Source: Rule 12h-6(h) of the Exchange Act.

Disclosure Obligations by Beneficial Owners

Are officers, directors and shareholders of an FPI subject to the short-swing provisions of Section 16 of the Exchange Act?

No. Section 16 of the Exchange Act prohibits "short-swing" profits by officers and directors of the issuer of any class of securities registered under Section 12 of the Exchange Act, and to beneficial owners of more than 10% of a Section 12-registered class of securities (collectively, "insiders") by allowing the issuer of the security to recover any profits made by an insider in connection with the "short-swing transaction." A "short-swing transaction" is the purchase and sale, or sale and purchase, of any equity security of an issuer within a period of less than six months. Section 16(a) of the Exchange Act requires that insiders file public reports of their holdings of, and transactions in, equity securities which are registered under Section 12 of the Exchange Act. Such forms include Forms 3, 4 and 5. Rule 3a12-3 under the Exchange Act exempts securities registered by an FPI from Section 16 of the Exchange Act. Accordingly, insiders of an FPI are not subject to the short-swing profit limits set forth in Section 16(b), nor are they required to comply with the Section 16(a) reporting requirements.

Source: Section 16 of the Exchange Act; Rule 3a12-3 under the Exchange Act.

What is the effect of the loss of FPI status on directors and officers for purposes of Section 16 of the Exchange Act?

A transaction carried out by a director or officer in the six months prior to the director or officer becoming subject to Section 16 of the Exchange Act is subject to Section 16 and must be reported on the first Form 4 required to be filed by the director or officer only if: (1) the transaction occurred within six months of the transaction giving rise to the Form 4 obligation; and (2) the director or officer became subject to Section 16 of the Exchange Act solely as a result of the FPI registering a class of equity securities pursuant to Section 12 of the Exchange Act.

Source: Section 16 of the Exchange Act; Form 4.

Do issuers have a cause of action against insiders under Section 16 of the Exchange Act?

Yes. Issuers or shareholders suing on behalf of an issuer, are afforded a private right of action under Section 16(b) of the Exchange Act to recover from an insider any profit realized by an insider engaged in short-swing trading.

Source: Section 16(b) of the Exchange Act.

Are directors, officers and beneficial owners of an FPI subject to the disclosure requirements of Section 13 of the Exchange Act?

Yes. Under Sections 13(d) and 13(g) of the Exchange Act, and the SEC's related rules, subject to certain exemptions, any person who after acquiring, directly or indirectly the beneficial ownership of a certain class of equity securities, becomes, either directly or indirectly, the beneficial owner of more than 5% of such class must deliver a statement to the issuer of the security and to each exchange where the security is traded. Delivery to each exchange can be satisfied by making a filing on EDGAR. In addition, the beneficial owner must file with the SEC a statement containing certain information, as well as any additional information that the SEC may deem necessary or appropriate in the public interest or for the protection of investors.

Source: Sections 13(d) and (g) of the Exchange Act.

What forms are beneficial owners required to file with the SEC in connection with their ownership position?

Beneficial owners, subject to the disclosure requirement under Section 13(g), are required to file with the SEC a statement on either Schedule 13D or Schedule 13G. Rule 13d-1 mandates that a person who acquires, directly or indirectly, beneficial ownership of a class of registered equity security, must file a statement containing the information required by Schedule 13D with the SEC, within 10 business days. Generally, Schedule 13D requires the following disclosures (however, Rule 13d-1 gives the SEC discretion to ask for information it may deem necessary or appropriate in the public interest or for the protection of investors):

- the background, identity, residence, citizenship of, and the nature of such beneficial ownership by such person and all other persons by whom or on whose behalf the purchases have been or are to be effected;
- the source and amount of the funds or other consideration used or to be used in making the purchases, and if any part of the purchase price is represented or is to be represented by funds or other consideration borrowed or otherwise obtained for the purpose of acquiring, holding, or trading such security, a description of the transaction and the names of the parties thereto, except where a source of the funds is a loan made in the ordinary course of business by a bank, if the person filing such statement so requests, the name of the bank shall not be made available to the public;
- any plans or proposals which such persons may have to liquidate such issuer, to sell its assets to or merge it with any other persons, or to make any other major change in its business or corporate structure;
- the number of shares of such security which are beneficially owned, and the number of shares concerning which there is a right to acquire, directly or indirectly, by (i) such persons and (ii) by each associate of such

person, giving the background, identity, residence, and citizenship of each such associate; and

- information as to any contracts, arrangements, or understandings with any person with respect to any securities of the issuer, including but not limited to, transfer of any of the securities, joint ventures, loan or option arrangements, puts or calls, guaranties of loans, guaranties against loss or guaranties of profits, division of losses or profits, or the giving or withholding of proxies, naming the persons with whom such contracts, arrangements, or understandings have been entered into, and giving the details thereof.

Alternatively, certain holders of securities of an FPI may be permitted to report their beneficial ownership on Schedule 13G, pursuant to Rule 13d-1(b) of the Exchange Act. The disclosures under Schedule 13G are considerably less detailed than those required by Schedule 13D. Rule 13d-1 contemplates the filing of a Schedule 13G in lieu of a Schedule 13D in the following three circumstances:

- *Eligible institutional investors*: A person that would otherwise be required to file a Schedule 13D may file a Schedule 13G provided that: (1) such person acquired the securities in the ordinary course of business and not with the purpose of, or with the effect of, changing or influencing the control of the issuer, nor acting in connection with or as a participant in any transaction having such purpose or effect; (2) the person is a registered broker or dealer, a bank as defined in the Exchange Act, an insurance company as defined in the Exchange Act, an investment company registered under the Investment Company Act, an investment adviser registered under the Investor Advisers Act of 1940, an employee benefit plan as defined under ERISA, a parent holding company or control person of the issuer, subject to certain conditions, a savings association as defined under the Federal Deposit Insurance Act, a church plan that is excluded from the definition of investment company in the Investment Company Act, a non-U.S. institution that is the fundamental equivalent of any of the preceding types of persons (subject to certain conditions), or a group, provided that all of the members are persons specified above; and (3) such person has promptly notified any other person on whose behalf it holds, on a discretionary basis, securities exceeding 5% of the class, of any acquisition or transaction on behalf of such other person which might be reportable by that person under Section 13(d) of the Exchange Act. Eligible institutional investors must file a Schedule 13G within 45 days after the calendar year in which the investor holds more than 5% as of the year end or within 10 days after the end of the first month in which the person's beneficial ownership exceeds 10% of the class of equity securities computed as of the end of the month;
- *Eligible passive investors*: A person that would otherwise be required to file a Schedule 13D may file a Schedule 13G provided that the person: (1) has not acquired the securities with

any purpose of, or with the effect of, changing or influencing the control of the issuer, or in connection with or as a participant in any transaction having that purpose of, or effect, including any transaction subject to Rule 13d-3(b); (2) is not already an eligible institution, as set forth above; and (3) is not directly or indirectly the beneficial owner of 20% or more of the class of security that is the subject of the Schedule. Eligible passive investors must file a Schedule 13G within 10 business days after becoming a 5% beneficial holder; and

- *Passive investors eligible to file Schedule 13Gs*: A person who, as of the end of any calendar year, is or becomes directly or indirectly the beneficial owner of more than 5% of any class of equity security, but is not otherwise required to file a Schedule 13D, must file a Schedule 13G within 45 days after the end of the calendar year in which the person becomes obligated to report.

As noted above, a beneficial owner is required to file a Schedule 13D or Schedule 13G with the SEC. Additionally, Rule 12b-11 of the Exchange Act also requires a beneficial owner to deliver a copy to each applicable exchange on which the FPI has securities registered. However, beneficial holders can satisfy this delivery requirement by filing the Schedule 13D or Schedule 13G on EDGAR.

Source: Rule 13d-1 of the Exchange Act; Schedules 13D and 13G; Rule 12b-11 of the Exchange Act.

Federal Tax Concerns

Is an FPI a passive foreign investment company ("PFIC") for U.S. federal income tax purposes?

Not necessarily. In general, a non-U.S. corporation will be treated as a PFIC for U.S. federal income tax purposes in any taxable year in which either (i) at least 75% of its gross income is "passive income" or (ii) on average at least 50% of the value of its assets is attributable to assets that produce passive income or are held for the production of passive income. Passive income for this purpose generally includes, among other things, dividends, interest, royalties, rents and gains from commodities and securities transactions and from the sale or exchange of property that gives rise to passive income. In determining whether a non-U.S. company is a PFIC, a proportionate share of the income and assets of each corporation in which it owns, directly or indirectly, at least a 25% interest (by value) is taken into account. Interests in less than 25% owned corporations are treated as passive assets.

The PFIC asset test is performed by looking at the average quarterly gross value of the company's assets and determining what percentage of the gross asset value is active versus passive. In general, operating assets such as property, plant and equipment, accounts receivable and inventory are considered active assets, while cash (including working capital), non-trade receivables and short-term investments of working capital are considered passive. While a preliminary assessment of potential PFIC status can be made using the balance sheet of the company, in general, the balance sheet reflects generally accepted accounting principles and may not be a true indication of value. In the case of a publicly traded company, legislative history supports the notion that the gross asset value is equal to the value of the stock as indicated by trading value plus liabilities. It may also be possible to support a claimed value using recent private placements or appraisals.

The PFIC income test is performed by looking at the percentage, on an annual basis, of the income of the company derived from passive assets. Income for this purpose is gross income, generally defined as gross receipts minus cost of goods sold. Because the percentage of passive income required to qualify as a PFIC is relatively high, most companies generally do not fail the income test, unless a special situation arises such as where a company has no active gross receipts but has passive investment income from investing its working capital.

If an FPI is a PFIC for U.S. federal income tax purposes, what are the tax consequences to U.S. investors in a PFIC?

A U.S. investor that invests directly or indirectly in a PFIC will suffer adverse tax consequences, the general effect of which is to eliminate the potential economic benefit of deferring U.S. tax on the PFIC's earnings. Some of the adverse tax consequences may be ameliorated by making certain elections (the "QEF election" and the "mark-to-market election"), if available.

A U.S. Investor who does not make a timely QEF election or a mark-to-market election for the PFIC (a "Non-Electing U.S. Investor") will be subject to special rules with respect to (1) any "excess distribution" (generally, the portion of any distributions received by the Non-Electing U.S. Investor on the shares in a taxable year in excess of 125% of the average annual distributions received by the Non-Electing U.S. Investor in the three preceding taxable years, or, if shorter, the Non-Electing U.S. Investor's holding period for his shares), and (2) any gain realized on the sale or other disposition of such shares. Under these rules, (i) the amount of the excess distribution or gain would be allocated ratably over the Non-Electing U.S. Investor's holding period for the shares; (ii) the amount allocated to the current taxable year and any year prior to the company becoming a PFIC would be taxed as ordinary income; and (iii) the amount allocated to each of the other taxable years would be subject to tax at the highest rate of tax in effect for the applicable class of taxpayer for that year, and an interest charge for the deemed deferral benefit would be imposed with respect to the resulting tax attributable to each such other taxable year. Distributions received by a U.S. investor from a PFIC do not qualify for the favorable rates currently applicable to certain "qualified dividends." Additionally, if a Non-Electing U.S. Investor who is an individual dies while owning PFIC shares, the Non-Electing U.S. Investor's successor would be ineligible to receive a step-up in tax basis of such shares.

In general, if a company is treated as a PFIC for any taxable year during the holding period of a Non-Electing U.S. Investor, the company will continue to be treated as a PFIC with respect to such investor for all succeeding years during which the Non-Electing U.S. Investor holds shares even if the company is not a PFIC for such years.

An FPI that is, or may become, a PFIC should consult U.S. tax advisors with respect to the availability of and the tax consequences of making either the QEF election or the mark-to-market election.

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