Foreign Issuers Doing IPOs in the U.S.

October 21, 2015

Presented by: Ze’-ev D. Eiger
Main Topics of Discussion

- Benefits available to foreign private issuers (“FPIs”)
- Benefits available to emerging growth companies (“EGCs”)
- Registration process generally
- IPO process
- Accounting considerations
- Corporate governance considerations
- Ongoing reporting obligations
- Specialized disclosure requirements
- Liability concerns
FPIs
What is a “Foreign Private Issuer?”

An FPI is any issuer (other than a foreign government) incorporated or organized under the laws of a jurisdiction outside of the U.S., unless more than 50% of the issuer’s outstanding voting securities are held directly or indirectly by residents of the U.S., and any of the following applies:

- the majority of the issuer’s executive officers or directors are U.S. citizens or residents;
- the majority of the issuer’s assets are located in the U.S.; or
- the issuer’s business is principally administered in the U.S.
Calculating the Percentage of an FPI’s Outstanding Voting Securities

• Securities held of record by a broker, dealer, bank or nominee for the accounts of customers residing in the U.S. are counted as held in the U.S. by the number of separate accounts for which the securities are held.

• In addition, an FPI 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 only counts record owners and not beneficial owners holding securities in street name).
Annual Qualification Test

- An FPI is only required to determine its status on the last business day of the most recently completed second fiscal quarter.
- An FPI that obtains its issuer status is not immediately obligated to comply with U.S. reporting obligations.
  - Reporting obligations begin the first day of the FPI’s next fiscal year, when it is required to file an annual report on Form 20-F for the fiscal year its issuer status was determined (within four months of the end of that fiscal year).
- However, a foreign company that obtains FPI status following an annual qualification test can avail itself of the benefits of FPI status immediately.
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., NYSE and Nasdaq); or
  • within 120 days after the last day of its first fiscal year in which the issuer had total assets that exceed $10,000,000 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.

• However, an FPI may also deregister more easily than a domestic issuer.
Benefits to Being a Public Company in the U.S.

- 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
- The ability to send credible signals to the market that the company will protect minority shareholder interests
Considerations for Being a Public Company in the U.S.

- Foreign issuers usually weigh having greater access to capital and the imprimatur of success associated with a public offering in the U.S. with the following concerns:
  - Heightened disclosure standards
  - Corporate governance considerations, stemming from SRO requirements and requirements under the Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”)
  - Accounting related disclosures
  - Possibility for exiting the system (deregistration)
  - Litigation exposure
Benefits Available to FPIs

• A FPI may exit (or deregister) the U.S. reporting regime more easily than a U.S. issuer
• Quarterly reports: A FPI is not required to file quarterly reports
• Proxies: A FPI is not required to file proxy statements
• Ownership reporting: No Section 16 reporting
• Governance: A FPI may choose to rely on certain home-country practices
• XBRL: Temporary XBRL relief for FPIs
Benefits Available to FPIs (cont’d)

- Internal controls: Annual internal control reporting
- Executive compensation: As a FPI, certain of the more onerous executive compensation disclosure requirements are not applicable
- IFRS without GAAP reconciliation
- 12g3-2(b) exemption
Confidential Submissions

• Only certain kinds of FPIs may now confidentially submit registration statements:
  • 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 law of an applicable foreign jurisdiction.

• In addition, shell companies, blank check companies and issuers with no or substantially no business operations are precluded from using the confidential submission process.
Confidential Submissions (cont’d)

• However, an FPI may still qualify as an “emerging growth company” (“EGC”) under Title I of the Jumpstart Our Business Startups Act (the “JOBS Act”), in which case it could still submit registration statements confidentially, provided that:
  • The FPI elects to be treated as an EGC; and
  • The initial confidential submissions and all amendments are filed with the SEC no later than 21 days prior to the FPI’s commencement of the road show.
EGCs
EGCs

- An EGC is defined as an issuer with total gross revenues of under $1 billion (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 a $1 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.”
- An issuer will not be able to qualify as an EGC if it first sold its common stock in an initial public offering (“IPO”) prior to December 8, 2011.
Other EGC Accommodations

• 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:
  
  • *Testing-the-Waters*: An EGC is permitted to engage in oral or written communications with qualified institutional buyers (“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 Reports*: Broker-dealers are permitted to publish or distribute a research report about an EGC that proposes to register or 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.
EGC Accommodations (cont’d)

- **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.
Total Annual Gross Revenues – Defined

• “Total annual gross revenues” means total revenues as presented on the income statement presentation under U.S. GAAP (or IFRS, if used as the basis of reporting by a FPI).

• If the financial statements of a FPI are presented in a currency other than U.S. dollars, total annual gross revenues should be calculated in U.S. dollars using the exchange rate as of the last day of the most recently completed fiscal year.

• In addition, if the financial statements for the most recent year included in the registration statement are those of the predecessor of the issuer, the predecessor’s revenues should be used when determining if the issuer meets the definition of an EGC.
Timing of EGC Status

• An issuer will not be able to qualify as an EGC if it first sold its common stock in an IPO prior to December 8, 2011. This test is not limited to a company’s initial primary offering of common equity securities for cash. It could also include offering common equity pursuant to an employee benefit plan on a Form S-8 as well as a selling stockholder’s secondary offering on a resale registration statement.

• If the issuer that would otherwise qualify as an EGC had a registration statement declared effective on or before December 8, 2011, but no sales took place before that date, the issuer would still qualify as an EGC.
Losing EGC Status

• EGC status is tested at the timing of the first public filing of the issuer’s registration statement. So if an issuer confidentially submits a draft registration statement and while the issuer’s draft registration statement is pending with the SEC, the issuer crosses the $1 billion revenue threshold (or one of the other tests for EGC status), it will lose its EGC status.

• This issuer would need to file a registration statement to continue the review process and comply with current rules and regulations applicable to companies that are not EGCs. At that time, the prior confidential draft submissions would be filed as exhibits to the registration statement.

• If however, a company publicly files its registration statement at a time when it qualifies as an EGC, the disclosure provisions for EGCs would continue to apply through effectiveness of the registration statement even if the company loses its EGC status during registration.
Losing EGC Status (cont’d)

• For other purposes, the SEC has advised that an issuer would need to assess EGC status at the time it undertook certain permitted activities.
• For example, if the issuer were an EGC at the time it engaged in “test-the-waters” communications, and subsequently lost its EGC status, the issuer’s activities would not be seen as violating Section 5 of the U.S. Securities Act.
EGC Opt-In

• An EGC may forego reliance on any exemption available to it. However, if it chooses to comply with financial reporting requirements applicable to non-EGCs, it must comply with all such standards and cannot selectively opt in or opt out of requirements.
• Any election to be treated as an EGC must be made at the time the EGC files its first registration statement or Exchange Act report.
• The SEC has made clear it expects EGC issuers to disclose their EGC status on the cover page of their prospectuses.
Registration Process in General
What Securities to Register?

• An FPI may offer any type of security that a U.S. domestic issuer is permitted to offer.
• In addition, an FPI may offer its securities using American Depositary Receipts (“ADRs”).
• An FPI registering securities for the first time, will register ordinary shares or ADRs.
• Once an FPI has ordinary shares or ADRs listed in the U.S., it may register debt securities under another registration statement.
What are ADRs?

- An ADR is a negotiable instrument issued by a U.S. bank that represents an ownership interest in a specified number of securities that have been deposited with a custodian, typically in the FPI’s country of origin.
- There are two types of ADRs: (1) “Unsponsored” ADRs and (2) “Sponsored” ADRs.
  - Unsponsored ADRs” are ADRs in which the FPI of the underlying security is not involved.
  - “Sponsored ADRs” are ADRs that are issued in cooperation with the FPI whose equity shares underlie the ADR shares and do not trigger U.S. federal securities reporting obligations.
- ADR facilities are established by depositary banks pursuant to the disclosure obligations under Rule 12g3-2(b) of the Exchange Act.
Which Registration Form Should be Used?

• Typically, an FPI will register ordinary 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.

• However, Form 20-F may also be filed as a registration statement for ordinary shares when an FPI is not engaged in a public offering of its securities, but is still required to be registered under the Exchange Act.
  • For example, when an FPI reaches the holder of record threshold under Section 12(g) of the Exchange Act, and there is no other exemption available.

• “Unsponsored” ADRs must be registered on Form F-6.
Which Registration Form Should be Used? (cont’d)

• Certain Canadian issuers may take advantage of the Multi-Jurisdictional Disclosure System (“MJDS”), which allows a shorter form of disclosure and incorporation by reference to Canadian disclosures.

• 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.
SEC Review Process

- The SEC’s review of the registration statement is an integral part of the registration process and should be viewed as a collaborative effort.
- Once a registration statement is filed, a team of SEC Staff members is assigned to review the filing, which consists of accountants and lawyers, including examiners and supervisors.
- The SEC’s principal focus during the review process is to assess the company’s compliance with the SEC’s registration and disclosure rules, although the nature of some comments shade into substantive review.
  - The SEC considers the disclosures in the registration statement through the eyes of an investor in order to determine the type of information that would be considered material to an investor. The SEC Staff will closely review websites, databases and magazine and newspaper articles, looking in particular for information that they think should be included in the registration statement or that contradicts information included in the registration statement.
SEC Review Process (cont’d)

• The review process is time-consuming. While there was a time when the review process could be completed in roughly two months, now given the length of many prospectuses and the complexity of the company’s business and the nature of the issues raised in the review process, it can take three to five months.
  • Initial comments on the registration statement are provided in about 30 days; however, depending on the SEC’s workload and the complexity of the filing, the receipt of first-round comments may take longer.
  • The SEC’s initial comment letter typically includes about 50 to 75 comments, with a majority of the comments addressing accounting issues.
  • The company and counsel will prepare a complete and often lengthy response. In some instances, the company may not agree with the SEC Staff’s comments, and may choose to schedule calls to discuss the matter with the SEC Staff.
  • The company will file an amendment to the registration statement, and provide the response letter along with any additional information.
  • The SEC Staff generally tries to address response letters and amendments within 10 days, but timing varies considerably.
SEC Review Process (cont’d)

• The SEC makes comment letters and responses from prior reviews available on its website, so it is possible to determine the most typical comments raised during the registration process and, if appropriate, to address them in the first filing.

• Overall, the SEC Staff looks for a balanced, clear presentation of the information required in the registration statement.
  • Some of the most frequent comments raised by the SEC Staff on disclosure, other than on the financial statements, focus on whether the risk factors are specific to a company and devoid of mitigating language, whether the MD&A addresses known trends and events that affect the company’s financial statements, operations and liquidity, and whether the description of the company’s market position is supportable by third party data.
  • The SEC will even review artwork based on the theory that “a picture is worth a thousand words.”
IPO Process
**Typical IPO Timeline - Nasdaq/NYSE/NYSE MKT**

**6-12 months before IPO**
- Company rounds out management team (if necessary); focus on "corporate cleanup"

**4-6 months before IPO**
- Company formally decides to do IPO
  - appoint underwriter
  - publicity restrictions commence

**3-6 weeks before first SEC filing**
- due diligence
- prospectus drafting
- adopt public co. policies/controls/procedures if not done already
- complete audit and review of interim financials
- corporate governance matters

**Initial filing**
- file Form F-1 with SEC and submit application to exchange
- file confidential treatment request, if necessary

**4-6 weeks after filing**
- receive first round of comments from SEC

**Typically 3-5 months after first filing**
- resolve material SEC comments
- listing approval
- bulk print preliminary ("red") prospectus

**Road show**
- price deal
- commence public offering

**Typically 2-3 weeks**
- print final prospectus and close offering

**1-2 weeks after receipt of comments**
- resubmit revised F-1

**Comments at 2-4 week intervals**
- respond to 2nd (and 3rd, 4th and 5th) round of comments from SEC

**Typically 2-3 weeks after first SEC filing**
- file Form F-1 with SEC and submit application to exchange
- file confidential treatment request, if necessary

**Typically 3-5 months after first filing**
- resubmit revised F-1

**Comments at 2-4 week intervals**
- respond to 2nd (and 3rd, 4th and 5th) round of comments from SEC
EGC IPO Process

The SEC must review the draft registration statement on a confidential basis.

An EGC may remain in the confidential review process until required to file Form F-1, with the SEC issuing comments and the EGC responding with draft submissions.

The Form F-1 and all prior confidential submissions must be filed 21 days before the road show.

After filing the Form F-1, the process is the same as a pre-JOBS Act IPO.

An EGC or any other person authorized by the EGC can “test the waters” in communications with QIBs and institutional accredited investors before or during the IPO.

Broker-dealers, including those participating in the IPO, can publish research before, during or after the IPO without the research being deemed an “offer” under the Securities Act.
Key Phases of the IPO Process

The basic financial reporting timeline for an IPO

Phase I
- Assessing readiness allows for increased accuracy in management’s IPO planning and timing.

Phase II
- Planning to set overall horizon and key milestones.
- Going public activities, including preparation and audit of relevant historical financial data, prospectus drafting and SEC review process.

Phase II and III
- Being public involves corporate governance, Sarbanes-Oxley 404 compliance, developing and sustaining quarterly close procedures.
The Players

- **Accounting team** - Coordinates the audit of the company’s financial statements and operations and is responsible for drafting key parts of the IPO prospectus, such as management’s discussion and analysis of financial condition and results of operations (the “MD&A”).

- **CEO and senior management** - Presents the “road show” to investors.

- **Outside legal counsel** - Because of the complexity of the federal and state securities laws, handling the legal work of an IPO from within is not advisable.

- **Independent auditing firm** - Assist the company in preparing the financial statements and furnishing a “comfort letter” to the underwriters.

- **Lead underwriter** - Responsible for the orderly distribution of the IPO shares into the marketplace.
The Company’s Internal IPO Team

- **CEO** - presents the company’s message;
- **CFO** - presents the company’s financials, coordinate the preparation and disclosure of the financial information in the prospectus;
- **General counsel/controller** - coordinates the due diligence process, helps ensure the accuracy of the prospectus, ensure compliance by the company with the SEC’s rules relating to corporate communications during the IPO process; and
- **Investor relations/public relations manager** - coordinates the company’s public communications during the offering.
Underwriter Due Diligence

• The underwriters and their counsel are likely to spend a substantial amount of time performing business, financial and legal due diligence in connection with the IPO.

• The process is typically triggered with a so-called “due diligence request,” which is a somewhat lengthy memo requesting information and documents that is prepared by the underwriters and their counsel.

• The company will want to make sure that it has appropriate personnel ready to ensure that the underwriters and their counsel have access to the information that they need to perform their due diligence.

• In facilitating the due diligence process, the company and its counsel should seek to maintain the confidentiality of company information.
Drafting the Registration Statement

• The registration statement should be the result of a joint effort by the company, company’s counsel, the underwriter and the underwriter’s counsel, led by the company and its counsel.

• The prospectus constitutes most of the registration statement. It is a disclosure document and is the only document the underwriters are permitted to use to sell the deal. Significant liability could result from material misstatements or omissions in connection with the disclosure.

• The underwriters will conduct due diligence on the company’s operations and management. The due diligence exercise serves to protect the underwriters from liability and plays an important role in the drafting of the prospectus.

• Preparing due diligence documents for the underwriters and their counsel may involve significant amounts of management’s time. Companies are well served by taking the time to organize the due diligence production.

• Many companies will need to provide diligence materials in the future for other transactions, such as follow-on financings, alternate financings, licensing transactions, asset sales, M&A transactions and others. To the extent the process is organized, the company will not have to redo the work in the future. It will also serve as a good corporate practice to make sure the materials are organized in the company’s files.

• A virtual data room is the best use of resources for providing and maintaining diligence materials for these transactions. Most printers, and other vendors, have VDRs.
Disclosure Requirements

• SEC regulations dictate the disclosure required in the prospectus. The principal sections of the prospectus are:

  • Summary. The summary is a short overview of the more important elements of the offering and the company. Typically, this section will cover the type of security offered, the use of proceeds, the amount of securities offered, the trading market for the securities and a brief description of the company. Most investors who actually read the prospectus prior to investing in an initial public offering will limit their review primarily to the summary section.

  • Financial Statements. Those investors who read on will often jump to the back of the prospectus and review the audited annual financial statements of the company, which include balance sheets for each of the last two completed fiscal years and income statements for each of the last three completed fiscal years and unaudited financial statements for any interim periods subsequent to the last completed fiscal year.

  • MD&A. The MD&A is a discussion of the company’s liquidity, capital resources and results of operations. MD&A also includes a discussion of known trends and uncertainties that may have a material impact on the company’s future operating performance, liquidity or capital resources.
Disclosure Requirements (cont’d)

• The SEC has identified three principal objectives of MD&A:
  • to provide a narrative explanation of a company’s financial statements that enables investors to see the company through the eyes of management;
  • to enhance the overall financial disclosure and provide the context within which financial information should be analyzed; and
  • to provide information about the quality of, and potential variability of, a company’s earnings and cash flow, so investors can make assessments about the company’s future performance.

• Risk Factors. Often, the risk factors section is divided into three parts: risks pertaining to the offering, risks pertaining to the issuer and risks pertaining to the issuer’s industry. Under pressure from the SEC, there is a noticeable trend of making the descriptions more issuer-specific.

• Business. The section of the prospectus which allows for the greatest amount of creativity is the description of the company’s business. The discussion goes beyond being a discussion of the company’s products or services to cover a wide variety of issues such as the company’s key suppliers, customers, marketing arrangements, strategic partners and intellectual property.
Disclosure Requirements (cont’d)

• **Management.** The company’s officers and directors must be identified and brief biographical descriptions given.

• **Executive Compensation.** Executive compensation disclosure must be given for the five highest paid executive officers, which must include the CEO and CFO. Most of this disclosure will be provided in tabular format. Additional disclosure is also required concerning directors’ compensation and employee benefit plans. The SEC has also imposed a compensation disclosure and analysis (CD&A) section whereby the company must provide an analysis of the considerations and processes associated with the company’s executive compensation.

• **Security Ownership.** A tabular presentation of each officer’s and director’s beneficial share ownership as well as the beneficial ownership for each holder of greater than 5% of the outstanding stock of the company is required.

• **Plan of Distribution.** This section describes the underwriters’ plans for distributing the shares in the offering. The disclosure in this section is generally the same in most IPOs.
Disclosure Requirements (cont’d)

- **Related Party Transactions.** Any material business transaction among the issuer and its executive officers, directors, significant stockholders or other key personnel must be identified and described. Any business relationships or indebtedness involving the issuer and the same persons must be disclosed. Although there are *de minimis* exceptions for transactions with affiliates, as a general rule, any transaction which raises questions of conflict of interest should be discussed.

- **Selected Financial Data.** Included in the registration statement are selected historical financial data for at least the last five fiscal years and for the period since the end of the last full fiscal year (or for EGCs, for the last two fiscal years and the most recent interim period).
Audited Financial Statements

• Also included in the prospectus are:
  • audited balance sheets as of the end of the company’s last two fiscal years,
  • audited statements of operations, statements of cash flows and statements of changes in stockholders’ equity and footnotes for each of the last three fiscal years, and
  • depending on the length of time between the end of the prior fiscal year and the date of filing the prospectus, an unaudited balance sheet as of the end of the interim period and statements of operations, statements of cash flows and statements of changes in stockholders’ equity for the interim period and for the corresponding prior-year period.
The SEC IPO Review Process

• Once the draft of the registration statement is satisfactorily completed, the registration statement is filed with the SEC.
• The registration statement will be reviewed by the staff of the SEC’s Division of Corporation Finance in Washington, D.C.
• The SEC review process consists of both a legal and an accounting review. This period is often referred to as the waiting period.
  • The SEC staff will provide the company with a comment letter, typically within 30 days after the filing of the registration statement.
  • It is not unusual for the SEC’s initial comment letter for an IPO to contain a substantial number of comments.
  • The company responds to the comment letter by filing an amendment to the registration statement, a response letter and any supplemental materials the SEC staff requests.
  • In a typical IPO, several comment letters and responsive amendments are produced before the review process is finished.
The SEC IPO Review Process (cont’d)

• During the SEC review and comment process, the underwriter is permitted to make offers to the public only through distribution of:
  • the preliminary prospectus,
  • any free writing prospectuses (“FWPs”), and
  • live oral presentations.

• The preliminary prospectus or “red herring” is printed when the SEC review and response process is finalized.

• The waiting period ends when the SEC declares the registration statement effective.

• Once the SEC has completed its review, the company and the underwriters will request that the SEC declare the registration statement effective as of a specified date and time.
  • Generally, the SEC requires 48 hours notice of the date and time of desired effectiveness.
  • A notice of effectiveness will be posted on the SEC’s website.
Other Regulatory Clearances

• **Stock Exchange Listing:**
  • Listing the company’s securities on a securities exchange (e.g., NYSE or Nasdaq) is one of the most important steps the company can take to achieve stockholder liquidity.
  • The company’s counsel will assist the company in determining the specific listing requirements for the various securities markets and will assist the company in preparing and filing its listing application.

• **FINRA:**
  • Immediately following the initial filing of the registration statement, underwriter’s counsel is required to file the registration statement, the form of underwriting agreement and any other underwriting documents (e.g., agreement among underwriters, selected dealers agreement, etc.) with the Financial Industry Regulatory Authority or “FINRA.”
  • FINRA reviews the offering terms and the underwriting agreement to determine whether the underwriting terms and arrangements are fair and reasonable.
  • Before the SEC will declare the registration statement effective, FINRA must advise the SEC staff that FINRA does not object to the fairness or reasonableness of the underwriting terms and arrangements.
Marketing the Offering – Road Show

• Once the preliminary prospectus has been printed and distributed, representatives of the company (usually the CEO and CFO) and the underwriters go on a “road show” to market the offering.

• The road show slide presentation will be prepared by the underwriters and company management.
  • The road show presentation should not include information to investors about the company that is not in the registration statement.

• The company should consult with its counsel before issuing any press releases, conducting interviews or making any public statements about the company.

• Following completion of the road show, the company will seek SEC clearance and the offering will be priced.
Limitations on Communications

• Beginning 30 days before the filing of the registration statement, the company is subject to substantial limitations on communications with potential investors and the financial markets during its IPO.

• A critical step is for the company to take actions to ensure that it will limit its public statements, and the public statements of its management, in order to avoid “gun-jumping” and otherwise comply with the SEC rules. This will involve:
  • limiting appearances of senior personnel at investor conferences and related events;
  • reviewing and editing the company’s website to conform to the statements in the prospectus, and to remove pages, links or statements that might be construed as an effort to attract interest in the stock; and
  • reviewing its marketing and advertising materials to ensure that they do not contain statements that the SEC might consider objectionable.
“Gun-Jumping”

• Once the company has decided to go public, it is deemed to be “in registration;” this period is often referred to as the “quiet period.”

• The quiet period extends for typically 25 days following the effective date of the registration statement.

• During the quiet period, the company should avoid:
  • public announcements,
  • attendance and presentations at industry conferences,
  • giving interviews to the financial press, and
  • other communications that the SEC could view as attempts to “condition the market” or otherwise generate interest in the company’s IPO.

• During the 30-day period before filing, and through the offering period, the company may publish “factual business information” (e.g., information of the kind it has regularly released in the past intended for use by customers or suppliers, so long as there is no reference to the IPO).
Sanctions for “Gun Jumping”

• The SEC can impose a “cooling-off period.”
  • This means delay, or even temporarily halt, the effectiveness of the registration statement until the effect of the publicity has “cooled off.”

• The SEC may require inclusion in the registration statement of:
  • The “gun jumping” statements (which subjects the company and its directors and officers to liability for those statements).
  • A risk factor stating that investors may have a right of rescission for up to 1 year.

• A violation can also result in an SEC enforcement action:
  • Civil penalties.
  • Possible criminal action.

• A company should monitor its corporate communications, website and publicity activities to ensure that public announcements, advertising programs and other communications about the company do not violate the Securities Act and SEC regulations.
Pricing

• Immediately after the pricing, the company, the attorneys and the auditors need to prepare the final prospectus.
• Generally, a press release and Form 8-K will be filed the next morning before the market opens.
• As the final prospectus is being prepared, the underwriting agreement is signed by the underwriters and the company.
• The auditors should deliver the comfort letter after pricing (generally as soon as the final prospectus is completed).
• Any lock-up agreements that were not delivered prior to the road show will need to be delivered at the pricing.
• The company must make sure that the necessary persons are available to help prepare the final prospectus and sign the underwriting agreement and Form 8-K.
Pricing (cont’d)

• Setting the price:
  • In most IPOs, after the market closes on the date of effectiveness, representatives of the underwriter and the company will meet in person or by phone to “price the offering,” based on the demand for the company’s shares, current stock market conditions, and the price range stated in the preliminary prospectus.

• Forming the underwriting syndicate:
  • In a so-called “syndicated offering,” at the time of the pricing, the managing underwriter will invite additional underwriters to participate in the offering.
  • Each of these underwriters will agree to underwrite a portion of the shares to be sold and enter into an “agreement among underwriters” with the managing underwriter.

• The final prospectus:
  • After the pricing is completed, the working group will prepare the final prospectus.
  • The final prospectus adds the information that is based on the final terms of the offering, including the IPO price, the proceeds of the offering, the final pro forma balance sheet reflecting the offering, and the allocation of the offered shares among the underwriters.
  • The final prospectus must be filed with the SEC within two business days after pricing, but is not required to be physically delivered to investors unless they request a paper copy.
Time of sale

• Post Securities Offering Reform, issuers and underwriters must focus on the materials and “mix of information” that is available to investors at the “time of sale.”

• From a practical perspective, an underwriter should decide, as a matter of policy, the approach that it will take to conveying information at the time of sale:
  • Oral conveyance;
  • Term sheet or FWP to effect conveyance;
  • Confirmation or re-confirmation of indications of interest or orders.
Closing

- The closing requires less involvement by the company than the pricing.
- The company will need to deliver certificates and other closing documents signed by either the CEO, the CFO or both.
- The company’s counsel will deliver the offering opinion. Company counsel will generally prepare a back-up certificate to be signed by a company officer in connection with its opinion. Other opinions (such as tax opinions, IP opinions or regulatory opinions) may be delivered at closing as well.
- Underwriter’s counsel will also deliver an opinion but will not require the company's involvement.
- The auditors will deliver a bring-down comfort letter. The auditors bring-down process will require company involvement.
- A company representative will need to confirm deposit of the offering proceeds in the company account.
Key IPO Documents

- Underwriting Agreement:
  - Shortly after the pricing, the managing underwriter, on behalf of itself and the other underwriters, will enter into the underwriting agreement with the company and any selling stockholders.
  - The underwriting agreement is an agreement by the underwriters to purchase the stock in the IPO, and to sell it to investors.
  - The company will give extensive representations and warranties to the underwriters (diligence benefit).
  - Will include the terms of purchase and sale of securities by the underwriters, including the number of securities, price (including discount or commission) and closing date.
  - Covenants by both issuer and underwriters (prospectus deliveries, blue sky, changes to issuer’s business and amendments to prospectus).
  - Further legal protections to underwriters (closing conditions, officers’ certificates, opinions of counsel and comfort letters from issuer’s auditors).
  - Indemnification from issuer to underwriters for alleged misstatements and omissions (except for specific information provided by underwriters).
Key IPO Documents (cont’d)

• Lock-up Agreements:
  • Directors, executive officers and major stockholders of the company will typically be required to sign “lock-up agreements” with the managing underwriter.
  • These are short documents designed to bar these parties from selling any company stock during the critical period after the pricing (usually 180 days).
  • The underwriters also may seek to extend the lock-up period beyond the 180 days if there would be a publication or other distribution of research reports or analyst recommendations within the 15 days of the lock-up expiration date because FINRA places restrictions on such publication or distribution during that period.
Key IPO Documents (cont’d)

• Comfort Letter:
  • The underwriting agreement will require that the company’s auditors deliver to the company a so-called “comfort letter” on the date of the pricing.
  • The comfort letter is signed by the auditing firm, and is typically negotiated among the auditing firm, on one side, and the underwriters and their counsel, on the other side.
  • The comfort letter helps the underwriters satisfy their “due diligence” obligation, by relying on the auditors, in their capacity as “experts,” to confirm certain information relating to the company’s financial statements that appears in the prospectus.

• Beneficial Ownership Reports:
  • Officers, directors and 10% stockholders must report their holdings of the company’s securities, and report their purchases and sales.
  • These matters are reported on short forms known as Form 3, Form 4 and Form 5. These reports are publicly available to all investors.
  • The initial filing (on Form 3) is due on or prior to the effective date of the registration statement.
Accounting Considerations
Accounting Considerations

• FPIs that prepare their financial statements under U.S. GAAP will find that the SEC will require additional disclosures and other explanations in their financial statements.

• In addition, FPIs that prepare financial statements under U.S. GAAP should be prepared to address SEC accounting comments regarding their registration statements.
Elimination of GAAP Reconciliation

- Modified financial disclosures

- Under Item 18 of Form 20-F, an FPI is required to make certain disclosures regarding its financial statements.

- Traditionally, an FPI listing securities in the U.S. was required to either prepare its financial statements in accordance with U.S. GAAP or reconcile its financial statements to those rules.

- Most FPIs were obligated to provide information that was not otherwise required under their home countries’ GAAP.
Elimination of GAAP Reconciliation (cont’d)

• SEC rules omit U.S. GAAP reconciliation requirements if an FPI satisfies the following conditions:
  
  • The financial statements must be prepared in accordance with the English language version of the International Financial Reporting Standards (“IFRS”) as published by the International Accounting Standards Board (the “IASB”); 
  
  • The FPI must state in the notes to the financial statements that its financial statements are in compliance with IFRS as issued by the IASB; and 
  
  • The FPI must provide an opinion by an independent auditor stating that the financial statements are in compliance with IFRS as issued by the IASB.
GAAP Reconciliation and IFRS Convergence

• General Instruction G to Form 20-F permits eligible foreign private issuers to file only two years of statements of income, shareholders’ equity and cash flows prepared in accordance with IFRS for their first year of reporting in accordance with IFRS.

• In its second year of IFRS reporting and thereafter, an FPI must provide three years of audited IFRS financials.
• FPIs that do not prepare their financial statements in accordance with IFRS as issued by the IASB can either:

  • Continue to reconcile their financial statements to U.S. GAAP; or
  • Include in their IFRS financial statements such additional information as is necessary to comply with the IASB issued IFRS, as well as the jurisdiction specific IFRS.
Convenience Translations and Exchange Rates

• If the reporting currency is not the U.S. dollar, U.S. dollar-equivalent financial statements or convenience translations are not permitted to be included, except that an FPI may present a translation of the most recent fiscal year and any subsequent interim period.

• The exchange rate used for any convenience translations should be as of the most recent balance sheet date included in the registration statement, except where the exchange rate of the most recent practicable date would yield a materially different result.
Convenience Translations and Exchange Rates (cont’d)

• In addition, FPIs that do not prepare their financial statements in U.S. dollars must provide disclosure of the exchange rate between the reporting currency and the U.S. dollar.
  • The disclosure should show: (1) the exchange rate at the last practicable date; (2) the high and low exchange rates for each month during the previous six months; and (3) for the five most recent fiscal years, and any subsequent interim period covered by the financial statements, the average rates for each period (based on the average exchange rates on the last day of each month during the period).
  • The exchange rate to use for these purposes is the noon buying rate in New York City for cable transfer in non-U.S. currencies as certified for customs purposes by the Federal Reserve Bank of New York.
Corporate Governance Considerations
Corporate Governance: Audit Committee

• Item 6.C.3 of Form 20-F requires an FPI to disclose the names and method of operation of its audit committee.

  • However, according to the SEC, an FPI has no legal obligation to establish an audit committee.

• An “audit committee” is defined as “a committee (or equivalent body) established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer; and if no such committee exists with respect to an issuer, the entire board of directors of the issuer.”

• Section 10A-3 of the Exchange Act, pursuant to Rule 10A(m) of the Exchange Act and Section 301 of Sarbanes-Oxley, contains specific rules for how to conduct and organize an audit committee.
Audit Committee: Disclosures

• An issuer is required to disclose in its periodic reports whether the audit committee includes at least one financial expert.

• In addition, the audit committee must:
  • Exercise “independence”;
  • Possess the authority to employ, compensate and oversee the work of the independent auditors;
  • Possess the authority to employ and compensate outside advisors; and
  • Implement procedures for handling complaints regarding accounting, internal accounting control or auditing matters, including “confidential, anonymous submission by employees of the issuer of concern regarding questionable accounting or auditing matters.”
Audit Committee: Composition

• Each audit committee member must be a member of the board of directors of the issuer, and must be otherwise independent.

• Under Rule 10A-3(b) of the Exchange Act, in order to maintain “independence,” an audit committee member may not (except in his or her capacity as a member of the audit committee, the board of directors or any other board committee):

  • Accept directly or indirectly any consulting, advisory, or other compensatory fee from the issuer or any subsidiary thereof, provided that, unless the rules of the national securities exchange or national securities association provide otherwise, compensatory fees do not include the receipt of fixed amounts of compensation under a retirement plan (including deferred compensation) for prior service with the listed issuer (provided that such compensation is not contingent in any way on continued service); or

  • Be an affiliated person of the FPI or any subsidiary of the FPI.
Audit Committee: Exemptions

• In certain instances, a FPI may be exempt from the independence requirement.

• Recognizing that there may be conflicts of law between home-country and domestic practices, the SEC established exemptions to the independence requirement tailored to accommodate differing global practices.

• Exemptions apply to the following audit committee compositions:
  • Employee represented,
  • Two-tiered board system,
  • Controlling security holder representation,
  • Foreign government representation, and
  • Board of auditors.
Audit Committee: Financial Experts

• Under Item 16A of Form 20-F, an FPI is required to disclose whether its audit committee has at least one “audit committee financial expert” (“ACFE”).

• An FPI must disclose the name of the ACFE and whether that person is deemed “independent,” as defined under Rule 10A-3(b) of the Exchange Act.

• An ACFE is defined as any person with the following attributes (obtained through education and experience by serving as an officer, accountant, or auditor, by supervising such individuals, or any other relevant experience):

  • An understanding of generally accepted accounting principles and financial statements;

  • The ability to assess the general application of such principles in connection with the accounting for estimates, accruals and reserves;

  • Experience preparing, auditing, analyzing, or evaluating financial statements that present a breadth and level of complexity of accounting issuers that are generally comparable to those raised by the issuer’s financial statements or experience actively supervising one or more persons engaged in such activities;

  • An understanding of internal control over financial reporting; and

  • An understanding of audit committee functions.
Audit Committee: Securities Exchange Rules

• Each securities exchange imposes its own set of rules regarding audit committees.

  • For example, under NYSE Listed Companies Manual Section 303A, an FPI that lists its securities on the NYSE and follows its home-country audit procedures must:

    (1) Disclose how its corporate governance rules differ from those required by the relevant exchange;

    (2) Satisfy the independence requirement under Rule 10A-3(b) of the Exchange Act;

    (3) Provide certification from the CEO that he or she is not aware of any violation of the NYSE corporate governance listing standards; and

    (4) Submit an executed written affirmation annually or an interim written affirmation each time a change occurs its board or any of the committees of the board.
Corporate Governance: Compensation Committee

• Under Item 6.C.3 of Form 20-F, an FPI must disclose information regarding its compensation committee, including the names of committee members and a summary of the terms under which the committee operates.

• Each securities exchange may impose specific disclosure requirements with respect to compensation committees.
Ongoing Reporting Obligations and Governance
Ongoing Reporting Obligations

• 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
  • Reports on Form 6-K
The information required to be disclosed in an Annual Report on Form 20-F includes, but is not limited to, the following:

- operating results;
- liquidity and capital resources;
- trend information;
- off-balance sheet arrangements;
- consolidated financial statements and other financial information;
- significant business changes;
- selected financial data;
- risk factors;
- history and development of the FPI;
- business overview; and
- organizational structure.
Annual Report on Form 20-F (cont’d)

• A Form 20-F also must 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 (e.g., mine health and safety and oil and gas operations that are material to its business operation or financial position).
Reports on Form 6-K

• An FPI must also “furnish” reports on Form 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.
  • 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.
  • 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.
Reports on Form 6-K (cont’d)

• 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.
Sarbanes-Oxley Requirements

- Section 302 of Sarbanes-Oxley requires certifications by an FPI’s CEO/CFO regarding the effectiveness of the FPI’s disclosure controls and procedures, the completeness and accuracy of the FPI’s reports filed under Section 13(a) and 15(d) of the Securities Act, and any deficiencies in, and material changes to, the FPI’s internal control over financial reporting.
  - Section 302 reporting begins once the FPI is an SEC registrant.
  - These certifications must be included in the FPI’s Form 20-F.
  - Other reports filed or furnished by the FPI, such as reports on Form 6-K, are not subject to the certification requirements.

- Section 404 of Sarbanes-Oxley requires an annual report by both management and external auditors regarding the effectiveness of the company’s internal controls over financial reporting.
  - Section 404 reporting begins with the second annual filing with the SEC.
  - FPIs that are “non-accelerated” filers do not have to provide the auditor’s attestation.
“Disclosure controls and procedures” are controls and other procedures designed to ensure that the information required to be disclosed in the reports filed under the Exchange Act, on a timely basis, are recorded, processed, summarized and reported.

Disclosure controls and procedures include, but are not limited to, controls and procedures designed to ensure that information required to be disclosed by a company in its Exchange Act reports is appropriately accumulated and communicated to the company’s management, including its principal executive and financial officers, to allow timely decisions regarding required disclosure.

Important to have an “up the chain” process of reporting from lower managers to CEO and CFO.
Enhanced Disclosure Obligations for FPIs

• There are enhanced disclosure requirements regarding an FPI’s Annual Report on Form 20-F.

• The enhanced disclosures apply to the following areas:

  (1) Changes in or disagreements with the FPI’s certifying public accountant;
  
  (2) ADR fees, payment and other charges; and
  
  (3) Differences in corporate governance practices.
Changes In or Disagreements With the FPI’s Certifying Public Accountant

• The SEC adopted Item 16F of Form 20-F, which requires an FPI to disclose:

  (1) Whether an independent accountant has resigned, declined to stand for re-election, or was dismissed;

  (2) Any disagreements or reportable events that occurred within the issuer’s latest two fiscal years and any interim period preceding the change of accountant; and

  (3) Whether the current accountant has treated information in a different manner than the former accountant with whom the issuer has disagreed.
Changes In or Disagreements with the FPI’s Certifying Public Accountant (cont’d)

- Under Item 16F of Form 20-F, an FPI must provide a copy of such disclosure to the former accountant and is required to file as an exhibit to its Form 20-F any response from the former accountant.

- The SEC also requires such disclosure in all registration statements used by FPIs in connection with public offerings.
ADR Fees, Payment and Other Charges

• Under Item 12 of Form 20-F, a FPI must disclose certain information regarding its ADR facility (if applicable), including:

  (1) Fees and charges that ADR holders may have to pay for general depositary services, pursuant to Item 12.D.3 of Form 20-F; and

  (2) Fees and any payments an FPI receives from depositaries in connection with its ADR facility, pursuant to 12.D.4 of Form 20-F.
• Item 12 of Form 20-F was amended to provide more transparency in light of the new depositary fees that are being imposed on ADR holders in connection with sponsored ADR facilities.

• More robust disclosure regarding ADR fees and payments serves as a benefit to investors that purchase ADRs in book-entry form and may not have access to the depositary certificates.
Differences in Corporate Governance Practices

• Under Item 16G of Form 20-F, an FPI must provide a summary of the differences between its corporate governance practices and those applicable to U.S. companies under the relevant securities exchange’s listing rules.

• Securities exchanges, such as the NYSE and Nasdaq, require disclosures of differences between an FPI’s corporate governance, based on home-country practice and the requirements of the exchange.
Financial Statement Reporting

• An FPI must provide significant disclosures regarding its financial condition under Item 8 and Item 18 of 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.
Financial Statement Reporting (cont’d)

• In the past, certain FPIs were permitted to omit segment data from their financial statements that were otherwise prepared in accordance with U.S. GAAP pursuant to Item 17 of Form 20-F, but the SEC has eliminated this accommodation.

  • However, 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.
Financial Statement Reporting (cont’d)

• An FPI that prepares financial statements in accordance with U.S. GAAP is now required to provide financial information to the SEC in XBRL data format (as well as post XBRL data on its publicly available website).

• An FPI that prepares financial statements in accordance with IFRS as issued by the IASB will **not** be required to provide financial information in an interactive data format using XBRL until the SEC specifies the XBRL taxonomy for IFRS financial statements.
Reporting Obligations of Beneficial Owners

• Insiders of an FPI are not subject to the short-swing profit limits set forth in Section 16(b) of the Exchange Act, nor are they required to comply with the Section 16(a) reporting requirements (disclosing holdings of, and transaction in, equity securities of the FPI).

• However, insiders may have disclosure obligations 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.
Reporting Obligations of Beneficial Owners (cont’d)

• Beneficial owners, subject to the disclosure requirement under Section 13(g) of the Exchange Act, are required to file with the SEC a statement on either Schedule 13D or Schedule 13G.

• Rule 13d-1 of the Exchange Act 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.

• 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). The disclosures under Schedule 13G are considerably less detailed than those required by Schedule 13D.
Schedule 13D

• Generally, Schedule 13D requires the following disclosures:
  • 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, a description of the transaction and the names of the parties thereto;
  • 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.
Specialized Disclosure Requirements
Dodd-Frank Act

• Many provisions of The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) have extraterritorial effect and apply to foreign issuers.

• Quite a number of provisions affect public companies, including FPIs, including provisions related to:
  • Executive compensation and governance,
  • Whistleblower provisions, and
  • Ratings.
Dodd-Frank Act Governance and Disclosure Provisions

- Executive compensation and corporate governance provisions:
  - Sec. 951: Say on Pay
    - *Not applicable* to FPIs
  - Sec. 952: Compensation Committee Independence
  - Sec. 953: Pay vs. Performance & Pay Disparity
    - CEO pay ratio disclosure *not applicable* to FPIs
  - Sec. 954: Compensation Clawbacks
  - Sec. 955: Employee and Director Hedging Disclosure
  - Sec. 972: Disclosure of CEO and Chairman Separation
Compensation Committee Independence (Sec. 952)

• Independent Compensation Committee
  • Applies to FPIs unless the FPI provides annual disclosure of the reasons it does not have an independent compensation committee.
  • For FPIs with two-tiered board, “board of directors” means non-management board.

• Independence of Compensation Consultants and Disclosure of Conflicts of Interest
  • FPIs not subject to the SEC’s proxy rules are not required to provide disclosure regarding conflicts of interest.
  • Nasdaq and NYSE exempt FPIs that follow home country corporate governance practices must still provide disclosure regarding those practices and how they differ from the Nasdaq/NYSE requirements.
Compensation Clawbacks (Sec. 954)

- Exchanges must implement rules mandating that listed companies:
  - Adopt and disclose an incentive compensation clawback policy; and
  - Impose a clawback mechanism disgorging certain incentive compensation of executives in the event of a restatement.

- SEC proposed rules on July 1, 2015, which would cover FPIs.
  - Under the proposed new Rule 10D-1, listed companies would be required to develop and enforce recovery policies that in the event of an accounting restatement, “claw back” from current and former executive officers incentive-based compensation they would not have received based on the restatement.
  - Recovery would be required without regard to fault and would apply to excess incentive-based compensation received by executive officers in the three fiscal years preceding the date a listed company is required to prepare an accounting restatement.
  - The proposed rules would also require disclosure of listed companies’ recovery policies, and their actions under those policies.
  - The listing standards would apply to incentive-based compensation that is tied to accounting-related metrics, stock price or total shareholder.
Liability Concerns
Section 11 Liability

• 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:

    • every person who signed the registration statement, including the FPI;
    • every director of the FPI at the time of the filing of the registration statement, whether or not such director signed the registration statement; and
    • experts who consent to such status, but only with respect to those sections of the registration statement (e.g., auditors).
Section 11 Liability (cont’d)

• 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.

• No action under Section 11 may be brought more than three years
  after the bona fide public offering of a security.
Section 12 Liability

• 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.

• No action under 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.
Liability Under the Exchange Act

- Rule 10b-5 of the Exchange Act prohibits:
  - the use of any device, scheme, or artifice to defraud;
  - 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
  - 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:
  - that there was a misrepresentation or failure to disclose a material fact,
  - that was made in connection with plaintiffs’ purchase or sale of a security,
  - that defendants acted with “scienter,” or the intent or knowledge of the violation,
  - that plaintiffs “relied” on defendants’ misrepresentation or omission, and
  - that such misrepresentation or omission caused plaintiffs’ damages.
Extraterritorial Application of Rule 10b-5

• 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.

• “Foreign-cubed” cases – foreign issuers, foreign plaintiffs and foreign transactions – may no longer be brought in the U.S. courts.
  • One U.S. federal appellate 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.” See *Absolute Activist Value Master Fund Ltd. v. Ficeto*, No. 11-0221-cv, Slip. Op. (2d Cir. Mar. 1, 2012).