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Foreign Private Issuers: Don't Forget to Confirm Your FPI Status!

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As we enter the second half of the year, it is once again time for many foreign private issuers ("FPIs") to complete their annual assessment of FPI status. The determination of whether an issuer is an FPI must be made *as of the last business day of the issuer's most recently completed second fiscal quarter*, which for calendar-year end companies is June 30.[1] Below is a reminder of how to perform this analysis and guidance on the application of the assessment criteria, as well as the implications of losing FPI status.[2]

FPI Assessment: How to Do the Test

An FPI is any issuer (other than a government) organized under the laws of any country outside the United States, which also meets certain additional criteria provided by the SEC embodied in a two-step test. The test works as follows:

1. **Step 1: U.S. Shareholder Test:** Are more than 50% of the outstanding voting securities of the issuer owned of record by residents of the United States?
   - (a) If no → company is an FPI, and analysis stop here.
   - (b) If yes → proceed to U.S. Business Contacts Test.
2. **Step 2: U.S. Business Contacts Test:** If the answer to the U.S. Shareholder Test is "yes," the company will remain an FPI, unless **any** of the following is true:
   - (a) The majority of the issuer's executive officers or directors are U.S. citizens or residents;
   - (b) The majority of the issuer's assets are located in the U.S.; or
   - (c) The business of the issuer is administered principally in the U.S.

To assist companies with their yearly analysis, we provide below details on the application of these tests. Companies may wish to formalize their analysis in the form of a short memorandum to file or other written record.

U.S. Shareholder Test

To determine whether more than 50% of the issuer's voting securities are beneficially owned by U.S. residents, an issuer must take into account any U.S. resident beneficial owners known to it, including through reports of

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1 This year, June 30th is not a business day, so the determination should be made as of June 28, 2024.

2 Non-U.S. companies filing a registration statement with the SEC for the first time must determine FPI status within 30 days prior to filing the registration statement.

beneficial ownership provided to the issuer or filed publicly, or otherwise available (*e.g.*, Schedules 13D and 13G and/or reports filed publicly in other countries that might include information on U.S. beneficial owners). In addition, if a record holder is an intermediary (*i.e.*, broker, dealer, or bank, or a nominee for any of them), the issuer must "look through" the record ownership of this intermediary to determine the U.S. residency of each separate customer account.[3] When calculating the percentage of voting securities owned by U.S. residents, the issuer must also include securities held by U.S. residents who received the securities under an employee compensation plan.[4]

If an issuer has multiple classes of voting securities with different voting rights, it may make its determination of U.S. holders based on either of the following, provided it does so on a consistent basis: (i) whether more than 50% of the voting power of those classes on a combined basis is directly or indirectly owned of record by U.S. residents; or (ii) the number of voting securities.[5]

U.S. Business Contacts Tests

U.S. Citizenship or Residency of Executive Officers and Directors

The issuer must assess separately the U.S. residency and citizenship of its executive officers and directors[6] to confirm whether a majority of either group are U.S. residents or citizens. In effect, the issuer must make four determinations:

- Whether a majority of its executive officers are U.S. citizens;
- Whether a majority of its executive officers are U.S. residents;
- Whether a majority of its directors are U.S. citizens; and
- Whether a majority of its directors are U.S. residents.[7]

3 The inquiry may be limited to brokers, dealers, banks, and other nominees located in the U.S., the issuer's jurisdiction of organization and the jurisdiction of the primary trading market for the issuer's voting securities (if different from the U.S. or the jurisdiction of organization). Additionally, the issuer only needs to obtain the percentage of the nominee's holdings of the issuer's securities that are represented by U.S. accounts, not the name or number of U.S. holders, and can rely in good faith on information provided by the intermediary. If the issuer is unable, after reasonable inquiry, to obtain information from the intermediary on the percentage of shares held by U.S. resident customer accounts, the issuer can assume that all of the intermediary's customers in question are residents in the place where the intermediary has its principal place of business. See International Disclosure Standards, Section II.E, SEC Release No. 33-7745 (Sept. 28, 1999); Instruction to Rule 3b-4(c)(1) under the Securities and Exchange Act of 1934, as amended (the "Exchange Act").

4 As noted above, in many cases, issuers will not be required to obtain information on the name or number of U.S. holders and will instead be relying in good faith on information provided by the intermediary. However, where an issuer is individually reviewing the identity of potential U.S. holders, the following should be noted:

- A person who has permanent resident status in the U.S. is presumed to be a U.S. resident. See Question 110.03, Exchange Act C&DIs; Question 203.18, Securities Act C&DIs.
- For individuals without permanent resident status, an issuer must decide which criteria it will use to determine residency and apply them on a consistent basis; examples of factors include tax residency, nationality, mailing address, physical presence, the location of a significant portion of the person's financial and legal relationships, or immigration status. See Question 110.03, Exchange Act C&DIs; Question 203.18, Securities Act C&DIs.

5 See Question 110.02, SEC Compliance and Disclosure Interpretations: Exchange Act Rules (Exchange Act C&DIs); Question 203.17, SEC Compliance and Disclosure Interpretations: Securities Act Rules (Securities Act C&DIs).

6 The terms "executive officer" and "director" may have different meanings in jurisdictions outside the US. In this context, "executive officer" includes a president, any vice president in charge of a principal business unit, division or function or any person who performs a policy making function for the issuer (see Rule 405 under the Securities Act and Rule 3b-7 under the Exchange Act). For "director," the issuer should analyze individuals who perform similar functions to those performed by a board of directors at a U.S. company.

7 See Question 110.04, Exchange Act C&DIs; Question 203.19, Securities Act C&DIs.

If the answer to "**any**" of the four determinations is "yes," the issuer fails the first U.S. Business Contacts Test and therefore does not qualify as an FPI.[8]

Location of Assets

The issuer must determine whether a majority of its assets are located in the U.S. The issuer should consider the location of both its tangible and intangible assets, and can use either: (i) the geographic segment information determined in the preparation of its financial statements; or (ii) any other reasonable methodology in assessing the location and amount of its assets for purposes of this determination, applied on a consistent basis.[9] If the answer to this determination is "yes," the issuer fails the second U.S. Business Contacts test and therefore does not qualify as an FPI.

Administration of Business

The issuer must determine whether its business is administered principally in the U.S. For this test, the issuer must assess on a consolidated basis the location from which its officers/managers primarily direct, control, and coordinate the issuer's activities. With no single factor or group of factors being determinative, factors can include the locations of its principal business segments or operations, board and shareholders' meetings, headquarters (including location of the actual facilities and location of the employees), or most influential key executives.[10] Absent other factors, holding an annual or special meeting of shareholders or occasional meetings of the board of directors in the U.S. would not result in a determination that the issuer's business is administered principally in the U.S.[11]

Why the Test Is Important; Consequences of Losing FPI Status

If a company ceases at any time to qualify as an FPI, it will become subject to the more stringent registration, reporting and corporate governance requirements applicable to U.S. domestic issuers. This includes the following:

- *SEC requirements*: following the SEC's financial reporting and compliance requirements applicable to U.S. domestic issuers (while still accounting for home country law requirements), including filing annual reports on Form 10-K, quarterly reports on Form 10-Q, periodic reports on Form 8-K, proxy solicitation rules (including the filing of proxy statements and "say-on-pay"), prescriptive executive compensation and governance disclosures, Section 16 filing compliance and liability for insiders, and the use of U.S. GAAP, rather than International Financial Reporting Standards or local GAAP.
- *Listing exchange requirements*: compliance with all NYSE or Nasdaq requirements with respect to board independence and shareholder approval requirements (as well as home country law requirements), without any opportunity for opt-outs available to FPIs.
- *Proxy advisory firm policies*: ISS and Glass Lewis will apply their U.S. guidelines to all voting items, except that it will generally apply home country law guidelines to items that are on the ballot only because of that home country's laws/regulations or listing rule.

8 The following should be kept in mind:
- If an issuer has two boards of directors, it must determine whether the majority of the directors are US citizens or US residents with respect to the board that performs the functions that are closest to those undertaken by a US-style board of directors. If those functions are divided between both boards, the issuer may aggregate the members of both boards for purposes of calculating the majority. See Question 110.05, Exchange Act C&DIs; Question 203.20, Securities Act C&DIs; and
- The same guidance set forth in footnote 2 applies to the determination of U.S. residency of executive officers and/or directors.

9 See Question 110.06, Exchange Act C&DIs; Question 203.21, Securities Act C&DIs.

10 See Question 110.07, Exchange Act C&DIs; Question 203.22, Securities Act C&DIs.

11 See Question 110.08, Exchange Act C&DIs; Question 203.23, Securities Act C&DIs.

These requirements will become applicable as of the first day of the fiscal year following loss of FPI status. Therefore, an FPI must carefully monitor its status to ensure it continues to qualify as an FPI, or to give it the longest lead time to prepare for compliance with the U.S. domestic company reporting regime if it fails to do so.

Conclusion

The above summary touches on various considerations for companies as they ascertain their FPI status on a yearly basis. The full inquiry can be complex and, given the potential impact on a company should it fail to qualify as an FPI, should be done in consultation with experienced legal counsel.

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