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CLIENT ADVISORY

SEC ADOPTS SIGNIFICANT AMENDMENTS TO THE FOREIGN PRIVATE ISSUER EXEMPTION FROM SECURITIES EXCHANGE ACT REGISTRATION

Changes Make it Easier for Most Foreign Companies to Have Their Equity Securities Traded in the US Over-The-Counter Market

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The US Securities and Exchange Commission (SEC) has adopted amendments to the rule that exempts foreign private issuers from registering a class of equity securities under Section 12(g) of the Securities Exchange Act of 1934 (Exchange Act).[1] The amendments to Exchange Act Rule 12g3-2(b) permit a foreign private issuer that does not have SEC reporting obligations and does not trade on a US national securities exchange to rely on an exemption from Exchange Act registration based on information the company publishes outside the United States—without the need to file an application with the SEC or determine the number of its US shareholders—subject to specified conditions. The foreign private issuer must not be an SEC reporting company, must maintain a listing of its equity securities in its primary trading market outside the United States, and must publish specified non-US disclosure documents electronically in English. The amended rules are effective October 10, 2008.

The new rule amendments should encourage more foreign companies to use the Rule 12g3-2(b) exemption in order to have their equity securities traded in the US over-the-counter (OTC) market,[2] typically in the case of non-Canadian issuers [3] through the establishment of an unlisted, sponsored or unsponsored depositary facility for American Depositary Receipts, or ADRs. The rule amendments will also be useful to foreign companies that have significant US shareholder interest resulting from trades in foreign markets, where the issuer uses US jurisdictional means in communicating with such shareholders, even when no OTC trading

1 *See "Exemption from Registration under Section 12(g) of the Securities Exchange Act of 1934 for Foreign Private Issuers,"* Release 34-58465 (Sept. 5, 2008) (the Final Release).

2 Securities that trade in the US "over-the-counter" or OTC market are issued by companies that either choose not to list on a US national securities exchange or which are unable to meet the listing standards. Most over-the-counter securities are quoted in a centralized quotation service maintained by Pink Sheets, LLC or on the OTC Bulletin Board, but OTC Bulletin Board securities are not eligible for the Rule 12g3-2(b) exemption, as discussed below.

3 Canadian issuers generally do not create ADRs for US trading, but instead facilitate US trading of the same security as is traded in Canadian markets.

This summary is intended to be a general summary of the law and does not constitute legal advice. You should consult with competent counsel to determine applicable legal requirements in a specific fact situation.

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occurs in the United States. Foreign private issuers that are exempt from Exchange Act registration under the Rule 12g3-2(b) exemption are not subject to Exchange Act periodic reporting requirements or the requirements of the Sarbanes-Oxley Act of 2002. The exemption also facilitates the resale of a foreign private issuer's securities to qualified institutional buyers under Rule 144A of the Securities Act of 1933 (Securities Act) because use of the exemption satisfies the informational requirements for Rule 144A resales.

There are situations where a foreign private issuer that is currently exempt under Rule 12g3-2(b) could lose its exemption under the amended rules. Although the SEC has not grandfathered these issuers in, it has provided a three-year transition period to provide sufficient time for currently exempt issuers to either comply with all of the conditions of amended Rule 12g3-2(b) or register under the Exchange Act. There is a separate three-month transition period that gives all foreign private issuers time to comply fully with the electronic publishing requirement.

The amended rules will also benefit US investors, who will now have an easier time accessing a foreign private issuer's material non-US disclosure documents through home country websites.

The amended rules are discussed in more detail below.

REGISTRATION UNDER SECTION 12(g) OF THE EXCHANGE ACT

Under Section 12(g) of the Exchange Act, issuers must register a class of equity securities that is widely-held in the United States, even if the securities are not listed on a US exchange and the issuer has never publicly offered its securities in the United States. Under Section 12(g) of the Exchange Act, as modified by SEC rule, a foreign private issuer must register a class of its equity securities with the SEC if it has total assets of US$10 million or more and such class is owned of record by 500 or more persons worldwide (of whom at least 300 are US residents)[4] as of the last day of its most recently completed fiscal year, even if the securities are not listed on a US national securities exchange. The registration statement is due within 120 days after the end of the fiscal year unless an exemption is available. It is likely that many foreign private issuers that are subject to registration under the Exchange Act are completely unaware of these requirements.

Due to the inability of many foreign private issuers to rely on an exemption under Rule 12g3-2(a) because they exceed the threshold of 300 holders of their securities in the US, most foreign private issuers that are exempt from Section 12(g) registration rely on the Rule 12g3-2(b) exemption, which is discussed below. Many foreign issuers perfect the exemption soon after going public in their home markets so that they do not have to worry about later becoming subject to SEC registration and full reporting company status.

THE RULE 12g3-2(b) EXEMPTION

The Rule 12g3-2(b) exemption allows a foreign private issuer[5] to have its equity securities traded on a limited basis in the over-the-counter market in the United States without registering under Exchange Act Section 12(g), even though the foreign private issuer exceeds the registration thresholds of Section 12(g). Non-Canadian foreign private issuers typically obtain the Rule 12g3-2(b) exemption so that an unlisted, sponsored or unsponsored ADR facility

4 For purposes of determining whether securities are held by fewer than 300 US residents, securities of a foreign private issuer that are held of record by a broker, dealer, bank (or nominee for any of the foregoing) for the accounts of customers resident in the United States are counted as held in the United States by the number of separate accounts for which the securities are held.

5 The Rule 12g3-2(b) exemption is not available to a foreign company that does not meet the definition of a "foreign private issuer." Under a separate rulemaking that affects foreign private issuers, the definition of a "foreign private issuer" in Rule 3b-4 of the Exchange Act is being amended. Prior to the December 6, 2008 effective date, all foreign companies are "foreign private issuers" unless more than 50% of the company's outstanding voting securities are directly or indirectly held of record by US residents and any of the following three conditions apply:

1. The majority of the executive officers or directors are US citizens or residents;
2. More than 50% of the assets of the issuer are located in the US; or
3. The business of the issuer is administered principally in the US.

Under the amended definition of "foreign private issuer," effective December 6, 2008, a foreign private issuer will only need to test its eligibility for foreign private issuer status once a year, rather than continuously, as of the last business day of its most recently completed second fiscal quarter.

can be established. The exemption is also utilized by foreign companies that attract US investors who trade such securities in their home markets and as a result surpass the 300 US holder test. As a result of the increasing internationalization of securities markets and efforts by US investors to seek international diversification, it is increasingly common for foreign companies to be subject to SEC registration, and therefore to need to rely on this exemption, notwithstanding that they have not voluntarily entered the US capital markets through a US listing or public offering.

The amended Rule 12g3-2(b) exemption eliminates the current written application and paper submission requirements under Rule 12g3-2(b) by automatically exempting a foreign private issuer from registration under Section 12(g) of the Exchange Act, regardless of the number of its US or worldwide shareholders, if it meets the following three conditions:

1. Foreign Listing/Primary Trading Market Condition

The foreign private issuer must maintain a listing of the subject class of securities on one or more foreign exchanges in a foreign jurisdiction that, either alone or together with the trading of such class of securities in another foreign jurisdiction, comprises the "primary trading market" for such securities. For this purpose ADRs and ordinary shares are treated as the same class.

The amended rules define "primary trading market" to mean that at least 55% of the worldwide trading volume of the issuer's subject class of securities occurs in no more than two foreign jurisdictions during the most recently completed fiscal year. In addition, the trading volume in at least one of the foreign jurisdictions must be larger than the US trading volume for the same class of securities. According to the SEC's Final Release, this requirement was designed to ensure that there is a foreign jurisdiction that principally regulates and oversees trading of the foreign private issuer's securities and its disclosure obligations to investors. This will make it more likely that US investors will be able to access a set of non-US securities disclosure documents from one primary foreign source.

2. Electronic Publishing Condition

Unless the exemption is in connection with or following a recent Exchange Act deregistration,[6] the foreign private issuer must electronically publish, in English, information that from the first day of its most recently completed fiscal year it:

a. has made public or been required to make public by its home jurisdiction;

b. has filed or been required to file with the principal stock exchange in its primary trading market on which its securities are traded and which has been made public by that exchange; and

c. has distributed or been required to distribute to its security holders,

that in each case is material to an investment decision regarding the subject class of securities.

To meet the electronic publishing condition, the above information must be published on the issuer's Internet website or through an electronic information delivery system generally available to the public in its primary trading market.[7] The information that the issuer is required to publish electronically is information that is "material" to an investment decision with respect to the subject class of securities. The amended rule lists the following examples of material information: (i) an issuer's results of operations or financial condition, (ii) changes in its business, (iii) acquisitions or dispositions of assets, (iv) the issuance, redemption or acquisition of securities, (v) changes in management or control, (vi) the granting of options or the payment of other remuneration to directors or officers, and (vii) transactions with directors, officers or principal security holders.

6 Rule 12g3-2(b) has separate provisions that apply to foreign private issuers that deregister under the Exchange Act. These rules are not discussed in this Advisory.

7 If a foreign private issuer's non-US stock exchange or securities regulatory authority permits it to publish a required report electronically on an electronic delivery system set up by such exchange or securities regulatory authority, and the public has ready access to the report and other documents maintained on the system, that electronic publication solely will satisfy the electronic publishing requirements. For example, filings made in Canada on the System for Electronic Document Analysis and Retrieval (SEDAR) would satisfy such requirement.

In addition, at a minimum, the following documents are required to be translated in English, regardless of whether such documents are required in the non-US jurisdiction or the primary trading market:

a. the issuer's annual report, including or accompanied by annual financial statements;

b. interim reports that include financial statements;

c. press releases; and

d. all other communications and documents distributed directly to security holders of each class of securities to which the exemption relates.

Although the SEC's Final Release states that foreign private issuers may not meet the English translation requirements through the use of a brief English description or summary, the SEC clarified that generally an issuer may provide an English summary for a non-US disclosure document if such summary would be permitted by Exchange Act Rule 12b-12(d)(3)[8] or for a document submitted under cover of Form 6-K.[9]

8 Rule 12b-12(d)(3) provides that a party may submit an English summary instead of an English translation of a foreign language document as an exhibit or an attachment to a filing or submission subject to review by the SEC as long as the foreign language document does not consist of certain specified documents enumerated in paragraph (d)(2) of Rule 12b-12 (e.g., articles of incorporation, bylaws, certain material contracts, audited annual and interim consolidated financial information) or if the applicable form permits the use of an English summary. Any English summary must fairly and accurately summarize the terms of each material provision of the foreign language document, and fairly and accurately describe any terms that have been omitted or abridged.

9 General Instruction D of Form 6-K states that an issuer must provide a full English translation of: (1) press releases; (2) communications and other documents distributed directly to security holders for each class of securities to which a reporting obligation under the Exchange Act exists, except for offering circulars and prospectuses that relate entirely to securities offerings outside the US; and (3) documents disclosing annual audited or interim consolidated financial information. Form 6-K permits a foreign private issuer to use an English summary instead of a full English translation for the documents specified in Rule 12b-12(d)(3), and for a report required to be furnished and made public under the laws of the issuer's home country or the rules of the issuer's home country stock exchange, as long as it is not a press release and is not required to be and has not been distributed to the issuer's security holders. Such a document may include a report disclosing unconsolidated financial information about a parent company.

3. Non-Reporting Condition

The foreign private issuer must not be required to file or furnish reports under Section 13(a) or 15(d) of the Exchange Act. Although this is similar to the non-reporting condition in effect prior to the amendments, the 18-month "look-back" period is being eliminated.[10]

Elimination of Written Application to the SEC. The amended rules eliminate the current written application process that requires an issuer to submit to the SEC in paper specified information concerning, for example, its non-US disclosure requirements, along with paper copies of its non-US disclosure documents published since the beginning of its last fiscal year. This will make it easier for foreign private issuers to claim the Rule 12g3-2(b) exemption.[11]

Maintaining the Exemption. Under the amended rules, a foreign private issuer will lose the Rule 12g3-2(b) exemption if it registers a class of securities under Section 12 of the Exchange Act or incurs Exchange Act reporting obligations, ceases publishing electronically its non-US disclosure documents in English on an ongoing basis "promptly"[12] after the information has been made public, or fails to maintain a listing on one or more exchanges in its primary trading market.

10 Exchange Act reporting obligations can arise if a foreign private issuer files a registration statement under Section 12 of the Exchange Act or when a foreign private issuer files a registration statement for a public offering under the Securities Act. Under the rule in effect prior to the amendments, an issuer had to look back over the previous 18-month period and determine whether it had Exchange Act reporting obligations during that period.

11 Periodically, the SEC has published a list of issuers claiming the Rule 12g3-2(b) exemption based on a review of submitted paper documents. The SEC does not plan to publish these lists after the effective date of the new rules. There is no requirement that a foreign private issuer provide notice that it is claiming the Rule 12g3-2(b) exemption to either the SEC or market participants. However, an issuer that wants to provide notice that it claims or maintains the Rule 12g3-2(b) exemption may do so, for example, by stating on its website that it has electronically published specified non-US disclosure documents in order to claim or maintain the Rule 12g3-2(b) exemption.

12 As is currently SEC staff practice, the term "promptly" in this context is dependent on the type of document and the amount of time required to translate it into English. The Final Release indicates that "[c]urrently an issuer typically must electronically publish or submit in paper a copy of a material press release on or around the same business day of its original publication."

Effect of Non-Compliance. The exemption does not cure any prior non-compliance with the Section 12(g) registration requirement where the exemption has not been perfected on a timely basis. However, it appears that even in cases of such non-compliance foreign companies can rely on the exemption for subsequent periods when they act in good faith and have satisfied the conditions for the exemption in a reasonably prompt manner.[13]

PRACTICAL IMPLICATIONS OF THE AMENDMENTS

The amended rules should encourage more foreign companies to rely on the Rule 12g3-2(b) exemption and thereby have their securities traded in the United States OTC market in the form of ADRs or ordinary shares. The exemption will also allow a foreign private issuer to develop a US shareholder base through trading in its home market without the need to facilitate US OTC trading. Prior to the amendments, a foreign private issuer was required to include in its application to the SEC Rule 12g3-2(b) information about the number of its US security holders and the percentage of its outstanding securities that they held. Because it is generally more difficult for a foreign private issuer to calculate the number of its US holders than to determine its US or foreign trading volume for purposes of the new foreign listing/primary trading market condition, the amended rules will make it significantly easier for most foreign companies to claim the exemption.

Prior to the SEC's amendments, foreign private issuers who wished to rely on the Rule 12g3-2(b) exemption were required to submit a written application to the SEC containing information about their US shareholdings, and to thereafter either make paper submissions to the SEC, or electronically publish, specified information required to be filed in their home country on an ongoing basis. A foreign private issuer that exceeded the threshold of 300 holders of its securities in the US would only have its application to the SEC for a Rule 12g3-2(b) exemption approved if the statutory 120-day period for filing a Section 12(g) registration had not lapsed. Foreign private issuers that exceeded the threshold and failed to file their application within this statutory period were required to register under the Exchange Act.

The SEC's amended rules do not change the thresholds that apply under Section 12(g), as modified by rule. In the absence of an exemption, an issuer is still required to file an Exchange Act registration statement regarding a class of equity securities within 120 days of the last day of its fiscal year if, on that date, the number of its record holders is 500 or greater, the number of its US resident holders is 300 or more, and the issuer's total assets exceed US$10 million. However, the SEC's Final Release states that if a foreign private issuer meets the conditions of Rule 12g3-2(b), as amended, a foreign private issuer would be immediately exempt from Exchange Act registration even if, on the last day of its most recently completed fiscal year, it exceeded the asset and shareholder thresholds for Section 12(g) registration, and even though the 120-day window for filing a registration statement had elapsed.

All foreign private issuers that are not currently registered under the Exchange Act should make a determination as to how the revised rules apply to them. There are still some situations where a foreign private issuer could run into difficulty. For example, if a non-reporting foreign private issuer with a June 30 year end were to determine that as of its year end it had exceeded the thresholds for registration under Section 12(g) of the Exchange Act (as modified by rule), and it was unable to meet the foreign listing/primary trading market condition of the exemption, then the foreign private issuer would be required to file a registration statement under the Exchange Act within 120 days of its year end. However, in the above example, if a foreign private issuer met all of the conditions of the revised exemption except the electronic publishing condition, it would be able to correct that deficiency even after the 120-day window period had elapsed by meeting the electronic publishing

13 The SEC decided not to adopt a specific cure period during which an issuer would either have to correct any deficiency or register under the Exchange Act. However, the Final Release indicates that an issuer that finds itself not in compliance with any of the conditions required to maintain the Rule 12g3-2(b) exemption must either re-establish compliance with the rule in a "reasonably prompt" manner or register under the Exchange Act. The SEC is likely to exhibit some flexibility in this regard as long as the issuer acts in good faith and re-establishes the exemption in a timely manner.

condition. Of course, it would need to correct the deficiency before June 30 of the following year.

As is currently the case, foreign private issuers must continue to register a class of their equity securities under Section 12(b) of the Exchange Act if the class is listed on a US national securities exchange. Foreign private issuers seeking a quotation on the OTC Bulletin Board cannot rely on the Rule 12g3-2(b) exemption because such issuers must generally be subject to the periodic reporting requirements of the Exchange Act.[14] To be exempt under Rule 12g3-2(b), a foreign private issuer's securities would have to trade through an over-the counter market such as the market maintained by the Pink Sheets, LLC or exclusively in foreign markets.

Foreign private issuers should bear in mind that Exchange Act registration applies to *classes* of equity securities and are separate from the registration requirement that applies to securities offerings under the Securities Act and from the exemptions from registration under the Securities Act, such as Regulation S, the private placement exemption of Section 4(2) of the Securities Act, and rules implementing the private placement exemption including Rule 506 and Rule 144A.[15]

TRANSITION PERIODS

The SEC adopted a three-year transition period to provide sufficient time for foreign private issuers that are currently exempt but who would lose the exemption upon the effective date of the amended rule to either comply with all of the conditions of amended Rule 12g3-2(b) or register under the Exchange Act. This transition period only applies to companies that are already exempt under the current rule.

The SEC also adopted a three-month transition period following the effective date of the rule (until January 10, 2009) during which the SEC will continue to accept and process any non-US disclosure documents in paper from issuers that are exempt under Rule 12g3-2(b). After the January 10 cut-off date, the SEC will no longer process paper Rule 12g3-2(b) submissions.

APPLICATION TO ADR FACILITIES

Most non-Canadian foreign stocks that trade in US markets trade as American Depositary Receipts, or ADRs. ADRs are issued by US depositary banks, and each ADR represents one or more shares of a foreign stock or a fraction of a share that is on deposit with the bank. ADRs generally trade at prices that correspond to the price of the foreign stock in the issuer's home market, based on the ratio of ADRs to foreign company shares. ADRs are convenient for US investors as the trade clears and settles in US dollars.

Most ADR programs are "Level I," which means that the ADRs are traded in the US OTC market with prices published in a centralized quotation service maintained by Pink Sheets, LLC rather than on an exchange. Level II ADRs are listed on a US exchange and the foreign private issuer is subject to SEC reporting requirements, and are more expensive to establish than Level I facilities. Level III ADRs are listed on a US exchange and involve a registered public offering of the ADRs in the US. Level 1 ADRs may either be sponsored, which means that they are created by the foreign private issuer itself, or unsponsored, which means that the ADR is created by a third party US broker-dealer or depositary bank. Level II and Level III ADRs are always sponsored by the issuer because they involve a stock exchange listing.

Foreign private issuers establishing an unlisted, sponsored or unsponsored ADR facility generally rely on the Rule 12g3-2(b) exemption unless they are SEC reporting companies.[16] Because foreign private issuers can claim the Rule 12g3-2(b) exemption automatically without regard to the number of their US shareholders by complying with the conditions of the exemption, it will be easier for foreign private issuers to establish sponsored ADR facilities.

14 Foreign companies that choose to register under the Exchange Act almost always prefer to be traded on the New York Stock Exchange (NYSE) or NASDAQ rather than the OTC Bulletin Board (OTCBB). Companies that are no longer eligible to trade on the NYSE or NASDAQ may be eligible to list on the OTCBB.

15 Generally, any company—foreign or domestic—that offers or sells its securities in a public offering in the United States must register the proposed public offering under the Securities Act unless an exemption from registration is available. State securities laws may also apply.

16 The depositary shares evidenced by ADRs are typically registered on a Form F-6 registration statement under the Securities Act, which requires that the issuer of the deposited securities either be an SEC reporting company or have an exemption under Rule 12g3-2(b). Depositary shares registered on Form F-6, but not the underlying deposited securities, are exempt from Section 12(g) of the Exchange Act.

At the same time, foreign private issuers should be aware that the amended rules make it easier for third party broker-dealers or depositary banks to set up an unsponsored ADR facility. Prior to the rule amendments, foreign private issuers could impede the ability of ADR depositary banks to establish an unsponsored ADR facility by not applying to the SEC for a Rule 12g3-2(b) exemption. However, the revised 12g3-2(b) exemption automatically applies to non-reporting foreign private issuers that meet the foreign listing condition and publish specified non-US disclosure documents in English on their Internet website or through an electronic information delivery system generally available to the public in their primary trading market. As a result, third-party depositary banks will be able to establish unsponsored ADR facilities for a larger group of foreign private issuers based upon their reasonable, good faith belief, after exercising reasonable diligence, that such issuers qualify for the Rule 12g3-2(b) exemption. The amended rules will make it easier for broker-dealers to fulfill their current information obligations under the Exchange Act with respect to the equity securities of non-reporting foreign private issuers for which they seek to publish quotations.

The SEC solicited comments on whether the SEC should require, as a condition to the registration of ADRs on Form F-6, that the foreign private issuer give its consent to the depositary, or alternatively that the depositary must first notify the issuer of its intention to register ADRs and must not have received an affirmative statement of objection from the issuer. The SEC decided not to adopt any additional conditions regarding the formation of unsponsored ADR facilities at this time because it agreed with those commenters that stated that imposing additional conditions would run counter to the objective of streamlining the Rule 12g3-2(b) exemption. One commenter stated that in practice, depositary banks typically obtain the issuer's consent before establishing an unsponsored ADR facility. This commenter also indicated that in its experience, foreign issuers are often willing to permit a depositary bank to establish an unsponsored ADR program but are reluctant to state this in writing.[17]

17 *See* letter of Deutsche Bank, dated April 21, 2008, cited in fn. 113 of the Final Release, *supra* at n. 1.

APPLICATION TO RULE 144A EXEMPTION

A Rule 12g3-2(b) exemption facilitates resales of a foreign private issuer's securities to qualified institutional buyers (QIBs) under Rule 144A of the Securities Act. Under Rule 144A, certain basic business and financial information must be furnished to the holder of the securities and any prospective purchaser designated by the holder upon request, except in the case of foreign private issuers that are SEC reporting companies or that rely on the Rule 12g3-2(b) exemption.

CONCLUSION

The revised Rule 12g3-2(b) exemption allows a foreign private issuer to claim the exemption automatically, without the need to file an application with the SEC and without regard to the number of its US or worldwide shareholders. By making it easier for foreign private issuers to obtain a Rule 12g3-2(b) exemption, the SEC's revisions will encourage more foreign private issuers to have their equity securities traded on a limited basis in the US over-the-counter market. The revised exemption facilitates the establishment of ADR facilities or a US shareholder base arising from trading in foreign markets, assists broker-dealers in satisfying their Exchange Act obligations with respect to the equity securities of non-reporting foreign private issuers for which they seek to publish quotes, and facilitates resales of an issuer's securities under Rule 144A of the Securities Act.

We hope that you have found this client advisory useful. If you have additional questions, please contact your Arnold & Porter attorney or:

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