

Corporate and Securities Transactions and Regulations Practices

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FPI Exit: U.S. Securities Law Considerations

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Companies operating as foreign private issuers ("FPI") must assess their status as an FPI annually as of the last business day of their second fiscal quarter (typically June 30, for issuers with a December 31st fiscal year) to determine that they no longer met the requirements under Rule 405 under the U.S. Securities Act of 1933, as amended (the "Securities Act") and Rule 3b-4 under the U.S. Securities Exchange Act of 1934, as amended (the "Exchange Act") to be treated as an FPI. Under such rules, an FPI is defined as any issuer, other than a foreign government incorporated or organized under the laws of a foreign country, except any foreign issuer which meets the following conditions:

What You Need to Know:

- Companies operating as foreign private issuers ("FPI") must assess their status as an FPI annually as of the last business day of their second fiscal quarter (typically June 30, for issuers with a December 31st fiscal year).
- If a company is no longer eligible for FPI treatment, beginning on the following January 1, the company is required to comply with the more rigorous reporting obligations applicable to domestic U.S. issuers.
- The transition away from FPI status to full SEC reporting may feel onerous at times given the increase in reporting obligations. However, this transition can also represent increased access and success for a non-FPI company in the capital markets that often makes the transition worth the effort.

1. Shareholder Test. More than 50 percent of the outstanding voting securities of the foreign issuer are directly or indirectly owned of record by residents of the United States; and
2. Business Contacts Test. Any of the following:
 - a. The majority of the foreign issuer's executive officers or directors are United States citizens or residents;
 - b. More than 50 percent of the assets of the foreign issuer are located in the United States; or
 - c. The business of the foreign issuer is administered principally in the United States.

This annual determination is particularly critical for companies in rapidly growing industries, such as the cannabis industry, where the transition out of FPI status might occur within a year or two of the company having gone public in Canada as an FPI.^[1] Indeed, if a company is no longer eligible for FPI treatment, beginning on the following January 1, the company is required to comply with the more rigorous reporting obligations applicable to domestic U.S. issuers.

The purpose of this Alert is to be a sort of primer on the topic, to help inform management of a company transitioning out of FPI status about the various reporting obligations with the U.S. Securities and Exchange Commission (the "SEC") as a result of such change in status. By and large, this memorandum will not delve into: (i) the specifics of how to calculate the Shareholder and Business Contacts Test (which will be covered in a separate Alert), and (ii) the laws that an issuer would have already been required to follow as an FPI reporting company, such as officer certifications on SEC filings, and state-level "Blue Sky" securities laws.

Analysis

Annual Reports. Previously, an FPI would file an Annual Report on Form 20-F. Now, such company will file its Annual Report on Form 10-K. The filing deadline for the Form 10-K will depend on the company's classification as a Large Accelerated Filer, an Accelerated Filer, or a Non-Accelerated Filer. As will be discussed further below, depending on when a company sets its annual meeting date, certain disclosures may not be included in the company's Form 10-K, and will instead be included in the proxy statement filed with the SEC relating to the company's annual meeting.

Financial Reconciliation. As an FPI, companies present their financial statements in accordance with IFRS. In time for its Form 10-K filing, a non-FPI company must reconcile its financial statements to U.S. GAAP (and have such financial statements audited under U.S. GAAP).

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Quarterly Reports. An FPI did not have to file quarterly reports. Now, a non-FPI company will have to file quarterly, unaudited financial information in Quarterly Reports on Form 10-Q.

Current Reports. Unlike information in FPIs' Current Reports on Form 6-K, some information in the Current Reports on Form 8-K a non-FPI company will now be required to file will be deemed as "filed" (rather than "furnished") with the SEC, and therefore may be incorporated by reference in other SEC filings, such as registration statements. However, such "filed" information is subject to liability for misleading statements, under Section 18 of the Exchange Act.

Proxy Statements. An FPI is not required to file proxy solicitation materials with the SEC. A non-FPI company will be required to file proxy solicitation materials on Schedule 14A or 14C, including materials that might be produced in connection with such company's annual meeting.

Tender Offer Regulation. A non-FPI company will not have any accommodations relating to Section 14(d) and 14(e) of the Exchange Act, regarding the regulation of tender offers.

Board Committees. FPIs are afforded more accommodations in terms of the nature and composition of their audit committee. A non-FPI company should now conduct an assessment with the help of outside counsel, to ensure its audit committee complies with the relevant SEC and OTC Markets rules for a domestic U.S. reporting company, principally ensuring that all members of the committee are independent directors. Similarly, the Company should ensure it is in compliance with any SEC committee rules (more of these committee requirements are driven by the national exchanges, which would only apply to a non-FPI company that obtains membership on such exchange).

Internal Control Reporting. A non-FPI company should now assess its internal control over financial reporting on a quarterly basis (not just annually, as under FPI rules). A non-FPI company may also need its auditor to conduct a separate audit on such company's internal controls and procedures in order to obtain the required auditor attestations of such company's internal controls and procedures.

Executive Compensation. FPIs are exempt from many of the disclosure requirements relating to individual executive and director compensation. A non-FPI company must include detailed disclosures in a separate section of the company's Form 10-K entitled "Compensation Discussion and Analysis", if it is not an Emerging Growth Company or a Smaller Reporting Company. Additionally, if such company has not yet filed individual management agreements, those exhibits will now be required to the company's Form 10-K.

Section 16 Reports. Unlike FPIs, a non-FPI company will now need to file Forms 3, 4 and 5 for its executives, directors and 10 percent beneficial holders. The company's obligation under Section 16 also extends to the prohibition on short-swing trading and other insider trading prohibitions (as discussed further below).

Schedule 13 Reports. A non-FPI company's officers, directors and 5 percent beneficial holders should continue to file Schedule 13D/Gs, as applicable.

Regulation FD and Section 10b-5. A non-FPI company should comply with Regulation FD in order to avoid liability under Section 10b-5 of the Exchange Act relating to selective disclosure of material non-public information and fraud on the market. Like Section 16, company insiders are now also subject to 10b-5 restrictions on insider trading.

Deregistration Accommodations. A non-FPI company is no longer eligible for FPIs' "easy termination" of registration of equity securities under Section 15(d) of the Exchange Act.

Conclusion

The transition away from FPI status to full SEC reporting may feel onerous at times, given the increase in reporting obligations detailed in this Alert. However, this transition can also represent increased access and success for a non-FPI company in the capital markets that often makes the transition worth the effort.

1. We also note that in the case of a new registrant with the Commission, the determination of whether a foreign issuer is eligible to be treated as an FPI must be made within 30 days prior to the issuer's filing of an initial registration statement under either the Securities Act or the Exchange Act.

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