SEC Seeking Comment on Foreign Private Issuer Definition

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The U.S. Securities and Exchange Commission (SEC) has recently proposed significant changes to the definition of a Foreign Private Issuer (FPI), marking a critical shift that could impact many companies trading on U.S. exchanges.

Historically, FPIs have benefited from reduced regulatory burdens compared to U.S. domestic issuers, including simplified disclosure requirements and more flexibility in financial reporting standards. The SEC's proposed revisions, however, aim to refine and tighten these criteria.

Between 2003 and 2023, FPIs have become increasingly headquartered in a country other than the US, incorporated in a different location outside the US, and traded solely or predominately on the US markets. The SEC suggests that FPIs are bending the rules to capitalize on lax regulations in other jurisdictions while still accessing the US markets. For instance, incorporation in the Cayman Islands and headquarters in China is a common fact pattern that they are not happy with. The concept release covers significant ground and could result in broad and costly changes that would essentially make FPIs subject to domestic company filing requirements, including the filing of quarterly reports, compliance with GAAP accounting, beneficial ownership disclosures and others. But making FPIs subject to the same standards as domestic issuers is an extreme result that is unlikely to happen.

Key Changes Under Consideration:

The proposed changes within the SEC's concept release would:

1. Tighten FPI eligibility tests by updating the shareholder and business contacts test to better reflect economic substance, and including new criteria that reflect where the company actually operates and trades.
2. Require material foreign trading volume, allowing only issuers with a meaningful proportion of trading outside the U.S. to qualify as FPIs.
3. Mandate listing on a major foreign exchange to retain FPI status.
4. Assess the FPI's home jurisdiction's regulatory framework to evaluate whether the foreign jurisdiction has comparable investor protections.
5. Require international cooperation mechanisms with the FPIs country to ensure robust regulatory cooperation agreements with the U.S.
6. Limit FPI status to issuers from jurisdictions with mutual regulatory recognition.

Items 5 and 6 above are, I believe, non-starters even with a Commission led by Atkins. The SEC wants to get to the "bad actors" like companies in China that may be skirting the regulatory requirements and "exploiting" financial responsibilities associated with trading on US markets. Caroline Crenshaw, the lone Democratic commissioner, expressed her support for reconsideration of exemptions for foreign issuers that trade in the US. But she points out that the definition of FPI is part of a larger analysis to be performed.

https://www.sec.gov/newsroom/speeches-statements/statement-crenshaw-concept-release-foreign-private-issuer-eligibility-060425

The SEC is primarily motivated by concerns surrounding investor protection, transparency, and fairness in the market. The goal of the proposed amendments is to ensure that companies predominantly trading in U.S. markets meet disclosure and regulatory standards comparable to their domestic counterparts, thereby providing investors with more reliable and comprehensive information.

Potential Effects on FPIs:

- **Increased Compliance Costs**: Companies that previously benefited from the relaxed standards may now incur higher regulatory compliance expenses, particularly around increased reporting requirements.
- **Alignment with Domestic Issuers**: FPIs with significant U.S. trading volumes may need to comply with more stringent reporting obligations similar to those imposed on domestic U.S. companies.
- **Investor Confidence and Market Participation**: Although costs might increase, these changes could enhance investor trust and potentially attract greater investment by increasing transparency and comparability among issuers.

As we know, Atkins is in favor of "free markets" and innovation in broad terms. Any changes to the FPI definition - which are years down the road given the comment period and drafting of the final rule - will equally affect all FPIs; countries such as Italy, Spain, and others with robust regulatory standards and enforcement will likely be in a different category than FPIs from Russia and China for example.

These proposed changes reflect a broader regulatory shift towards increased protection of the US financial markets and, ostensibly, US investors. Several of the changes as proposed are likely a pipe dream for the current Commission. Nonetheless, FPIs should remain informed of the comments received in response to the concept release and consider submitting a letter themselves.