

SEC Provides Clarification of Foreign Private Issuer Calculation

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For Canadian issuers and their advisers, compliance with U.S. securities laws generally begins with the question: Is the issuer a “foreign private issuer”?

The FPI definition, which is set out in Rule 405 under the Securities Act and 3b-4(c) of the Exchange Act, involves the following four inquiries:

- Are more than 50% of the issuer’s outstanding voting securities held of record, directly or indirectly, by residents of the United States?
- Are a majority of the issuer’s executive officers and directors citizens or residents of the United States?
- Are a majority of the issuer’s assets in the United States?
- Is the issuer’s business principally administered from within the United States?

While the FPI test is a seemingly straightforward calculation, the application of the test in certain circumstances can be challenging. The SEC staff has recently issued guidance that clarifies the application of the tests in certain circumstances and provides comfort for the application of reasonable methodologies that are consistently applied.

Multiple Classes of Voting Securities. Issuers that have multiple classes of outstanding voting securities with different voting rights may choose to make the calculation on the basis of voting power or the number of outstanding securities, provided that the methodology is applied on a consistent basis.

United States Residency. A person who has permanent resident status in the United States (a “Green Card” holder) is presumed to be a U.S. resident. For purposes of other holders, an issuer may select other reasonable criteria, and apply them consistently, such as tax residency, nationality, mailing address, physical presence, location of financial or legal relationships, or immigration status.

Officers and Directors. In evaluating the citizenship and residency of executive officers and directors, each test must be separately applied to executive officers as a group and

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directors as a group.

Administration of Business. No single factor or group of factors is determinative of the location from which a business is administered. An issuer must assess, on a consolidated basis, the location from which the issuer's officers, partners or managers direct, control and coordinate the issuer's business activities. Absent other factors, shareholder meetings or occasional meetings of the board of directors in the United States would not indicate that the issuer's business was administered in the United States.

Location of Assets. Issuers may look to the geographical segment information determined in the preparation of financial statements for purposes of calculating the location of assets. Alternatively, an issuer may apply any other reasonable methodology on a consistent basis to determine location of assets.

Foreign private issuer status is of considerable benefit to Canadian issuers that access the U.S. markets. Issuers that are in danger of a change in status may find that the recent SEC guidance gives them some additional flexibility in satisfying the FPI test. For those issuers, careful advance planning may make it possible to avoid the loss of the FPI benefits.