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SEC Exploring Changes to Foreign Private Issuer Definition

June 2025



Potential updates to foreign private issuer eligibility rules would make it more difficult for some non-U.S. companies to qualify for FPI status

In a recently issued concept release, the U.S. Securities and Exchange Commission (the "SEC") has asked for public comment on potential rule changes to amend the eligibility requirements for foreign private issuer ("FPI") status in response to significant changes in the population of FPIs since the SEC last conducted a review of FPI eligibility. These rule changes may make it more difficult for many non-U.S. companies – particularly those that are only listed on a U.S. exchange or are incorporated in jurisdictions without equivalent disclosure and other regulatory requirements in their home country jurisdictions – to qualify as "foreign private issuers."

Background

The SEC is exploring amending the term "foreign private issuer" (as defined below) to address changes over the last 20 years to the types of non-U.S. companies that have listed on U.S. exchanges. FPIs that list in the United States are granted significant accommodations that provide full or partial relief from requirements imposed on U.S.-listed domestic companies, and most non-U.S. companies listing in the United States rely on these accommodations. Among other things, U.S.-listed FPIs do not have to file quarterly reports and are generally allowed to follow their home country corporate governance requirements rather than comply with U.S. requirements. A U.S.-listed non-U.S. issuer which is unable to qualify as an FPI – an assessment that must be made annually, as of the last business day of its most recently completed second fiscal quarter – must comply with the SEC and listing rules governing U.S.-listed domestic issuers. Further, FPI status also affects the application of various other exemptions, including Regulation S, Rule 12g3-2(b) and the cross-border tender offer exemptions.

Potential changes

The concept release focuses on these possible approaches to amending the FPI definition:

- Updating the existing FPI eligibility criteria;
- Adding a non-U.S. trading volume requirement;
- Adding a major non-U.S. exchange listing requirement;
- Incorporating an SEC assessment of non-U.S. regulation applying to the FPI;
- Establishing new mutual recognition systems; and
- Adding an international cooperation arrangement requirement.

A corporation or other organization incorporated or organized under the laws of any non-U.S. country will qualify as a "**foreign private issuer**" if 50% or less of its outstanding voting securities are held of record directly or indirectly by U.S. residents (the "shareholder test").

If more than 50% of its outstanding voting securities are held by U.S. residents, the issuer would still qualify for FPI status unless any one of the following are true: (1) a majority of its executive officers or directors are U.S. citizens or residents; (2) more than 50% of its assets are located in the United States; or (3) its business is administered principally in the United States (the "business contacts test").

According to the concept release, when the current FPI accommodations were adopted, the SEC's expectation was that most eligible FPIs would be subject to meaningful disclosure and other regulatory requirements in their home country jurisdictions, and that FPIs' securities would be traded in foreign markets. In fiscal year 2003, the most common jurisdictions for both incorporation and headquarters for FPIs that filed annual reports on Form 20-F ("20-F FPIs") were Canada and the United Kingdom. By contrast, in fiscal year 2023, the most common jurisdiction of incorporation among 20-F FPIs was the Cayman Islands (which has very limited corporate governance and disclosure requirements), and the most common jurisdiction of headquarters for those issuers was mainland China. Additionally, the majority of 20-F FPIs today have their equity securities traded almost exclusively in the U.S. capital markets.

Potential changes

The focus of the potential regulatory responses explored in the concept release is on amending the FPI definition – mainly to make it more difficult for an issuer to qualify as an FPI – rather than on eliminating any of the existing FPI accommodations, although Commissioner Caroline Crenshaw queried whether these should be revisited in her statement.

Updating the existing FPI eligibility criteria

One potential way the SEC could amend the FPI definition would be to update the existing bifurcated FPI test. The possibilities include:

- Lowering the existing 50% threshold of U.S. holders in the shareholder test, above which a foreign issuer would need to apply the business contacts test to be eligible for FPI status; or
- Revising the existing list of criteria under the business contacts test by either adding new criteria (as described below) or revising the existing threshold for assets located in the United States.

Adding a foreign trading volume requirement

Another approach discussed in the concept release, either as an alternative or in addition to updating the existing eligibility criteria, would be to add a foreign trading volume test, which could apply in addition to the current shareholder test or business contacts test and require an FPI to have a certain percentage of the trading volume of its securities in a market or markets outside the United States over a preceding 12-month period.

The SEC found that, at the lowest 1% threshold, more than half of current reporting FPIs would lose their FPI status. However, the SEC also found that increasing the threshold from 1% to 5% would not dramatically increase the number of affected FPIs, but could make it harder for non-U.S. issuers to "game" the system (e.g., by establishing a small foreign market for their securities solely to avoid complying with the registration and reporting requirements for U.S. domestic issuers).

Adding a major foreign exchange listing requirement

The SEC is also requesting comment on potentially requiring FPIs to be listed on a major non-U.S. exchange, particularly in connection with a trading

Why is FPI status important?

FPIs currently benefit from a number of accommodations compared to U.S. domestic issuers, including:

- FPIs' annual reports on Form 20-F have a later due date than annual reports on Form 10-K;
- FPIs are not required to file quarterly reports;
- FPIs are only required to make Sarbanes-Oxley certifications once a year, while domestic issuers must make them quarterly;
- FPIs furnish current reports on Form 6-K rather than the more prescriptive Form 8-K;
- FPIs may present their financial statements using IFRS as adopted by the IASB, or local GAAP with a reconciliation to U.S. GAAP;
- FPIs are exempt from Section 16 reporting;
- FPIs are exempt from the SEC's proxy rules;
- With some exceptions, FPIs can follow home country corporate governance rules;
- FPIs are eligible for the Rule 12g3-2(a) and (b) exemptions from Section 12(g) registration; and
- FPIs are eligible for certain cross-border tender offer exemptions.

volume requirement as described above. One possible approach would be for the SEC to maintain a list of non-U.S. exchanges whose listing requirements meet certain specific criteria, similar to the current approach to determining which exchanges qualify as a "designated offshore securities market" under Regulation S. The SEC could prescribe certain criteria that the listing requirements of a non-U.S. exchange must satisfy to be considered "major," which could include a threshold of total market size reflected, corporate governance requirements, reporting and other public disclosure requirements, enforcement authority, or other factors.

Incorporating an SEC assessment of foreign regulation applicable to the FPI

Another potential approach would be to require that each FPI be:

- incorporated or headquartered in a jurisdiction that the SEC has determined to have a robust regulatory and oversight framework for issuers; and
- subject to such securities regulations and oversight without modification or exemption.

The SEC could, for example, require that an FPI be incorporated and/or headquartered in a jurisdiction where the FPI must file annual reports with financial statements audited by an independent auditor and reports disclosing interim financial results and material events; that has liability provisions for material misstatements and omissions and an effective enforcement mechanism; and that conducts regular reviews of public filings.

The concept release acknowledges, however, that this approach is more complex and requires more SEC resources, as the SEC would have to individually assess the regulatory regimes of non-U.S. jurisdictions on an ongoing basis. Furthermore, once the regulatory requirements of a non-U.S. jurisdiction have been assessed, any subsequent changes that warrant a change in the SEC's determination could be highly disruptive to issuers.

Establishing new mutual recognition systems

The SEC is also considering whether to develop a system of mutual recognition, with respect to Securities Act registration and Securities Exchange Act periodic reporting, for issuers from selected non-U.S. jurisdictions, similar to the MJDS system for Canadian issuers.

Adding an international cooperation arrangement requirement

Another possibility – although already rejected by Commissioner Hester Peirce in her statement – would be to require an FPI to certify that it is either incorporated or headquartered in, and subject to the oversight of the signatory authority of, a jurisdiction in which the foreign securities authority has signed the International Organization of Securities Commissions' Multilateral Memorandum of Understanding Concerning Consultation, Cooperation, and the Exchange of Information ("MMoU") or the Enhanced MMoU.

Other considerations

The SEC is also requesting comment as to whether any amendments to the FPI definition should apply to reporting FPIs only, and not to FPIs which are exempt from registration under Securities Exchange Act Section 12(g) pursuant to either Rule 12g3-2(a) or Rule 12g3-2(b).

Next steps

A concept release is intended to be exploratory in nature and to help the SEC decide whether new rules are needed or whether existing requirements should be changed. Although issuing a concept release is one of the first formal steps in SEC rulemaking, it is possible that the SEC will decide against making any changes, or that the final rulemaking will differ significantly from the concept release.

However, the unanimous vote of the current four SEC Commissioners – the one Democratic Commissioner rarely agrees with the three Republicans – to publish the concept release may indicate that there is some momentum behind a rulemaking to amend the FPI definition.

The SEC has set a comment period of 90 days after publication of the concept release in the Federal Register. Afterwards, the SEC will take some time, usually at least a few months, to review the comments and, if it determines changes are necessary, draft a proposing release, which will also likely have a 90-day comment period.

We plan to submit a comment letter to the SEC in response to the concept release and would like to reflect our clients' views. Accordingly, we encourage you to reach out to your contacts, or to any of the lawyers listed below, with your thoughts.

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