



SEC Amends Reporting Requirements for Foreign Private Issuers

Qualification Testing Becomes Clearer, But Some Reporting Burdens Increase

In an effort to improve the accessibility of the U.S. public capital markets to foreign companies while also enhancing the information that is available to their investors in September 2008, the SEC amended several reporting requirements for foreign private issuers, or FPIs. These changes follow earlier SEC actions that extended the compliance date for filing audit reports on the internal controls of smaller companies, including smaller FPIs. A FPI is any foreign issuer other than a foreign government, except for an issuer that (1) has more than 50% of its outstanding voting securities held of record by U.S. residents, and (2) any of the following: (i) a majority of its officers and directors are citizens or residents of the United States, (ii) more than 50% of its assets are located in the United States, or (iii) its business is principally administered in the United States. Naturally, many of the Israeli companies that are traded in the U.S. capital markets meet the definition of a FPI and therefore are impacted by these amendments. While some of these changes will save FPIs time and effort, others will increase their reporting burdens.

ANNUAL—NOT CONTINUOUS—FPI QUALIFICATION TESTING

As a result of the SEC's amendments, FPIs may now test their qualification to use the forms and rules available to FPIs annually, rather than on a continuous basis. FPI status is generally desirable because, compared to U.S. issuers, FPIs have relatively few reporting obligations. For example, FPIs are exempt from the SEC proxy rules and from insider reports and short-swing profit recovery provisions under Section 16 of the Securities Exchange Act of 1934, or the Exchange Act. FPIs provide interim reports based on home country regulatory and stock exchange practices, rather than the quarterly reports required of U.S. domestic issuers, and provide reports on Form 6-K for a much more limited set of events than do domestic issuers subject to reporting material events on Form 8-K. This results in only an annual report and occasional Form 6-Ks being filed by FPIs in the U.S. Further, FPIs may provide executive compensation disclosures on an aggregate basis, if such is the practice in their home countries, and are not subject to many of the disclosure provisions applicable to U.S. domestic issuers. These scaled back disclosure requirements provide strong incentives for FPIs to retain their status.

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Until the SEC's amendments, FPIs with close to 50% of their voting securities in U.S. residents' hands had to continually monitor their ownership and needed to constantly be aware of their assets and business locations, and their investors', officers' and directors' residencies to assess their continued FPI status since failure to meet the conditions of the FPI definition *at any time* could cause the immediate loss of FPI status. FPIs concluding in the middle of a fiscal year that they no longer qualified as FPIs had to change their bases of accounting to U.S. GAAP in order to comply with domestic issuer reporting requirements under the Exchange Act. FPIs also had to modify their information and processing systems to comply with domestic issuer reporting and registration requirements, including increased disclosure levels and frequency, individualized, more detailed executive compensation information and Section 16 reporting requirements.

The new annual test eliminates issuer and investor uncertainty. FPI status will now be determined solely on the last business day of the second fiscal quarter—the same date used to determine “accelerated filer status.” This allows FPIs that discover they no longer qualify for FPI status six months' notice of their required transition to U.S. domestic status for SEC rules, filings and reporting. Such an issuer would start reporting as a domestic U.S. issuer on the first day of the next fiscal year. For example, a FPI with a December 31 fiscal year end would assess its status as of June 30. If as of June 30 it failed to qualify as a FPI, it would begin using domestic issuer forms and following domestic issuer rules starting on January 1 of the following year. This would include filing an annual report on Form 10-K rather than Form 20-F for the year in which the change in status occurs. On the other hand, issuers that qualify as FPIs for the first time as of the end of the second fiscal quarter can begin taking advantage of FPI status immediately rather than waiting an additional six months.

ACCELERATED FILING DEADLINE FOR ANNUAL REPORTS

FPIs file their annual reports with the SEC on Form 20-F, a form previously due six months after a FPI's fiscal year end. The Form 20-F filing deadline

has been reduced to four months after a FPI's fiscal year end (after a three-year transition period ending December 15, 2011).

The former six-month filing window was intended to accommodate disclosure requirements in FPIs' home jurisdictions. However, the SEC believes that the filing lag has deprived investors of timely information. The new deadlines shorten this disclosure window in recognition of improved information gathering efficiencies and increased filing frequency in other jurisdictions. The new deadlines are not expected to significantly burden most FPIs since FPIs often have already obtained and reported much of the information in their home jurisdictions within shorter timeframes. Also, because many ongoing “shelf” registration statements in the U.S. require recently audited financial statements to remain effective, some FPIs will find that they already meet the new filing deadlines in the course of their existing Form 20-F filing procedures, or at least will already have their audited financial statements ready and need only accelerate the rest of the Form 20-F preparation process.

COMPULSORY REPORTING OF U.S. GAAP SEGMENT DATA

An instruction permitting certain FPIs to omit segment data from their U.S. GAAP financial statements has been eliminated. Before the amendments, FPIs presenting financial statements that were otherwise fully compliant with U.S. GAAP could omit segment data and were permitted to have a qualified U.S. GAAP audit report as a result. The SEC eliminated the accommodation to bring the rules into harmony with recent financial reporting practices such as International Financial Reporting Standards, or IFRS, which have already compelled FPIs not reconciling their financial statements to U.S. GAAP to present segment data. Noting possible timing issues for FPIs to obtain the required segment information, the SEC adopted a one-year transition period ending December 15, 2009.

COMPULSORY RECONCILIATION TO U.S. GAAP

Until the SEC's amendments, a FPI that was only listing a class of securities on a national exchange

or only registering a class of securities under the Exchange Act without conducting a public offering of those securities could provide financial statements in registration statements and annual reports without certain reconciliations to U.S. GAAP.

Beginning with fiscal years ending on or after December 15, 2011, the new rule eliminates the distinction between disclosures to primary and secondary markets by requiring the additional reconciliation information from FPIs that are listing or registering a class of securities under the Exchange Act without conducting a public offering in all FPI registration statements and annual reports. FPIs that prepare their financial statements on a basis other than U.S. GAAP or IFRS now must include reconciliations to U.S. GAAP.

COMPULSORY DISCLOSURE OF CORPORATE GOVERNANCE PRACTICE DIFFERENCES

FPIs must disclose the differences between their home jurisdictions' regulations and those of the U.S. in their annual reports beginning with fiscal years ending on or after December 15, 2008. Many U.S. securities exchanges exempt listed FPIs from many of their corporate governance requirements if such requirements are inconsistent with home country requirements or practices. Such exchanges do, however, require FPIs to disclose differences between their home corporate governance practices and those of the exchanges' standards. FPIs have been permitted to provide such information in their annual reports and/or on their websites, with FPIs frequently opting to use their websites. To consolidate corporate governance disclosure in a single location, the SEC now requires FPIs whose securities are listed on a U.S. exchange to make these disclosures in annual reports on Form 20-F.

REPORTING REGARDING ACCOUNTANTS

Beginning with fiscal years ending on or after December 15, 2009, FPIs must make disclosures in Form 20-F and registration statements about changes of, and disagreements with, their accountants similar to those that are required of domestic filers. Before the amendments, domestic companies—but not FPIs—were required to file this information about their certifying accountants. While FPIs listed on the New York Stock Exchange

are already required to notify the market of auditor changes, neither Form 20-F nor any other FPI form or filing previously included such a requirement.

INCREASED HARMONY BETWEEN GOING PRIVATE AND DEREGISTRATION RULES

In 2007, the SEC amended the deregistration provisions applicable to FPIs to permit them to cease reporting obligations through a quantitative benchmark measuring the market interest in the company, in addition to existing deregistration provisions that rely on the number of shareholders (for more information on these deregistration reforms, see the ZAG/S&W LLP client advisory entitled [New SEC Rules to Make Deregistering and Exiting U.S. Reporting System Easier for Foreign Companies](#) at www.zag-sw.com). The amendments to the going private rules specify that the required effect of a transaction triggering the rules is deemed to have occurred when a FPI becomes eligible to deregister under either method of deregistration now available to FPIs.

COMPULSORY DISCLOSURE OF ADR FEES AND PAYMENTS

To increase investors' awareness of fees associated with American Depositary Receipt, or ADR, facilities, the SEC has required increased Form 20-F disclosure of such fees and payments. Until the amendments, issuers of ADRs disclosed fees and other payments made to depositaries in their filings to register the securities under the Exchange Act, but not in annual reports on Form 20-F. The information included only generic information such as maximums paid on the deposit and the withdrawal of the securities underlying the ADRs. While the ADR fees were disclosed in the ADRs themselves, holders purchasing ADRs in book-entry form did not see the disclosures found in the physical certificate. The amendments revise Form 20-F to require annual disclosure of such fees and additional fees related to ADRs, including annual general depositary services fees. The amendments further state that payments made to FPIs whose securities underlie the ADRs must also be reported, as those payments may be incorporated into the fees and charges ADR holders pay to the depositary. To alleviate timing concerns regarding implementation of the new ADR disclosure requirements, this disclosure will not be

required until fiscal years ending on or after December 15, 2009.

ONE-YEAR EXTENSION FOR SMALL BUSINESSES FROM AUDITOR ATTESTATION REQUIREMENT IN SARBANES-OXLEY ACT

Back in June 2008, the SEC approved a one-year extension of the compliance date for smaller public companies to meet the Section 404(b) auditor attestation requirement of the Sarbanes-Oxley Act. With the extension, "non-accelerated filers", including non-accelerated FPIs, will now be required to provide the attestation reports in their Form 20-Fs for fiscal years ending on or after December 15, 2009. Non-accelerated filers are generally companies with less than a \$75 million public float as of the end of their most recently completed second fiscal quarters (June 30 for December 31 fiscal year end companies). Public float is the market capitalization of common or ordinary shares held by non-insiders of the company.

Section 404, as enacted under SEC rules and regulations, has two provisions: 404(a) requires company management to assess the effectiveness of the company's internal control over financial reporting, while 404(b) requires an auditor attestation on the company's internal control over financial reporting. Accelerated filers, comprising more than 95 percent of the market capitalization of U.S equity securities markets, have been subject to both provisions since 2004 (accelerated FPIs since 2006), while smaller companies have only been subject this year for the first time to 404(a). So, while managements of smaller companies must still undertake significant effort to design and assess internal controls, they can defer the full costs of the additional outside audit for at least another year.

BURDENS OF THE NEW RULES

The effects of the above amendments will vary significantly from issuer to issuer, depending on existing filing and reporting practices. The SEC predicts that, while some of the new rules will have effectively no impact on filing and reporting expenses for FPIs, others will markedly increase the time and financial resources some FPIs spend on compliance in those areas. A detailed look at each FPI is necessary to determine what, if any, added burdens will result from these amendments.