

Client Alert

April 2005

European Organizations Propose New Deregistration Framework to SEC

As part of an ongoing dialogue with the U.S. Securities and Exchange Commission (SEC), eleven European organizations proposed a new deregistration framework that would enable non-U.S. companies to terminate the registration of their securities under the U.S. Securities Exchange Act of 1934, as amended (Exchange Act), on the basis of two alternative standards: one based on non-U.S. market liquidity and post-deregistration disclosure standards, and another based on the level of U.S. investment affected by deregistration.¹

During the past year, members of certain European organizations and others have engaged in a dialogue with the SEC regarding deregistration rules for non-U.S. companies.² In February 2004, a proposal was made to the SEC to amend the deregistration rules,³ and in June 2004, the SEC published proposed amendments to the deregistration rules. Since then the SEC Chairman, other SEC Commissioners and SEC Staff members have addressed the European organizations' proposal and other concerns in several public statements.⁴ In each case, the SEC Chairman, SEC Commissioners and SEC Staff have been willing to consider amendments to the deregistration rules but have objected, on investor protection grounds, to proposals that eliminate the U.S. ownership thresholds set forth in the current deregistration rules.

In their March 18 letter, the European organizations acknowledged the SEC's concern for investor protection and argue that the focus of the policy behind deregistration rules for non-U.S. companies should be the protections available to U.S. investors *after* deregistration rather than on the number of U.S. investors *prior to* deregistration. The European organizations note that different deregistration standards should apply to non-U.S. companies whose primary non-U.S. securities market is liquid, transparent and subject to effective regulatory oversight that requires substantial financial and non-financial public disclosure. In the view of the European organizations, the standards for deregistration of a security of a non-U.S. company that trades on such a liquid, transparent and regulated market outside the U.S. should be less stringent than the current deregistration standards because post-deregistration high quality financial and non-financial disclosure would still be available to U.S. investors, as well as liquidity for the security on the primary non-U.S. securities market.

The European organizations urge the SEC to establish alternative deregistration standards that allow non-U.S. companies to choose any of the standards for which they can satisfy the requirements. The first standard would be based on the liquidity of the primary non-U.S. trading market and the public availability of comprehensive financial and non-financial investment information. The second standard would be based on more traditional concepts of U.S. levels of investment in the non-U.S. company.

To deregister securities registered under the Exchange Act under the proposal of the European organizations, a non-U.S. company would need to satisfy the requirements of either of the deregistration standards described below.

Alternative 1 – Liquidity and Disclosure Standard

Prior to deregistration, the non-U.S. company must have filed two or more annual reports on Form 20-F with the SEC following its most recent securities registration; and

At the time of deregistration, the non-U.S. company must:

- Publish financial statements in accordance with International Financial Reporting Standards (IFRS);
- Report under standards meeting the recommendations of the International Organization of Securities Commissions (IOSCO);
- Have a principal trading market for the class of securities subject to deregistration in the U.S. on a “Designated Offshore Securities Market” (as defined in Regulation S of the U.S. Securities Act of 1933, as amended);
- Have a principal trading market for the class of securities subject to deregistration on an exchange with an average daily trading volume of at least U.S.\$1 billion (equivalent);
- Have less than 5% of the worldwide trading volume in the subject securities in the U.S. markets and at least 55% on a single non-U.S. market; and

After deregistration, the non-U.S. company must:

- Furnish to the SEC the documents that it provides to the local exchange on which the subject securities are listed and to its shareholders, including annual reports that include a description of its business and audited financial statements;

- Establish procedures, where legally permitted, under which U.S. retail investors will be permitted to sell their deregistered class of securities without cost for six months following deregistration; and
- Submit two transition reports to the SEC annually that discuss:
 - the principal differences between their home country corporate governance standards and applicable provisions of the Sarbanes-Oxley Act of 2002;
 - the principal differences between the accounting standards applicable in the non-U.S. company’s home market and U.S. generally accepted accounting principles (GAAP); and
 - the tax consequences to U.S. investors in the securities of the non-U.S. company.

Alternative 2 – Affected U.S. Investment Standard

Prior to deregistration, the non-U.S. company must have filed two or more annual reports on Form 20-F with the SEC following its most recent securities registration; and

*At the time of deregistration:*⁵

- (i) 10% or less of the non-U.S. company’s share capital is held in the U.S.; or
- (ii) 10% or less of the non-U.S. company’s shareholders are located in the U.S.; or
- (iii) the non-U.S. company had fewer than 3,000 shareholders in the U.S.; and

After deregistration, the non-U.S. company must furnish to the SEC the documents that it provides to the local exchange on which the subject securities are listed and to its shareholders, including annual reports that include a description of its business and audited financial statements.

By providing for alternative deregistration standards, the proposal of the European organizations intends to accommodate deregistration for securities registered under the Exchange Act of all types of non-U.S. companies, independent of the nature of the companies’ local securities trading system, reporting requirements, or size. The European organizations intend that their revised proposal will address the concerns of the SEC regarding protection of U.S. investors upon deregistration of the securities of a non-U.S. company under

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the Exchange Act and alleviate non-U.S. companies' concerns that participation in the U.S. capital markets would result in perpetual registration under the Exchange Act and reporting obligations to the SEC.

Should you have any questions concerning the deregistration proposals described in this Client Alert, please contact Herman H. Raspé at (212) 336-2301 (hhraspe@pbwt.com), Karen M. McCarthy at (212) 336-2529 (kmmccarthy@pbwt.com), or Karen M. Hartman at (212) 336-2787 (kmhartman@pbwt.com).

Endnotes

- ¹The proposal was made in a letter sent to the SEC Chairman, William H. Donaldson, on March 18, 2005. The signatories of the March 18 letter are: (i) Aktienforum; (ii) Association Française des Entreprises Privées (AFEP); (iii) Bundesverband der Deutschen Industrie (BDI); (iv) The Confederation of British Industry (CBI); (v) Confederation of Swedish Enterprise (Svenskt Näringsliv); (vi) Deutsches Aktieninstitut; (vii) Middledent; (viii) Quoted Companies Alliance (QCA); (ix) The ATHEX Listed Companies Association (SEISET); (x) Cyprus Public (Listed) Companies Association (SYDEK); and (xi) Union of Listed Companies in the Athens Stock Exchange. Attached to the March 18 letter, the European organizations provided the SEC Chairman with a detailed technical analysis and draft proposed rules prepared by Cleary Gottlieb Steen & Hamilton LLP, together with an analysis of U.S. trading patterns and ownership levels of certain large European companies prepared by Citigroup.
- ²For purposes of this Client Alert, we refer to the SEC rules governing deregistration and termination of reporting obligations under the Exchange Act as the “deregistration rules.” For purposes of this Client Alert, the term “non-U.S. company” is intended to mean “Foreign Private Issuer” (as such term is defined in the rules adopted by the SEC under the Exchange Act) that is required to comply with the registration and reporting requirements of the Exchange Act.
- ³The signatories to the February 9, 2004 letter were: (i) Aktienforum; (ii) Association Belge des Sociétés Cotées (Belgische Vereniging van Beursgenoteerde Vennootschappen) (ABSC-BVBV); (iii) Association Française des Entreprises Privées (AFEP); (iv) Association Nationale des Sociétés par Actions (ANSA); (v) The ATHEX Listed Companies Association (SEISET); (vi) Bundesverband der Deutschen Industrie (BDI); (vii) The Confederation of British Industry (CBI); (viii) Confederation of Finnish Industry and Employers; (ix) Confederation of Swedish Enterprise (Svenskt Näringsliv); (x) Deutsches Aktieninstitut; and (xi) European Association for Listed Companies (EALIC).
- ⁴See, for example, our March 2005 Client Alert on global coordination of securities regulation.
- ⁵When determining whether the quantitative standards of these thresholds are satisfied, investors who are qualified institutional buyers (QIBS), employees and directors of the non-U.S. company would be excluded from the calculation. Also, the rules governing the counting of the number of U.S. investors and the percentage of share capital held in the U.S. would include workable timing and calculation mechanisms for the market in question, as well as assumptions where reasonable inquiries do not produce conclusive results.

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