

## Hail, Hail Freedonia: Frequently Asked Questions About SEC Registration on Schedule B by Foreign Governments

*Non-US sovereigns can take advantage of a streamlined registration process to obtain financing in the US capital markets.*

### Key Points:

- SEC registration offers certain advantages that non-US sovereign issuers (foreign governments) may find attractive, such as the ability to sell securities to retail investors.
- The disclosure requirements and SEC registration process for foreign governments to sell debt securities in the United States are very manageable.
- Foreign government agencies and supranational organizations that wish to use Schedule B should consult with the SEC early in the process to determine eligibility.

### Introduction

In the Marx Brothers' movie *Duck Soup*, the finances of the mythical and bankrupt country of Freedonia depend on continuing loans from the wealthy Mrs. Teasdale (played by the unflappable Margaret Dumont). For her part, Mrs. Teasdale insists that Rufus T. Firefly (played by Groucho Marx) be named as Freedonia's leader.

It apparently never occurs to either of them — or to Freedonia's long-suffering Minister of Finance — to seek financing in the United States capital markets. While that questionable choice of leadership and fundraising doubtless made for better comedy, it probably didn't make life any easier for Freedonia's Treasury Department.

In fact, given their size and depth, the US capital markets are a frequent financing venue for foreign governments. Foreign governments can sell securities in the United States without going through the registration process with the US Securities and Exchange Commission (SEC). For example, Rule 144A under the US Securities Act of 1933 (Securities Act) is often used for private offerings to certain large institutional investors. But let's say a foreign government wants to access the US public capital markets and sell securities to the widest range of investors — what then?

We answer below key questions about how a foreign government can smoothly navigate its way through the SEC registration process and raise money in the United States in a public offering. These types of transactions are often referred to as "Schedule B" offerings, after the name of the specific foreign government registration statement mandated by the US Congress in the Securities Act.

## 1. What are some of the advantages of SEC registration?

- **Liquidity:** SEC registration allows a foreign government to sell its securities to the widest possible group of investors in the United States, including retail investors and those institutional investors with a preference for registered securities as opposed to unregistered securities.
- **Transparency:** SEC registration allows a foreign government to file its offering documents on the SEC's EDGAR system, giving investors worldwide access to core disclosure documents.
- **Flexibility:** In practice, a Schedule B registration statement bears a strong resemblance to a Rule 144A offering circular, allowing a foreign government flexibility to use common disclosure when tapping US institutional and retail markets.

## 2. I've heard that SEC registration is complicated and difficult. Is this true for a foreign government?

Not necessarily. In fact, an SEC-registered offering by a foreign government is not as difficult a process as for a typical corporate issuer. For example, there is no requirement that any information in the registration statement be audited.

## 3. Can a foreign government target its citizens in the United States — for example, with a diaspora bond — without registration?

No, unless the offering is carefully structured to comply with an exemption from registration, such as by limiting sales to qualified investors. Importantly, the SEC has brought enforcement cases against foreign governments for offerings of securities that did not comply with the registration requirements of the Securities Act.

## 4. Can a foreign government sell its securities to the public in the United States without registration, in the same way as US Treasury securities?

No. Securities of the US federal government are exempt from the registration requirements of the Securities Act.

## 5. Is there potential US securities law liability?

Yes. There is no specific liability exemption for issuances of securities by foreign governments under the US federal securities laws. The US Foreign Sovereign Immunities Act of 1976 provides the sole basis for obtaining jurisdiction over a foreign state in US courts, but that's a separate, complex topic (and outside the scope of these FAQs).

## 6. What does Schedule B specifically require?

Surprisingly little. While Congress and the SEC have adopted numerous financial and non-financial disclosure requirements over the years for corporate issuers, the short list of line-item disclosure requirements in Schedule B remains unchanged since originally adopted by Congress in 1933. For example, there is no specific requirement in Schedule B for disclosure of risk factors.

## 7. So is offering securities as simple as filling out Schedule B and sending it to the SEC?

Not exactly. Market practice is to provide a great deal more information in an offering prospectus than is specifically required, both to satisfy investor demand and because of the liability considerations mentioned above. A typical US offering prospectus for a foreign government covers topics such as:

- the country's economy;

- its exports and imports;
- government expenditures and receipts;
- the banking system;
- budget priorities; and
- the terms of the debt securities, use of proceeds and underwriting arrangements.

In addition, the prospectus will often contain:

- a number of statistical tables covering a range of topics, including GDP, inflation, unemployment and outstanding indebtedness;
- a map indicating principal cities, geographic features and neighboring jurisdictions; and
- information on a country's demographics, system of government, political parties, historical development, international relations, and natural or other resources.

## **8. How about risk factors?**

Although these are not specifically required, for some foreign governments it may be appropriate for the prospectus to highlight certain risk factors that investors should evaluate in making their purchase decisions. For example, these may relate to current macroeconomic developments or global trends that could have an impact on the country's economy.

## **9. What entities can use Schedule B?**

Appendix A provides a flowchart on how to approach questions of Schedule B eligibility.

The registration scheme for foreign governments is available to any foreign government and any political subdivision of a foreign government, such as a province, state or city. When a subnational foreign government registers with the SEC, the disclosure provided is appropriately tailored to relate to that government.

## **10. How about a government agency such as the Export Credit Bank of Freedonia, or a supranational entity such as the Freedonia-Sylvania Development Bank?**

On a case-by-case basis, the SEC Staff will permit the foreign government registration scheme to be used by government agencies or banks, such as import-export banks, and development banks or agencies. In these instances, the issuer must first convince the SEC Staff that the issuer in question should be treated like a foreign government and not a typical corporate issuer.

Factors that appear to influence the Staff in this regard include:

- whether the borrower's debt securities are guaranteed by a foreign government (and if not guaranteed, whether there is some type of enforceable credit support provided for the borrower);
- whether the foreign government controls the borrower and has budget or other management authority over the borrower; and
- whether the borrower serves a governmental purpose.

In the same way, supranational organizations, such as multilateral development banks, are able to seek the Staff's agreement that they may similarly use the registration scheme for foreign governments. Again, relevant factors that the Staff seems to focus on relate to sovereign guarantees or credit support, sovereign oversight and management, and governmental purpose, for the entity in question.

## **11. I'm a government agency and would like to use Schedule B. How can I find out if I am eligible to do that?**

As an initial step in obtaining the SEC Staff's agreement to let you use the foreign government registration process, US counsel for the entity would send a written request to the Staff, outlining the characteristics of the entity and explaining why the entity should be treated as a foreign government borrower rather than a corporate issuer. Assuming that the Staff agrees that a government entity or agency may use the foreign government registration process, the disclosure would again be tailored to fit the situation.

If the prospectus is to contain financial statements of the entity, they need not be audited under US auditing standards (or even audited at all), nor are they required to be prepared in accordance with International Financial Reporting Standards or US Generally Accepted Accounting Principles. In seeking the SEC's agreement to use Schedule B, it is important that foreign governmental entities use US counsel who are very familiar with the SEC's process, because relevant correspondence relating to similar issuers is not freely publicly available and it is vital to have insight into the SEC's areas of concern.

## **12. Is Schedule B available for equity offerings, such as the privatization of a government agency or state-owned enterprise?**

No. Only debt securities can be registered using the foreign government registration process. If a state-owned enterprise or financial institutional seeks to sell equity securities in the United States in an SEC-registered offering, then the process for typical corporate issuers would have to be used. Almost by definition, Schedule B assumes an offering of debt securities.

## **13. What can I expect in the initial registration process?**

With the assistance of its US counsel, and the lead underwriters for the offering and their US counsel, a foreign government will prepare its Schedule B registration statement and deliver it to the SEC. The SEC will then read through the document and, within 30 days of delivery, give comments on the document. The SEC's comments could perhaps ask for a more in-depth explanation of some matter, or request additional information on another matter, or question whether appropriate emphasis is provided for yet another matter. The SEC will give its comments in a formal letter addressed to the US representative of the government (often its US ambassador or financial attaché in Washington, D.C.).

The working group will then revise the registration statement in order to address the matters raised in the SEC's comments. The SEC will review the materials and, generally within two weeks, provide additional follow-up comments. This back-and-forth process continues until the SEC indicates that it has no further comments. For a foreign government, this process rarely exceeds three submissions.

## **14. Is confidential review available?**

Initially, yes. A foreign government registering with the SEC for the first time can have its Schedule B registration statement reviewed by the SEC on a confidential basis. Under this accommodation, the issuer can complete the review process and then publicly file the registration statement (along with the prior drafts delivered to the SEC) once it is ready to start the marketing effort in the United States. All of the back-and-forth comment correspondence with the SEC is also made public. After the first time, a foreign government that registers an offering with the SEC must file the registration statement publicly with the SEC, so that it is immediately available on the SEC's EDGAR system.

### **15. Do all subsequent offerings go through the same process?**

Not necessarily. When registering with the SEC for the first time, the SEC will always undertake the review discussed above. After the first time, the SEC manages a selective review process, deciding whether to review a registration statement based on a number of factors. The SEC may decide not to review the registration statement at all, or to focus on specific issues.

### **16. Am I required to have an indenture trustee and meet the requirements of the Trust Indenture Act of 1939 (TIA)?**

No. In SEC-registered offerings of debt securities, a corporate issuer is required to have a US trustee and a US-style trust indenture, which will include provisions designed to comply with the TIA. In contrast, a foreign government registering debt securities with the SEC is not subject to these requirements. It accordingly has the option of having a trustee (which could be US or foreign) or a fiscal agent (again, either US or foreign).

In addition, over the past several years, some foreign governments that have registered debt securities with the SEC have included various forms of “collective action clauses,” under which the payment terms relating to principal, interest and maturity may be amended without the consent of all affected debtholders when a sufficient percentage of other debtholders agree to revised payment terms. These types of provisions would generally not be permitted for a corporate issuer under the TIA.

### **17. Am I required to issue bonds in US dollars?**

No. There are no restrictions on the currency in which an issuer may denominate its securities. The amount of securities registered under Schedule B and the filing fee payable to the SEC are expressed in US dollars, but this does not limit the currency of the securities issued under a registration statement.

### **18. Is it typical to list foreign government bonds on a US stock exchange?**

No. It is rare to list foreign government securities issued in the United States on a US stock exchange, although a listing may be sought outside the United States. Rather, in the same fashion as the overwhelming majority of corporate debt issued in the United States, foreign government securities will trade over-the-counter (or on any non-US exchange on which the debt may be listed).

If a foreign government chooses to list its securities on a US stock exchange, the issuer would be required to undertake a separate but roughly parallel registration process with the SEC under the US Securities Exchange Act of 1934 (Exchange Act) relating to the listed securities.

### **19. What Exchange Act reporting is required?**

In contrast to corporate issuers, which are required to file annual, quarterly and other reports with the SEC, a foreign government (if it has not listed its securities on a US stock exchange) is free from any further filing requirements once it has completed its offering. If a foreign government has listed its securities on a US stock exchange, it is required to file with the SEC an annual report on Form 18-K containing specified information by the end of nine months after its fiscal year end. Notably, the SEC’s annual report form for foreign governments has not been updated in several decades (it still refers to disclosure required under League of Nations standards) and the information elicited has limited usefulness.

## **20. Will I subject myself to Sarbanes-Oxley?**

No. Foreign governments that register their securities with the SEC are not subject to the various provisions of the Sarbanes-Oxley Act of 2002 that apply to corporate issuers.

## **21. Is shelf registration available?**

Yes. While the SEC's rules for shelf registration by corporate issuers do not apply to foreign governments, the SEC Staff has long recognized that the registration process for foreign government offerings can be cumbersome and can result in an issuer missing advantageous financing opportunities. As a result, the SEC has created a process for seasoned foreign government issuers akin to the shelf registration process available to corporate issuers.

In this process, a foreign government can go through the registration process in advance with respect to a large amount of securities, and then over time do immediate "takedowns off the shelf" when a financing window opens. No SEC action is required for the takedown to occur, giving the issuer significant flexibility in choosing when to make a US offering.

## **22. How does a foreign government set up a shelf?**

In order to set up shelf registration, the foreign government must have conducted an SEC-registered offering and not defaulted on its debt securities within the past five years.

After that, a foreign government can choose between two techniques, depending on its preference (which may turn more on the desired marketing approach than legal requirements). It can either:

- file with the SEC a *long-form registration statement* containing the information described above for foreign government prospectuses; or
- file with the SEC a *voluntary annual report on Form 18-K* that contains the same prospectus-type information, and also file a *short-form registration statement*, which would incorporate by reference the annual report, so that the information contained in the annual report is deemed part of the short-form registration statement.

To use the second method of shelf registration involving an annual report and a short-form registration statement, an issuer (through its US counsel) is required to obtain permission from the SEC to use the incorporation-by-reference procedure. Through a well-trodden path, the foreign government's US counsel would write a letter to the SEC Staff outlining the issuer's desire to use this process and confirm that an annual report would contain the same information as was contained in a recent offering prospectus. The SEC has not adopted specific rules relating to shelf registration for foreign governments, and this informal ask-and-response procedure represents a constructive accommodation by the SEC Staff in allowing foreign governments to use the convenience of shelf registration.

## **23. Is there a need to worry about state securities laws?**

The "blue sky" laws at the state level should not be a problem. In virtually every jurisdiction there is an exemption from securities registration requirements for securities issued by a foreign government. Generally, the language of the exemption tracks Section 201(2) of the Uniform Securities Act (2002), which provides that an exempt security is "a security issued, insured or guaranteed by a foreign government with which the United States maintains diplomatic relations, or any of its political subdivisions, if the security is recognized as a valid obligation by the issuer, insurer or guarantor."

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Returning to *Duck Soup*, when Rufus T. Firefly receives a report from his Treasury Department, Firefly remarks, "Why, a four-year-old child could understand this report!" and then asks his personal secretary (Zeppo Marx) to find a four-year-old child because he can't make heads or tails of the report. While registering with the SEC would prove too complex for the typical four-year-old, it is certainly an attainable and worthwhile goal for foreign governments that wish to have broad financing options in the United States.

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# The Road: From Point A to Schedule B

