

1995

## American Depositary Receipts

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### Recommended Citation

Guy P. Lander, *American Depositary Receipts*, 29 INT'L L. 897 (1995)  
<https://scholar.smu.edu/til/vol29/iss4/9>

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## American Depositary Receipts<sup>†</sup>

United States investors have dramatically increased their investment in foreign securities over the years. As technological advances and regulatory initiatives facilitate more global securities markets, investments in foreign securities should continue to grow.<sup>1</sup> Foreign equity securities are traded in the United States in three forms: (1) Ordinary Shares as issued in the country of incorporation; (2) American Shares as issued specifically for use in the United States, frequently with different procedural rights; and (3) American Depositary Receipts (ADRs), the most common form.<sup>2</sup>

Foreign companies seeking to expand trading of their equity securities traditionally have established ADR programs, and the vast majority of foreign issuers, excluding Canadian companies, use ADRs when they list their securities in the United States.<sup>3</sup> In recent years, new applications for ADRs have been developed. ADRs have been used in mergers and acquisitions, restructurings, foreign government debt offerings, employee benefit and compensation plans, and offerings under Rule 144A of the Securities Act.<sup>4</sup>

Unless otherwise indicated, references throughout this article to "foreign com-

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†This article forms the basis for a chapter in a forthcoming treatise, "The U.S. Securities Laws Affecting International Financial Transactions," expected to be published in mid-1996 by Warren Gorham Lamont.

1. American Depositary Receipts, Exchange Act Release No. 29,226, [1990-1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,740 (May 23, 1991) [hereinafter ADR 1991 Release]. In the release, the SEC reviewed the ADR market, examined how it should be regulated, and solicited public comment on numerous issues relating to ADRs and ADR market participants.

2. LOUIS LOSS, *FUNDAMENTALS OF SECURITIES REGULATION* 229 n.3 (2d ed. 1988) (citing JOHN R. STEPHENSON & WILLIAM J. WILLIAMS, JR., *A LAWYER'S GUIDE TO INTERNATIONAL BUSINESS TRANSACTIONS* 70 (2d ed. 1980)).

3. Joseph Velli, *American Depositary Receipts: An Overview*, 17 *FORDHAM INT'L L.J.* S38, S38 (1994).

4. ADR 1991 Release, *supra* note 1, at 81,587-88.

pany" or "foreign issuer" refer to "foreign private issuer," defined in Securities Act Rule 405 and Exchange Act Rule 3b-4 to mean any foreign issuer (other than a foreign government), except an issuer that meets the following conditions: (1) more than 50 percent of its outstanding voting securities are held (either directly, through voting trust certificates, or through depositary receipts) by U.S. residents, and (2) any of the following: (i) the majority of its executive officers or directors are residents or citizens of the United States, (ii) more than 50 percent of its assets are located in the United States, or (iii) its business is administered principally in the United States.

Since 1983 the regulations of the Securities and Exchange Commission (SEC) distinguished ADRs from American Depositary Shares (ADSs). ADRs were the physical certificates that evidenced ADSs, similar to the way a stock certificate evidences shares of stock. An ADS was the security that represented an ownership interest in the deposited securities, in the way a share of stock represents an ownership interest in a corporation. Because of the resulting confusion and because market participants did not differentiate between ADRs and ADSs, the SEC abandoned this distinction in a release reviewing the ADR market. The SEC release and this article do not use the term "ADS," and "ADR" may, depending on its context, refer to either the physical certificate or the security evidenced by such certificate.<sup>5</sup>

## I. ADRs Defined and Described

An ADR is a substitute certificate that facilitates trading of foreign securities by enabling the holder to transfer title to the underlying foreign securities simply by transferring the ADR. An ADR is a negotiable certificate, a receipt issued by a U.S. depositary that represents ownership of shares of securities of a foreign private issuer. These shares are deposited by the holder of those securities and held overseas by the depositary.<sup>6</sup> Typically, equity securities of a foreign issuer are deposited with a foreign affiliate or correspondent of a U.S. bank or trust company.<sup>7</sup> The affiliate is usually located in the country of incorporation of the foreign issuer. The ADR is issued by the U.S. bank or trust company, and the certificates then trade in the U.S. securities market.<sup>8</sup> An ADR holder can exchange ADRs for the underlying foreign securities at any time, and additional foreign securities can be deposited for issuance of additional ADRs.<sup>9</sup> An ADR may

5. ADR 1991 Release, *supra* note 1, at n.5.

6. *Id.* at 81,587; American Depositary Receipts, Exchange Act Release No. 19,612, [1982-1983 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,329 (Mar. 18, 1983) [hereinafter ADR F-6 Release]. See *infra* note 12.

7. ADR 1991 Release, *supra* note 1, at 81,587. ADRs may also be issued for debt securities. *Id.* at n.7.

8. *Id.* at 81,587. The SEC does not require that a depositary be a bank. *Id.* at n.8.

9. EDWARD F. GREENE ET AL., U.S. REGULATION OF THE INTERNATIONAL SECURITIES MARKETS: A GUIDE FOR DOMESTIC AND FOREIGN ISSUERS AND INTERMEDIARIES 35 (2d ed. 1993).

represent one foreign security or, to compensate for the different pricing levels between U.S. and foreign markets, a fraction or multiple of the security.<sup>10</sup> Once an ADR program is established, the ADRs trade freely in the United States just like any other U.S. security.

## II. Historical Background—Evolution from Receipts

Originally, ADRs were receipts. ADRs began as “substitute certificates” that were developed by the financial community in the 1920s to facilitate trading by U.S. investors in foreign securities.<sup>11</sup> ADRs were viewed as receipts similar to warehouse receipts for commodities that were the underlying deposited shares.<sup>12</sup>

Typically, the depositor was a U.S. investment firm that wanted to sell a block of shares it held in a foreign company and that deposited the shares with the depositary in exchange for ADRs. The depositors, however, could also be foreign or U.S. shareholders who deposited their shares with the depositary in exchange for ADRs. Generally, the investment firm would enter into an agreement to have a U.S. bank act as the depositary. The foreign issuer normally was not a party to the agreement, but U.S. investors automatically became parties by purchasing the receipts. The investment firm as depositor usually retained the right to manage the deposit, and the depositary bank undertook only to hold the foreign shares and to issue receipts against them.<sup>13</sup>

Later, banks began initiating ADR facilities and ADR programs by offering to issue receipts against the deposit of designated foreign securities. U.S. dealers or private shareholders deposit their foreign securities with the bank's foreign agent in exchange for ADRs issued by the bank. In these arrangements, no formal deposit agreement is made, except as the receipts themselves evidence an agreement. The foreign issuer is not involved, although the depositary bank normally obtains the issuer's permission in advance to issue the receipts.<sup>14</sup>

In 1955 the SEC adopted Form S-12 to facilitate the offering of ADRs by banks. Form S-12 was replaced by Form F-6 in 1983.<sup>15</sup> Form F-6 applies if:

10. ADR 1991 Release, *supra* note 1, at n.6. ADR trading prices result from several variables such as (a) the issuer's performance, (b) the price of the deposited security in its primary foreign market, (c) the overall performance of that foreign market, (d) foreign currency exchange rates, (e) costs of carrying a position vulnerable to adverse currency changes, (f) administrative costs of establishing and maintaining an ADR facility, and (g) “trading” costs, i.e., the average costs of ADR creation and withdrawal of deposited securities. When sufficient price spreads exist between ADR prices and prices deposited in the home country, opportunities for arbitrage occur. *Id.* at 81,591.

11. LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 1054 (3d ed. 1989).

12. *Id.* at 774 n.72 (quoting SEC, OFFICE OF INT'L CORP. FIN., MEMORANDUM ON AMERICAN DEPOSITARY RECEIPTS (ADR) 1-2 (Sept. 9, 1983)); see also Douglas B. Spoors, *Exploring American Depositary Receipts: The International Augmentation of U.S. Securities Markets*, 6 TRANSNAT'L LAW. 181, 185 n.21 (1993).

13. LOSS & SELIGMAN, *supra* note 11, at 1054; Spoors, *supra* note 12, at 196.

14. LOSS & SELIGMAN, *supra* note 11, at 1054-55.

15. ADR F-6 Release, *supra* note 6.

(1) the ADR holder may withdraw the deposited securities at any time (subject to a few mechanical exceptions); (2) the deposited securities are offered or sold in transactions that are registered under the Securities Act or in transactions that would be exempt from registration if made in the United States; and (3) the foreign issuer of the deposited securities reports under the Exchange Act or is exempt from such reporting under the Rule 12(g)(3)-2(b) exemption.<sup>16</sup> Rule 174(a) of the Securities Act relieves a dealer of its obligation under section 4(3) to deliver a prospectus when the registration statement is on Form F-6.<sup>17</sup> Under Form F-6, as under Form F-12, the entire prospectus may be embodied in the receipts and consists of only two pieces of information: (1) the description of the ADRs and (2) whether the issuer supplies information under Rule 12g3-2(b) or reports under the Exchange Act.<sup>18</sup>

### III. Advantages of ADRs for Investors and Foreign Companies

#### A. ADVANTAGES FOR U.S. INVESTORS

For U.S. investors, the ADR arrangement provides two major advantages over owning the underlying foreign securities directly: convenience and cost. ADRs are transferred easily; present fewer problems than owning bearer certificates (ADR holders make collecting dividends easier);<sup>19</sup> provide more information about the foreign issuer (which also makes collecting dividends easier); and have a lower carrying cost than owning the foreign securities directly.

##### 1. *Ease of Transfer*

To U.S. investors, ADRs trade and settle just like U.S. securities. ADRs are quoted and traded in U.S. dollars in the U.S. securities markets. ADRs mitigate problems that may arise under foreign investment restrictions or foreign exchange controls. The use of ADRs also avoids inconvenient requirements of foreign laws, foreign inheritance taxes, and probate in foreign courts. A decedent's beneficiary can obtain ownership of the ADRs upon compliance with U.S., rather than foreign, laws related to the transfer of securities upon death of the owner.<sup>20</sup>

These benefits are possible because the depositary or its nominee is the owner of record or legal owner of the deposited securities. When an ADR holder transfers shares, the holder endorses the certificate and delivers it to the depositary, which

16. General Instructions I, 17 C.F.R. § 239.36 (1989).

17. 17 C.F.R. § 230.174 (1989); LOSS & SELIGMAN, *supra* note 11, at 510.

18. ADR 1991 Release, *supra* note 1, at 81,596; *see also* ADR F-6 Release, *supra* note 6, amended by Securities Act Release No. 6951, 2 Fed. Sec. L. Rep. (CCH) ¶¶ 7001, 7003 (Aug. 12, 1992).

19. LOSS & SELIGMAN, *supra* note 11, at 774 n.72; Velli, *supra* note 3, at S41-42.

20. LOSS & SELIGMAN, *supra* note 11, at 774 n.72; Mark A. Saunders, *American Depositary Receipts: An Introduction to U.S. Capital Markets For Foreign Companies*, 17 FORDHAM INT'L L.J. 48, 54 (1993).

transfers ownership of the underlying foreign securities by entries in its books. This procedure is much easier than a system whereby U.S. investors hold foreign securities and try to transfer them in accordance with the transfer and settlement procedures (including payment of foreign transfer taxes) of the foreign home market.<sup>21</sup>

## 2. Fewer Problems

ADR ownership eliminates some problems presented by ownership of bearer certificates. Foreign securities are frequently issued in bearer form so that a list of shareholders cannot be maintained.<sup>22</sup> Dividends on bearer securities are generally declared by publication in one or more newspapers, usually in the language of the foreign issuer's country of domicile, and the certificates must be mailed to a foreign paying agent. However, with ADRs, the foreign branch or correspondent of the depositary monitors the foreign papers for dividend declarations and collects the dividends. The dividends are then sent to the depositary, which converts them to dollars and pays them to the registered holders of the ADRs.<sup>23</sup> The depositary usually assists ADR holders with any filings that may be necessary to reduce any foreign withholding tax on dividend payments available under a tax treaty.<sup>24</sup>

## 3. Greater Availability of Information

ADRs also lead to greater availability of information about the foreign issuer. Many foreign issuers fear being subjected to liability under U.S. securities law and, consequently, are reluctant to send shareholder communications directly to U.S. investors. With ADRs, however, the depositary, as the record owner of the underlying foreign deposited securities, receives shareholder information through its foreign branch or correspondent and sends the information to the ADR holders in the United States.<sup>25</sup> The ADR holders usually can direct the depositary to vote proxies for the underlying voting security.<sup>26</sup>

## 4. Other Advantages

ADRs may be listed on U.S. exchanges, which generally is not possible for bearer certificates because the issuer cannot prove that it has the requisite number of U.S. shareholders necessary for listing. ADRs are attractive to institutional investors whose investment restrictions require that they purchase securities that trade and settle in U.S. dollars. ADRs also may benefit from the enhanced liquidity

21. LOSS & SELIGMAN, *supra* note 11, at 774 n.72; Saunders, *supra* note 20, at 53; GREENE ET AL., *supra* note 9, at 36.

22. LOSS & SELIGMAN, *supra* note 11, at 774 n.72.

23. *Id.* at 775 n.72.; Saunders, *supra* note 20, at 52.

24. GREENE ET AL., *supra* note 9, at 36-37.

25. LOSS & SELIGMAN, *supra* note 11, at 775 n.72.

26. Saunders, *supra* note 20, at 54.

that results from an exchange listing.<sup>27</sup> Lastly, ADRs have lower carrying costs than holding foreign securities directly. Foreign shares purchased directly usually must be held by a foreign custodian that charges a fee. The depositary bank obtains better foreign exchange rates for converting dividends to U.S. dollars than individuals can obtain. Moreover, ADRs that settle in the United States have a lower fail to settle rate than non-U.S. securities, allowing lower financing costs to be passed on to the investor.<sup>28</sup>

## B. ADVANTAGES OF ADRs FOR FOREIGN ISSUERS

ADRs enable foreign issuers to enter the U.S. securities markets and to meet various commercial, financial, and strategic objectives. Some foreign companies use ADRs to gain increased visibility for the issuer's name and products in the United States. This visibility, which is enhanced by the trading of the foreign issuer's securities in the U.S. market, also expresses a commitment to the U.S. market. ADRs can trade on the New York Stock Exchange (NYSE), the American Stock Exchange (AMEX), the National Association of Securities Dealers, Inc.'s Automated Quotation System (NASDAQ) or over-the-counter through the Over-The-Counter (OTC) Bulletin Board Display Service<sup>29</sup> or the "pink sheets."<sup>30</sup>

However, the financial objectives of most foreign issuers are paramount. Many foreign issuers have found that establishing ADR programs that enable U.S. investors to buy their ADRs results in a higher share price. This higher price occurs because many industries receive a higher valuation from the U.S. investment community than from their home country. For example, France may place a price-to-earnings multiple of fourteen on an industry that receives a multiple of eighteen in the United States. Additionally, the mere fact that U.S. investors purchase the ADRs increases demand, resulting in a higher share price.<sup>31</sup> Finally, some foreign issuers seek to create an instrument for raising capital in corporate finance transactions for foreign issuers seeking access to the United States' deep, liquid capital markets. ADRs have been used in connection with mergers and acquisitions, restructurings, foreign government debt offerings, and Rule 144A offerings.

27. GREENE ET AL., *supra* note 9, at 36.

28. Velli, *supra* note 3, at S42.

29. The Bulletin Board Display Service is an automated, electronic service operated by the National Association of Securities Dealers, Inc., that provides market makers with a display of quotations for securities included in the system by brokers and dealers. GREENE ET AL., *supra* note 9, at 32 n.6. These securities are not quoted in NASDAQ. ADR 1991 Release, *supra* note 1, at 81,590.

30. The "pink sheets" are a listing of market maker quotations and names that is updated and distributed daily to securities brokerage firms by Commerce Clearing House's National Quotation Bureau, Inc. ADR 1991 Release, *supra* note 1, at 81,590.

31. Velli, *supra* note 3, at S41.

The strategic objective of some foreign companies may be to provide funding for employee benefit and compensation plans. Such plans, for example, may enable U.S. employees to invest in the foreign issuer's shares or grant U.S. executives stock options.<sup>32</sup>

#### IV. How ADRs Work—The ADR Trading Process

##### A. THE ADR MARKET GENERALLY

ADRs trade freely in the United States just like securities of U.S. companies. ADRs are listed on the major U.S. exchanges, quoted on NASDAQ, or quoted over-the-counter through the OTC Bulletin Board Service or in the "pink sheets."

##### B. HOW AN ADR TRADE WORKS

###### 1. *ADR-to-ADR Trades*

ADR-to-ADR trades, that is, the purchase or sale of ADRs in the U.S. markets, represents over 90 percent of all ADR transactions.<sup>33</sup> When a U.S. investor asks his broker to buy shares in a foreign issuer and deliver them in the form of ADRs, the broker buys ADRs, if available in a U.S. market. Similarly, when a U.S. investor requests that his U.S. broker sell ADRs, the broker sells ADRs in a U.S. market.

###### 2. *How ADRs Are Created and Canceled*

###### a. Creation (Issuance)—Purchase

When a U.S. investor asks his broker to buy ADRs in a foreign issuer, the broker tries to buy existing ADRs trading in the U.S. markets, but if they are unavailable, the broker has the depositary issue new ones. To issue new ADRs, the U.S. broker contacts a foreign broker in the appropriate foreign market to buy ordinary shares in the local market. The ordinary shares are deposited with a custodian in the foreign market, which is a foreign branch, affiliate, or correspondent of the U.S. depositary.<sup>34</sup> The foreign custodian credits the U.S. deposi-

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32. *Id.*

33. ADR 1991 Release, *supra* note 1, at 81,591.

34. When foreign stock shares are purchased, receipt of the shares may be delayed because of settlement practices in foreign markets. If depositaries waited to issue ADRs until they had received the underlying securities, the ADR market would be upset. Consequently, depositaries often pre-release ADRs by issuing ADRs for shares that have not yet been received. Some depositaries have established guidelines of 15-20% of total ADRs outstanding in their facility. However, there are no restrictions on the amount of pre-release lending an institution may undertake.

Agreements for the pre-release of ADRs should contain provisions that they be treated the same as underlying shares for U.S. and foreign tax purposes so that ADR holders are not denied any tax benefits associated with the ADRs, such as reduced withholding for dividends and credits and refunds of foreign taxes. See ADR 1991 Release, *supra* note 1, at 81,593-94; GREENE ET AL., *supra* note 9, at 42-43.



tary's account and instructs the U.S. depositary to issue ADRs that represent the ordinary shares received. The U.S. depositary issues ADRs and delivers them to the U.S. broker who initiated the trade by delivery either to the U.S. broker or to the Depositary Trust Company (DTC) in book entry form.<sup>35</sup> The U.S. broker then either delivers the ADRs to the customer or credits the customer's account.<sup>36</sup>

#### b. Cancellation (Withdrawal)—Sales

When a U.S. investor asks his broker to sell his ADRs, the broker may either: sell the ADRs in the U.S. market (in which case the U.S. depositary simply effects a transfer on its books); or if the U.S. broker finds that a sale in the local market would result in a better price, contact a foreign broker in the appropriate foreign market to sell the shares in the local market. The U.S. broker then delivers the ADRs to the U.S. depositary for cancellation, usually through the DTC. The DTC credits the ADRs to the depositary bank's account. The U.S. depositary cancels the ADRs and instructs the foreign custodian to release the underlying shares to a local broker for local settlement. The local broker sells the shares according to the instructions received directly from the U.S. broker. The local broker then remits the sales proceeds to the U.S. broker.<sup>37</sup>

Thus, ADRs can be created, traded in the United States like any other security, or canceled.

### V. Sponsored and Un-sponsored Facilities

An ADR program may be established by the foreign issuer (a "sponsored" facility) or established without the active involvement of the issuer (an "un-sponsored" facility). Although the two facilities are similar, they differ as to the rights and obligations of ADR holders and the practices of market participants.

#### A. SPONSORED FACILITIES

Most issuers now establish a sponsored ADR facility so they can deal with the depositary of their choice and maintain control over the trading of their securities.<sup>38</sup> Many issuers also establish a sponsored facility as a first step in

35. The DTC is a registered clearing agency that is the largest securities depository in the United States. The DTC keeps securities in custody in its vaults on a fungible basis, and it makes book entries for transfers of securities between the accounts of its participants. These procedures allow for timely settlement transactions without physical delivery of certificates. ADR 1991 Release, *supra* note 1, at 81,592.

36. CITIBANK, N.A., AN INFORMATION GUIDE 3 (1992) (updated Nov. 1993) [hereinafter CITIBANK]; BANK OF NEW YORK, DEPOSITARY RECEIPTS: AN OVERVIEW 4 (2d ed. 1993) [hereinafter BONY].

37. CITIBANK, *supra* note 36, at 4; BONY, *supra* note 36, at 4. For further information concerning trading ADRs and deposited securities, trading prices for ADRs, and custody, clearing, and settlement of ADRs, see ADR 1991 Release, *supra* note 1.

38. CITIBANK, *supra* note 36, at 5.

entering the U.S. securities markets. A sponsored ADR facility enables the issuer to become acclimated to the U.S. equity markets or to prepare for a later equity offering in the United States.

A foreign issuer establishes an ADR program by appointing a bank or trust company as depositary. In a sponsored ADR facility, the issuer of the deposited securities enters into a deposit agreement with the depositary and signs the Form F-6 registration statement. The issuer is "sponsoring" the ADRs' entry into the U.S. markets.

The depositary has three basic roles. First, the depositary issues and cancels ADRs. Second, it acts as a transfer agent, maintaining shareholder records, disbursing dividends, and sending out proxy notices and related matters. Third, it acts as an administrator, supplying the issuer with information about the ADR program.<sup>39</sup>

The deposit agreement sets out the rights and responsibilities of the issuer, depositary, and ADR holders. The agreement covers such matters as deposit and withdrawal of underlying shares, handling of dividends and distributions, indemnification of the depositary, and amendment or termination of the agreement. Generally, the depositary agrees to distribute to ADR holders voting material, shareholder communications, and other information at the issuer's request. ADR holders can vote on certain corporate actions. The depositary agreement also specifies fees the depositary charges. Generally, the issuer bears some of the costs (such as dividend payment fees) relating to the facility, and the ADR holders bear certain other costs (such as deposit and withdrawal fees).<sup>40</sup> The deposit agreement usually includes an indemnification provision under which the issuer indemnifies the depositary for liabilities that may arise under the program.<sup>41</sup> The foreign private issuer generally maintains greater control over a sponsored ADR facility because there is only one depositary, not multiple depositaries as with unsponsored facilities. Furthermore, certain stock exchanges, including the NYSE and the AMEX, require sponsored ADRs before they will permit listing.<sup>42</sup>

## B. UNSPONSORED FACILITIES

An unsponsored ADR facility is established without the active participation of the issuer, and the ADR holders pay the fees of the depositary. Typically, an unsponsored facility is established by a depositary that perceives U.S. investor

39. Velli, *supra* note 3, at S56.

40. ADR 1991 Release, *supra* note 1, at 81,589; CITIBANK, *supra* note 36, at 5.

41. GREENE ET AL., *supra* note 9, at 37.

42. Saunders, *supra* note 20, at 57 (citing AMEX, SEC. DIV., LISTING FOREIGN SECURITIES 3 (1987) and NYSE, LISTED COMPANY MANUAL ¶ 103.04 (1990)). NASDAQ permits unsponsored ADRs but prefers sponsored ADRs. *Id.* (quoting Gordon Matthews, *Banks' Depositary Receipts Business Sees Boom; Instruments Link Investors in U.S. to Foreign Firms*, AM. BANKER, Dec. 31, 1986, at 2).

interest in a foreign security and believes it may earn income from a facility. In other cases, a large shareholder or a securities broker familiar with U.S. investor interest and trading activity in a foreign security may request that a depositary create an ADR facility for trading.<sup>43</sup> Generally, the depositary requests a letter of nonobjection from the issuer before establishing the facility; if the issuer objects, the depositary refrains from establishing the facility.<sup>44</sup>

Un-sponsored ADR facilities differ from sponsored facilities in various ways. Most importantly, more than one bank can perform depositary services for the outstanding foreign securities. Because the depositary is not appointed by the issuer, the issuer is not a party to the deposit agreement. The ADR certificate acts as a contract between the ADR holder and the depositary, and the terms of the facility are on the ADR certificate. Typically, the depositary of an un-sponsored facility is under no obligation to distribute voting material, shareholder communications, or other information to ADR holders, nor is it required to pass through the voting rights to the ADR holders. Generally, holders of un-sponsored ADRs bear all costs of the facility, the depositary usually charging fees for the deposit and withdrawal of securities, conversion of dividends into U.S. dollars, disposition of noncash distributions, and the performance of other services. Un-sponsored programs typically trade in the OTC Bulletin Board or the "pink sheets."<sup>45</sup>

In 1983 the SEC required issuers to obtain an exemption from Exchange Act reporting under Rule 12g3-2(b) as a precondition to filing a Form F-6 and establishing an ADR program.<sup>46</sup> Rule 12g3-2(b) provides an exemption from the reporting requirements of the Exchange Act if the issuer provides to the SEC certain information provided in the issuer's home country. So, if the issuer is neither a reporting issuer under the Exchange Act nor exempt from reporting under Rule 12g3-2(b), the depositary must request the issuer to establish the exemption. Consequently, since 1983 greater issuer participation is required, and issuers have been establishing sponsored ADR programs, thereby gaining greater control over their shares traded in ADR form as well as over communications with shareholders outside their home market. Since 1983 fewer un-sponsored programs have been established.<sup>47</sup>

### C. DUPLICATE ADR FACILITIES

After one depositary establishes an ADR facility for a particular security, other depositaries frequently establish their own duplicate facilities for the same security

43. ADR 1991 Release, *supra* note 1, at 81,588. The securities broker-dealer sometimes assists with the expense of establishing the facility. GREENE ET AL., *supra* note 9, at 38.

44. ADR 1991 Release, *supra* note 1, at 81,588.

45. *Id.* at 81,588-89; CITIBANK, *supra* note 36, at 5.

46. General Instructions I.A.(3), 17 C.F.R. § 239.36 (1989); ADR F-6 Release, *supra* note 6, at 85,834; *see* ADR 1991 Release, *supra* note 1, at 81,595.

47. ADR 1991 Release, *supra* note 1, at 81,595; CITIBANK, *supra* note 36, at 5; Velli, *supra* note 3, at S43.

without the consent of either the issuer or the original depositary. The duplicate ADRs are given the same CUSIP number as the original ADRs. All the ADRs are considered fungible with each other and are traded without regard for the identity of the depositary.<sup>48</sup>

While the SEC has permitted duplication of unsponsored facilities, the SEC staff, until recently, has taken the position that an unsponsored facility can not coexist with a sponsored ADR facility for the same securities because of "resulting market disorder." Thus, if a sponsored facility existed, no other depositary could create another facility for the same securities.<sup>49</sup>

Ordinarily, when a sponsored facility is created after an unsponsored facility, the depositary of the unsponsored facility transfers its deposited securities and related ADR holders to the new sponsored facility and terminates its unsponsored facilities.<sup>50</sup> Nonetheless, in at least one instance a depositary tried to create an unsponsored duplicate facility despite the issuer's objection and the existence of a program. The SEC so far has refused to declare the program effective and has solicited comment from the public concerning whether this should be permitted.<sup>51</sup>

## VI. Securities Act Registration

### A. INTRODUCTION

For purposes of the Securities Act, ADRs and the underlying deposited securities are each considered securities; each must be registered unless an exemption applies.<sup>52</sup> When a foreign issuer or its affiliate sells securities to the public in the United States, the securities must be registered under the Securities Act. The use of ADRs does not affect the registration requirement for those securities. In public offerings of securities in ADR form, both the ADRs and the deposited securities must be registered.<sup>53</sup> Frequently, the foreign private issuer will file two registration statements, one on Form F-6 to register the depositary shares evidenced by the ADRs and a second on Form F-1, F-2, F-3, or F-4 to register the underlying deposited shares.<sup>54</sup>

When there is no public offering of securities, that is, when securities are purchased in foreign secondary markets and deposited in an ADR facility, registration of the deposited securities is not required. Section 4(1) of the Securities

48. ADR 1991 Release, *supra* note 1, at 81,589.

49. *Id.* at 81,589-90.

50. *Id.* at 81,590. Frequently, fees paid for the cancellation of unsponsored facilities can be significant. These fees usually are paid by the issuer or the depositary of the new sponsored facility. *Id.* at n.28. When these fees are disputed, the establishment of the sponsored facility may be delayed until negotiations have been concluded. GREENE ET AL., *supra* note 9, at 41.

51. ADR 1991 Release, *supra* note 1, at 81,590.

52. *Id.* at 81,594.

53. *Id.*

54. Saunders, *supra* note 20, at 62.

Act, which exempts transactions by persons other than an issuer, underwriter, or dealer, and section 4(3), which exempts certain transactions by dealers following a distribution, together exempt from registration the deposited securities purchased in the foreign secondary markets that underlie the ADRs, just as they exempt securities trading in the secondary markets in the United States. However, the issuance of ADRs upon the deposit constitutes a public offering of the ADRs that must be registered.<sup>55</sup>

## B. FORM F-6

### 1. Introduction

In 1983 the SEC adopted Form F-6, a simple form for registration of ADRs under the Securities Act.<sup>56</sup> The underlying deposited securities, if not exempt under sections 4(1) and 4(3) as described above, are registered on any other form the issuer is eligible to use.<sup>57</sup> ADRs may also be registered on any form used to register the deposited securities, provided that the registration statement conforms to Form F-6 and either the depository or the "legal entity created by the issuance of ADRs" signs the registration statement with respect to the disclosure and undertakings made in response to the requirements of Form F-6.<sup>58</sup>

### 2. Eligibility

Form F-6 may be used for registering ADRs under the Securities Act if three conditions are met: (1) the ADR holder may withdraw the deposited securities at any time subject to certain enumerated limitations;<sup>59</sup> (2) the deposited securities

55. ADR 1991 Release, *supra* note 1, at 81,594 n.49; see 15 U.S.C. § 77(d)(1) (1988); 15 U.S.C. § 77(d)(3) (1988); General Instructions I.A.(2), 17 C.F.R. § 239.36 (1989).

56. The filing fee for Securities Act registration statements is [<sup>1/25</sup>] of 1% of the estimated aggregate offering price for the securities being registered. § 6(b) of the Securities Act. For registration statements on Form F-6, the fee is calculated on the maximum aggregate charges to be imposed in connection with the issuance of the ADRs (such charges are typically \$0.05 per ADS), with a minimum fee of \$100. Rule 457(k) under the Securities Act.

GREENE ET AL., *supra* note 9, at 39 n.27.

57. General Instructions I.B., 17 C.F.R. § 239.31 (1989).

58. *Id.* Rule 174(a) specifically exempts Form F-6 registrations from the dealer delivery of prospectus requirement of section 4.

59. Holders of ADRs must be entitled to withdraw the deposited securities at any time, subject to (i) temporary delays caused by closing the transfer books of the depository or the issuer of the deposited shares in connection with voting at a shareholders' meeting or the payment of dividends, (ii) the payment of fees, taxes, and similar charges, and (iii) compliance with any laws or governmental regulations relating to ADRs or to the withdrawal of deposited shares. Form F-6, General Instructions I.A.(1), 17 C.F.R. § 239.36 (1989).

While this condition is intended to assure fungibility between the ADRs and the underlying securities, the third exception permits the creation of ADRs where the local law of the country of the issuer of underlying securities restricts withdrawal (e.g., local law could permit foreigners to own ADRs, but not underlying securities).

GREENE ET AL., *supra* note 9, at 40.

must be offered or sold in transactions registered under the Securities Act or in transactions that, if made in the United States, would be exempt from registration under the Securities Act; and (3) as of the filing date, the foreign issuer of the deposited securities is (or currently is becoming) either a reporting company under the Exchange Act or exempt from Exchange Act reporting under Rule 12g3-2(b) (the information supplying exemption), unless the issuer concurrently files a registration statement on another form covering the deposited securities.<sup>60</sup>

The last requirement, contained in Form F-6 General Instruction I.A.(3), was added in 1983 and was not a condition for the use of the former Form S-12 for registering ADRs. Consequently, it created a competitive disadvantage to new depositaries that would prevent them from duplicating previously registered unsponsored facilities. The SEC staff, however, created a conditional waiver of compliance with the third requirement for depositaries duplicating unsponsored facilities established before Form F-6 was adopted. Nevertheless, the depositary must provide the SEC with information on a continuous basis about the issuer. The information provided under this conditional waiver is substantially equivalent to the information the issuer must provide under Rule 12g3-2(b).<sup>61</sup>

Before obtaining a Rule 12g3-2(b) exemption, an issuer should carefully consider the exemption's advantages and disadvantages. A Rule 12g3-2(b) exemption

60. General Instructions I.A., 17 C.F.R. § 239.36 (1989). Form F-6 was adopted by the SEC in the ADR F-6 Release, *supra* note 6, and amended by technical amendment to Form F-6, Securities Act Release No. 6951 (Aug. 12, 1992).

61. ADR 1991 Release, *supra* note 1, at 81,595 & nn.55-58.

On September 24, 1990, and March 28, 1990, the Office of International Corporate Finance issued memoranda that set forth a procedure for filing Form F-6 without satisfying the conditions of General Instruction I.A.(3). The September memorandum advised that until the Division's consideration of issues relating to ADRs and Form F-6 concludes, no objection will be raised if a Form F-6 is filed without satisfying General Instruction I.A.(3), provided that:

- (1) the Form F-6 duplicates an existing facility that was established before the adoption of Form F-6;
- (2) ADRs are outstanding under such facility or an existing ADR facility that duplicated such facility;
- (3) the depositary provides to the SEC, prior to effectiveness of the Form F-6 and on an ongoing basis, materials and information relating to the issuer of the deposited securities similar to that required by Rule 12g3-2(b);
- (4) the depositary must make certain specified efforts to cause the issuer of the deposited securities to register its securities under the Exchange Act or establish a Rule 12g3-2(b) exemption, which then results in the refusal of such issuer to do so;
- (5) the ADR certificate discloses that the issuer neither files periodic reports with the SEC nor furnishes information pursuant to Rule 12g3-2(b), but that the depositary has undertaken to furnish certain information to the SEC;
- (6) Rule 466 can not be used in connection with the Form F-6 registration statement; and
- (7) ADRs registered in accordance with a waiver have to be deregistered when the ADR program being duplicated is exhausted.

The staff of the SEC has temporarily eliminated the condition related to exhaustion, pending its review of ADRs, i.e., currently, this waiver is available regardless of whether all ADRs registered on the original Form S-12 or C-3 have been sold. Any duplicating registration statement, however, should only register the number of ADRs reasonably anticipated to be raised within one year. The

permits the establishment of an ADR facility and facilitates Rule 144A private placements in the United States. However, when an issuer has a Rule 12g3-2(b) exemption with no sponsored ADR program, depositaries may establish their own unsponsored ADR facilities without the issuer's consent, even though depositaries generally request a letter of nonobjection from the issuer before establishing their ADR facilities. Unsponsored ADR facilities sometimes become an obstacle to an issuer later establishing its own sponsored ADR facility, because the SEC requires all unsponsored ADR facilities relating to the same underlying securities to close before an issuer may establish a sponsored facility. This leads to the payment of negotiated fees to the depositaries for cancellation of the unsponsored ADRs. These fees can be significant and are usually paid by the issuer or by the depositary of the new sponsored facility.<sup>62</sup>

### 3. *Disclosure Required by Form F-6*

The disclosures required by Form F-6 are short and simple because the underlying securities must be either registered under the Securities Act by another form or exempt from registration. The Form F-6 disclosures are usually contained in the ADR certificate which serves as a prospectus. For unsponsored facilities, the ADR certificate contains the full contractual terms, rather than just a description of the terms, because the ADR must serve both as a prospectus and as the contract between the depositary and each holder of ADRs.

Form F-6 is divided into two parts. Part I contains the prospectus information. Part II contains exhibits and undertakings that are little more than information concerning the depositary arrangements, the deposit agreement (if a sponsored facility), and a sample ADR certificate (the prospectus).<sup>63</sup>

In the Part I prospectus, the registrant must furnish the information required in item 202(f) of Regulation S-K, which is a description of the ADR with information about the depositary, the terms of the deposit arrangement (including obligations of the depositary), certain rights of ADR holders, the fees and charges that may be imposed upon the holder, and to the extent not otherwise disclosed, the effects of foreign laws on the holder and whether the foreign private issuer is subject to the reporting requirements of the Exchange Act or is exempt under Rule 12g3-2(b).<sup>64</sup>

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waiver is available irrespective of whether all ADRs registered in the original Form S-12 (or Form C-3) have been sold. These memoranda can be found at Chemical Bank, SEC No-Action Letter, [1990-1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,621 (Sept. 24, 1990); Security Pacific National Trust Co., SEC No-Action Letter, [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,460 (Mar. 28, 1990); Registration of ADR on Form F-6 When Depositary Receipts Facility Relating to Underlying Facility Exists, SEC No-Action Letter, [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,679 (Apr. 14, 1993); ADR 1991 Release, *supra* note 1, at nn.56, 58; Linda C. Quinn, Foreign Issuers and the U.S. Market, International Capital Markets 50 (May 10, 1994) (unpublished outline, on file with Practising Law Institute).

62. GREENE ET AL., *supra* note 9, at 41.

63. 17 C.F.R. § 239.36 (1989).

64. *Id.*

In Part II of Form F-6, the primary exhibit that must be filed is the deposit agreement and the depositary's undertakings that involve providing certain information to the SEC concerning the ADRs and making available to holders certain information about the issuer and fees.<sup>65</sup> The registrant also must file any agreements related to the ADRs issued (other than the deposit agreement) to which the depositary is a party, every material contract related to the deposited securities between the depositary and issuer in effect during the prior three years, and an opinion of counsel as to the legality of the ADRs being issued. Part II also requires disclosure of the name and number of securities proposed to be deposited for each dealer known to the registrant or depositary who (1) has deposited shares against the issuance of ADRs within the preceding six months, (2) proposes to deposit shares against the issuance of ADRs, or (3) has assisted or participated in creating the plan for the issuance of the ADRs or the selection of the deposited securities.<sup>66</sup>

The depositary also must undertake to furnish promptly to the SEC, semiannually, beginning on or before six months after the effective dates of the registration statement:

- (1) Information concerning the number of depositary shares evidenced by ADRs and the number of holders, and
- (2) The name of each dealer known to the depositary depositing shares against issuance of ADRs, during the period covered by the report. The depositary must make available at its principal office, for inspection by ADR holders, any reports and communications it receives from the issuer as the holder of the deposited securities that are made generally available by the issuer to the holders of the underlying securities.<sup>67</sup>
- (3) Fee information, if not disclosed in the prospectus.

Finally, the Form F-6 registration statement is signed by the "legal entity created by the agreement for the issuance of ADRs," that is, the facility.<sup>68</sup> The

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65. *Id.*

66. *Id.* item 3(e).

67. *Id.* item 4.

68. From the time ADRs first were used until the adoption of Form S-12 (the predecessor form to Form F-6), depositaries took the position that ADRs were securities issued by banks and, therefore, exempt from registration under section 3(a)(2) of the Securities Act as a security issued or guaranteed by a bank. The SEC did not accept this position, stating that the security represented an interest in a third party, not an interest in a bank. As a compromise, the SEC stretched the definition of issuer under section 2(4) (an issuer is every person who issues any security except that in the case of a trust, committee or other legal entity, the trustees or members thereof shall not be individually liable as issuer of any security issued by the trust, committee or other legal entity). The SEC considered the issuer entity to be the ADR facility itself and permitted the depositary to register the ADRs on Form S-12 on behalf of the facility. This compromise resulted in the depositaries not having section 11 liability as signers of the registration statement, which is just as good as if the section 3(a)(2) exemption applied, yet the ADRs must be registered, which is what the SEC wanted. Furthermore, in 1983 the SEC stated that the signature of the depositary on behalf of the facility is necessary because the depositary must undertake to submit certain information to the SEC and must determine the effective date of the registration statement under Rule 466. Loss, relying on the signature instructions to



depository signs the registration statement on behalf of that fictional entity. If the registration statement relates to a sponsored facility, it must also be signed by the issuer, the issuer's principal executive officers, its principal financial officer, a majority of its board of directors, and its authorized representatives in the United States.

Under Rule 466 of the Securities Act, a depository may designate when a second Form F-6 registration statement shall be effective, if the second registration statement is identical to the first (that is, the same deposit agreement and ADR certificate), except for the number of shares covered.

## VII. ADR Program Options

### A. INTRODUCTION

There are basically five types of sponsored ADR facilities, two of which are used to expand an issuer's shareholder base through broader distribution of existing shares with no issuances of new shares, and three of which are used for raising capital through the issuance of new shares.<sup>69</sup> Some depositories describe sponsored ADR facilities in terms of three categories based on the extent to which the issuer has accessed the U.S. capital markets.

The two types of ADR facilities that expand distribution of existing shares are sponsored (level 1) and listed (level 2). The three types of ADR facilities that raise capital through the issuance of new shares (level 3 facilities) are those that involve: the public offering of securities in the United States, the private placement of securities in the United States, and the global offering of securities. Levels 1, 2, and 3 generally indicate respectively lower to higher degrees of issuer involvement with the facility and lower to higher amounts of information made available by the issuer.<sup>70</sup>

### B. ADR PROGRAMS FOR EXISTING SHARES

#### 1. *Sponsored (Level 1)*

In a sponsored Level 1 ADR program, the ADRs are traded over-the-counter in the United States on the National Association of Securities Dealers, Inc.'s

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Form F-6, states that since the legal entity created by the agreement for the issuance of ADRs signs the registration statement as registrant, the depository is specifically excluded from section 11, and nobody has section 11 liability as an issuer. LOSS & SELIGMAN, *supra* note 11, at 774 n.74. However, at least one commentator (*see* Saunders, *supra* note 20) believes that position of the SEC is limited to an unsponsored facility and that when a foreign issuer signs the form for a sponsored facility it might be considered the "issuer" because it may be considered "a depositor or manager" under section 2(4) of the Securities Act (which defines "issuer") and, hence, may expose itself to section 11 liability. *See* GREENE ET AL., *supra* note 9, at 39 n.25; ADR 1991 Release, *supra* note 1, at 81,594-95; ADR F-6 Release, *supra* note 6; Saunders, *supra* note 20, at 65-67.

69. CITIBANK, *supra* note 36, at 7; Velli, *supra* note 3, at S43-45.

70. CITIBANK, *supra* note 36, at 7.

OTC Bulletin Board or are quoted in the "pink sheets." The issuer establishes the Rule 12g3-2(b) information supplying exemption under the Exchange Act and registers under the Securities Act on Form F-6. Neither a Form 20-F nor Exchange Act reporting is required.

Because the foreign private issuer does not register its securities under the Securities Act or under the Exchange Act, its securities cannot be listed on a U.S. exchange, and a Level 1 program cannot be used to raise capital. However, many foreign issuers use a Level 1 program as a first step in entering the U.S. public markets. It enables them to become acclimated to the U.S. markets and begin building a core group of U.S. investors.<sup>71</sup>

2. *Listing (When ADRs Are Not Being Offered in a U.S. Public Offering) (Level 2)*

In a Level 2 ADR program, the foreign private issuer has its securities listed on a U.S. exchange or market, such as the NYSE, AMEX, or NASDAQ. The issuer may register its ADRs under the Securities Act on Form F-6, but it must also register its securities under the Exchange Act by filing Form 20-F (partially reconciled to U.S. Generally Accepted Accounting Principles (GAAP) and Regulation S-X). However, because the foreign private issuer does not register its underlying securities under the Securities Act, a Level 2 program listing alone cannot be used to raise capital.<sup>72</sup>

3. *ADR Programs for Raising Capital with New Shares (and Listing after a U.S. Public Offering of ADRs) (Level 3)*

In a Level 3 ADR program, the foreign private issuer makes a public offering of its securities to raise capital. The securities are listed and traded on a recognized U.S. exchange or market, and registered under the Securities Act by a full registration statement, Form F-1, F-2, or F-3, as well as under the Exchange Act by a Form 20-F with full reconciliation to U.S. GAAP and Regulation S-X. Alternatively, in a Level 3 ADR program, the foreign private issuer may raise capital by making (a) a private placement of Restricted ADRs under Rule 144A, (b) a simultaneous global equity offering with a public offering outside the United States and a Rule 144A private placement in the United States, or (c) a simultaneous public offering outside the United States and a public offering and listing in the United States. For marketing purposes, if a large part of the offering is being conducted outside the United States, the underwriter may prefer to call the depositary receipt a Global Depositary Receipt (GDR) rather than American Depositary Receipt. However, in all other respects the ADRs and GDRs are the same.<sup>73</sup>

71. Velli, *supra* note 3, at S44.

72. *Id.*

73. *Id.* at S45.

Private placements, which are not registered with the SEC, generally are less expensive and faster to accomplish than public offerings.

Foreign private issuers frequently establish a Level 1 ADR that trades side by side with restricted (Rule 144A) ADRs in order to ameliorate the restrictions on resales and liquidity of the Restricted ADR. However, the issuer must be careful to protect against leakage between the two programs.<sup>74</sup>

Generally, foreign private issuers that enter the U.S. markets with the Level 1 ADR program upgrade over time either to being listed on an exchange or quoted in NASDAQ. As they upgrade, they typically increase the number of U.S. shareholders and the size of the U.S. shareholder base.<sup>75</sup>

### VIII. Conclusion

The international capital markets are more intertwined than ever before, and more foreign issuers access the U.S. capital markets each year. How an issuer approaches the U.S. capital markets depends on its objectives. More and more issuers have made primary offerings in the United States or taken steps to facilitate the secondary trading of their securities in the United States. At the same time, the SEC, which is the primary regulator of the U.S. securities markets, has undertaken numerous initiatives to facilitate access to the U.S. capital markets by foreign issuers. Throughout all this change, the way foreign private issuers access the U.S. capital markets is through ADRs, which give U.S. investors the means to acquire and trade foreign securities.

To help those considering establishing an ADR program, a chart that summarizes the various ADR programs accompanies this article as an appendix.

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74. *Id.* at S54.

75. *Id.* at S44-45.

## APPENDIX

ADR PROGRAMS FOR RAISING CAPITAL WITH NEW SHARES		
LEVEL 3 (WITH LISTING AFTER U.S. PUBLIC OFFERING)		
Public Offering in U.S. ADRs		
Rule 144 Private Placements "RADRs"		
Rule 144A Private Placement in U.S.		
Public offering and listing in U.S.		
Trading	OTC Bulletin Board or Pink Sheets	Recognized U.S. Exchange or Market: NYSE, AMEX or NASDAQ
Securities Act Registration	Form F-6	Form F-3; Form F-2; or Form F-1
Exchange Act Registration	Exempt under Rule 12g3-2(b) No Form 20-F	Form 20-F or Form 8-A (an abbreviated form)
Exchange Act Reporting	See above	Form 20-F filed annually with financials fully reconciled to U.S. GAAP & Reg. S-X.

Securities Act Registration	Form F-3; Form F-2; or Form F-1	Exempt	Among QIBs in U.S. through PORTAL	Recognized U.S. Exchange or Market: NYSE, AMEX, NASDAQ	Public Offering in U.S. ADRs	Rule 144 Private Placements "RADRs"	Global Equity Offering Usually public offering outside the U.S. and Rule 144A Private Placement in U.S.
Exchange Act Registration	Form 20-F or Form 8-A (an abbreviated form)	Rule 12g3-2(b) exemption is usually recommended to meet Rule 144A information requirement.	Rule 12g3-2(b) exemption is usually recommended to meet Rule 144A information requirement.	Form 20-F or Form 8-A (an abbreviated form)	Form 20-F or Form 8-A (an abbreviated form)	Form 20-F or Form 8-A (an abbreviated form)	Form 20-F or Form 8-A (an abbreviated form)
Exchange Act Reporting	Form 20-F filed annually with financials fully reconciled to U.S. GAAP & Reg. S-X.	Form 6-K filed periodically.	Form 20-F filed annually with financials fully reconciled to U.S. GAAP.	See above.	See above.	See above.	Form 20-F filed annually with financials fully reconciled to U.S. GAAP & Reg. S-X.

