



ADR Programs: Impact of Unsponsored Programs on Non-US Issuers

This article was first published by Practical Law Company on its PLC Corporate & Securities web service.

Contributed by Matthew D. Bersani, Masahisa Ikeda, Kyungwon Lee, Alan Seem, Antonia E. Stolper and Gail Ong of Shearman & Sterling LLP examine unsponsored ADR programs and the impact of them on non-US issuers

The SEC recently adopted amendments to Rule 12g3-2(b) promulgated under the Securities Exchange Act of 1934, as amended (Exchange Act) and modified certain provisions of Form F-6, which is the registration statement (us.practicallaw.com/4-382-3743) form used to register depositary shares evidenced by American depositary receipts (ADRs). As a result of these amendments, depositary banks have established unsponsored ADR programs that allow for the trading in the US of the equity securities of hundreds of non-US companies.

What is an ADR Program?

ADRs are a type of certificate issued by a depositary bank that represents a certain number of shares of a non-US company that have been deposited with the depositary bank to underlie such certificates. ADRs enable US investors to invest indirectly in the shares of a non-US company whose shares they would not otherwise want or be able to hold. ADR programs make it easier and more attractive for US investors to invest in non-US companies by, among other things, making available US dollar-denominated share price information and converting dividend payments to US dollars.

What are the Different Types of ADR Programs?

An ADR program may be sponsored or unsponsored depending upon the com-

pany's involvement in the program.

Sponsored Programs

In a sponsored program, the non-US company whose shares underlie the ADRs is a party to the agreement governing the arrangement (known as a deposit agreement) along with the depositary bank and is able to exercise control regarding the terms and conditions of the ADR program, including how many ADRs are registered for trading and what rights the holders of those ADRs are granted. The depositary agreement will generally instruct the depositary bank to arrange for holders to exercise voting rights and to receive shareholder communications. Sponsored ADRs are issued by a single depositary bank and cannot be duplicated by another depositary bank. Sponsored ADR programs also offer the benefit of allowing the company to know how many ADRs are outstanding and who is holding the ADRs, which can be helpful for investor relations. This information is usually communicated to the company by the depositary bank in the form of a periodic report.

Unsponsored Programs

An unsponsored ADR program is one that is established by a depositary bank without the participation or consent of the company. Since a company is not involved in the implementation or in the maintenance of the unsponsored ADR

program, it has limited or no influence on the treatment of ADR holders. In addition, it is possible that competing depositary banks will create multiple unsponsored ADR programs for the same company. Since shareholder services may vary from one depositary bank to another, this could result in investor confusion. For example, US dollar disbursements may differ in some cases for the same dividend payment, depending on the foreign exchange rate applied by each of the depositary banks. In addition, each depositary bank has its own fee schedules relating to the services it provides to US investors. Unsponsored ADR programs are considered less favorable to companies and investors, partly due to the lack of control by companies. The existence of an unsponsored ADR program may also make it more difficult for a company to establish its own ADR program should it wish to do so. A company seeking to establish a sponsored ADR program when an unsponsored ADR program is already in existence is required to ensure that the depositary bank of the unsponsored program transfers the deposited securities and the related ADR holders to the new sponsored facility and terminates the unsponsored facility. The SEC may require written confirmation from the depositary bank of the unsponsored program that it agrees with such arrangements. This can potentially create a roadblock to issuers wishing to establish a sponsored ADR program.



Impact of Rule 12g3-2(b) Amendments

Rule 12g3-2(b) is the principal exemption relied upon by non-US companies whose securities are not listed in the US to avoid Exchange Act registration under Section 12(g) and related disclosure requirements that would otherwise be triggered by having a broad US shareholder base (300 or more US resident shareholders). Non-US companies have typically applied for Rule 12g3-2(b) exemptions to establish unlisted, sponsored depositary facilities for their ADRs traded in the US over-the-counter (OTC) markets. In the past, unsponsored ADR programs could not be established unless a non-US issuer formally applied for such exemption by submitting documents to the SEC. The recent amendments to Rule 12g3-2(b) eliminate the written application process that used to be required and provide for the automatic availability of the exemption so long as required company information is made available on the company's website. The amendments, while intended to improve the trading liquidity of non-US companies, also facilitated the establishment of unsponsored ADR programs. This is because Form F-6, the form used by depositary banks to register ADRs with the SEC, was also amended to provide that depositary banks may rely in good faith on the adequacy of a company's website postings required under new Rule 12g3-2(b) for purposes of satisfying one of the conditions to filing the Form F-6. The existence of these unsponsored ADR programs and the potential shareholder interest they often generate could potentially cause a non-US company's US shareholder base to equal or exceed 300 holders, thereby triggering the registration requirements under Section 12(g) without the issuer taking any action itself unless the company is in fact in compliance with amended Rule 12g3-2(b). The unsponsored ADR programs also have the indirect effect of attracting investors' attention

to a non-US company's website.

Why do Depositary Banks Establish Unsponsored ADR Programs?

Since non-US issuers meeting the relevant requirements of new Rule 12g3-2(b) are automatically exempt from registration, any depositary bank can unilaterally establish an unsponsored ADR program in anticipation of, or in response to, investor and broker demand in the US for such issuer's equity securities. Depositary banks are incentivized to create ADR programs to meet this demand because they can generate substantial revenues from investors in the form of fees for issuing and cancelling ADRs.

Determining Whether an Unsponsored ADR Program Exists

The best way to determine whether an unsponsored ADR program exists is to check the SEC website at <http://www.sec.gov/edgar/searchedgar/companysearch.html> and enter a company name. If the results show that a Form F-6 has been filed, then an ADR program has been established for a company's shares.

Options for a Company if an Unsponsored ADR Program has been Established

Maintain the Number of Beneficial Holders at Less Than 300

One option is to ensure that the number of a company's US shareholders is less than 300 as of each fiscal year end, thereby exempting the company from registration under the Exchange Act by satisfying Rule 12g3-2(a). This can be done by counting the number of shareholders (which can be a difficult process since SEC rules require a company to look

through holders of record to determine who the actual beneficial holders are) or hiring an outside expert that specializes in tabulating this type of shareholder information. The advantage of this option is that it only requires a company to monitor the number of beneficial holders. A company does not need to satisfy the disclosure and other requirements of the Rule 12g3-2(b) exemption. It does not, however, eliminate any existing unsponsored programs or the risk that new unsponsored programs will be created.

Proactively Confirm the Availability of a 12g3-2(b) Exemption

Another option is for a company to proactively confirm Rule 12g3-2(b) exemption status by fulfilling the limited disclosure requirements (by posting required information on the company's website or through an electronic information delivery system), eliminating the need to follow the stricter SEC reporting requirements in the event the number of US shareholders equals or exceeds 300. This option does not, however, eliminate any existing unsponsored programs nor does it prevent the creation of new unsponsored programs.

Establish a Level 1 Sponsored ADR Program

Another option is to establish a Level 1 sponsored ADR program. In such a case, the depositary bank selected to implement the sponsored ADR program will request that the depositary bank(s) that have established the unsponsored program(s) withdraw the unsponsored program(s). The depositary bank(s) that have established the unsponsored program(s) will typically request to be compensated for any losses associated with termination of the unsponsored program(s). Depositary banks have sometimes been willing to pay the depositary bank(s) that have



established the prior unsponsored program(s) in order to establish a sponsored ADR program in anticipation of the future fees they can generate from the ADR investors. The advantage of this option is that it eliminates any unsponsored program(s), resulting in a company enjoying the benefits of a sponsored program, such as being able to decide how many ADRs to register and having control over what rights to grant to the holders. By sponsoring an ADR program with a single depositary bank, a company can exercise a degree of control over how its ADR facility is operated and can ensure that its ADR holders are treated fairly and consistently. Establishing a Level 1 sponsored ADR program would require a company to qualify for a Rule 12g3-2(b) exemption, entering into a deposit agreement with a depositary bank and filing a Form F-6.

Communicate with the Depositary Bank that Established the Unsponsored ADR Program

This may be the preferred option in the situation where a depositary bank has established an unsponsored ADR program based on a company's website content despite the fact that the posted disclosure falls short of the requirements of Rule 12g3-2(b). The depositary bank may agree to withdraw the unsponsored program if it is informed that the issuer is not Rule 12g3-2(b) compliant. However, this would not prevent other depositary banks from creating new unsponsored programs. One way to protect against further unsponsored programs would be for a company to state prominently on its website that the information provided is not sufficient to satisfy Rule 12g3-2(b). This needs to be balanced with any investor relations concerns relating to the possible perception that the company is reducing or opting for less disclosure to its existing shareholders.

Claiming the Rule 12g3-2(b) Exemption

Rule 12g3-2(b), as recently amended, provides for the automatic availability of the exemption for a foreign private issuer (as defined under the Exchange Act) that (i) has a listing outside the US, (ii) is not a reporting company under the Exchange Act and (iii) posts required information on its website or through an electronic information delivery system. To meet the electronic publishing requirement, a company must publish in English, on its website or through an electronic information delivery system that is generally available to the public in its primary trading market, information that, from the first day of its most recently completed fiscal year, it has:

- Made public or been required to make public pursuant to the law of its country of incorporation, organization or domicile.
- Filed or been required to file with the principal securities exchange in its primary trading market on which its securities are traded and which has been made public by that exchange.
- Distributed or been required to distribute to its security holders.

Establishing a Level 1 Sponsored ADR Program

In a Level 1 ADR program, the ADRs are not listed on a US securities exchange, but trade in the OTC market, most commonly through the so-called Pink Sheets electronic market (Level 1 ADRs are not eligible for quotation on the Over-the-Counter Bulletin Board (OTCBB), as this market only accepts the securities of companies that are subject to US reporting requirements). A Level 1 ADR program does not constitute a formal listing but still permits US residents and others to trade

in US dollar-denominated securities. The establishment of such a program does not trigger reporting obligations or the need to comply with US securities law, including Sarbanes-Oxley Act of 2002 requirements. To establish a Level 1 sponsored ADR program, the following three principal steps are required:

- Qualify for a Rule 12g3-2(b) exemption.
- Sign a deposit agreement among the company, the depositary bank and the ADR holders that detail the rights and responsibilities of each party.
- File Form F-6 with the SEC to register the ADSs under the Securities Act of 1933, as amended (Securities Act). The Form F-6 is signed by the depositary bank, the company and its directors and officers. Financial statements and a description of the company's business are not required to be included in a Form F-6 registration statement.

Level 2 and Level 3 Sponsored Programs

Among sponsored programs, there are three principal levels of programs. Level 2 ADR programs refer to a company listing its ADRs on an exchange. To qualify a company must comply with the registration and reporting requirements of the Exchange Act as well as the listing requirements of the relevant exchange. Level 3 ADR programs refer to an ADR program used in connection with the raising of capital through a public offering of securities and contemporaneous listing on an exchange. Level 3 ADR programs require registration of the underlying shares and ADRs under the Securities Act and compliance with the reporting requirements under the Exchange Act.