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American Depositary Receipts: An Overview

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AMERICAN DEPOSITARY RECEIPTS: AN OVERVIEW

*Joseph Velli**

INTRODUCTION

I would like to thank everybody involved for providing me with this opportunity to speak to you about the wonderful world of American Depositary Receipts ("ADRs"). Today I will attempt to provide you with an overview of the ADR market. I will talk about the different types of ADR programs available, and I will talk about the growth that has occurred over the last several years.

Before I start, though, I thought it would be useful to set the stage a little bit. I just want to mention a few points. As Bill Decker mentioned earlier,[1] for the first time, last year Glaxo, a non-U.S. company out of the United Kingdom, was the most actively traded stock on the New York Stock Exchange ("NYSE"). That, in and of itself, is very impressive. About 275 billion Glaxo ADRs were traded on the NYSE traded last year. But what I think is more impressive is that over 350,000 U.S. investors own Glaxo ADRs, and Glaxo's market capitalization here in the United States is approximately U.S.$20 billion. So the trading volume is impressive, but so is the number of shareholders and their market capitalization.

It is also important to realize that, excluding Canadian companies, the vast majority of non-U.S. companies use ADRs when they decide to list in the United States. In fact, some of these companies are more actively traded in the United States than in their home country. For example, for Hong Kong Telecom out of Hong Kong, Repsol out of Spain, Telemex out of Mexico, there is more trading volume both in share terms and in dollar

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1. *See* William E. Decker, *The Attractions of the U.S. Securities Markets to Foreign Issuers and the Alternative Methods of Accessing the U.S. Markets: From the Issuer's Perspective*, 17 FORDHAM INT'L L.J. S10 (1994) (discussing increased attraction of non-U.S. companies to U.S. capital markets and options available accessing into those markets).

terms in the United States than in their respective home countries.

I. *ADRs: GENERAL BACKGROUND*

A. *Operation of ADR Programs*

What are ADRs? How do they work? Very simply, an ADR is a receipt that is issued by a U.S. depositary bank, such as The Bank of New York, that actually represents the shares that are held overseas. So the ADR is merely a receipt that is issued in certificate form in the United States that represents the actual shares of a non-U.S. company.

Once the ADR program is established, the ADRs trade freely in the United States, like any other U.S. security. They can trade on the over-the-counter market or they can trade on one of the exchanges, such as NASDAQ, the American Stock Exchange ("ASE"), or the NYSE. ADRs can also be used to raise equity capital.

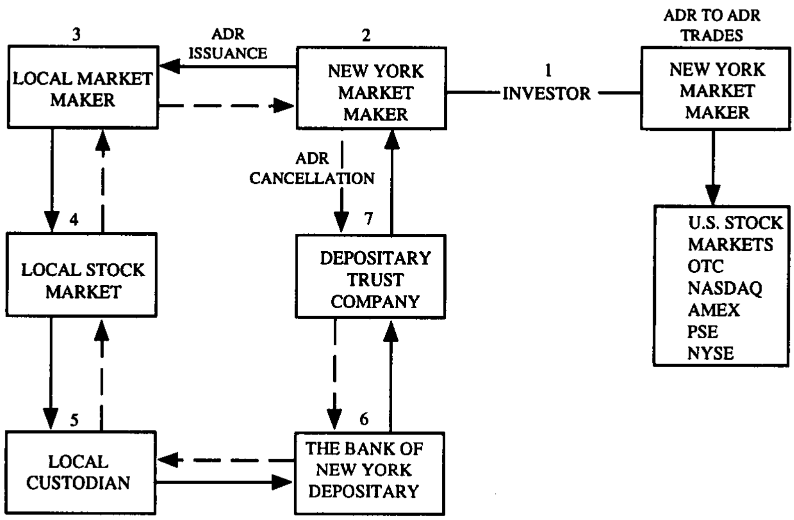
I think one recent trend is that people have gotten away from calling depositary receipts "American depositary receipts." Now, they basically either call them "global depositary receipts" ("GDRs"), or simply, as I prefer, "depositary receipts." In order not to confuse anybody, though, I will use the most common term, "ADRs."

The best way to understand how an ADR works is to look at an example of a trade. Again, let's go back to Glaxo, which trades on the NYSE. Glaxo did not raise capital here; the company simply listed on the NYSE without conducting a public offering.

Let's assume that the very first trade takes place here in Glaxo's ADRs. A U.S. investor, whether it's an institutional investor or a retail investor, would simply call up his U.S. broker and say, "Buy me 1,000 or 10,000 Glaxo ADRs." In many cases the investor is not even aware that he is buying an ADR; all he really knows is that he's investing in Glaxo. So he calls up his broker (for argument's sake Merrill Lynch or Goldman Sachs) and says, "Buy me 1,000 Glaxo ADRs."

The broker, because there are no ADRs outstanding here, goes to the foreign market, in this case the London market, buys 1,000 Glaxo shares off the London exchange, deposits those ac-

DEPOSITARY RECEIPT SETTLEMENT



tual shares with the depositary bank (for example The Bank of New York) and then the depositary bank issues 1,000 ADRs in the U.S. marketplace. So the shares are deposited by the broker and The Bank of New York would issue 1,000 ADRs. That's how an ADR is created.

Once the ADR is issued and outstanding, it freely trades like any other security. In the very next trade, if another investor calls up his broker and says, "I want to buy 500 Glaxo ADRs," the broker has a choice: he can either buy the ADR that is already existing in the U.S. marketplace, or he can repeat the process just described by going to the London Stock Exchange.

The last point on the trading aspect is what we call ADR cancellation. If I own 1,000 Glaxo ADRs and want to sell those ADRs, but cannot find a buyer, I simply would cancel those ADRs and sell the actual shares back into the home market, in Glaxo's case, in London. Thus, ADRs can be created or issued, they can be transferred here like any other U.S. security, or they can be canceled.

B. *Rationale Behind Establishing ADR Programs*

There are several different reasons why non-U.S. companies establish ADR programs. Some of them were covered today and I will not harp on them. Basically, companies establish ADR programs as a way of entering the U.S. markets to, hopefully, tap some demand for their securities. Many companies have found that by establishing ADR programs and enabling U.S. investors to buy their ADRs, they are able to get a better valuation for their share price. There are a couple of reasons for this.

First, in many industries or many sectors here, such as the telecommunications sector, the U.S. investment community may put a higher valuation or price/earnings ratio ("P/E") on that sector. As a result, if you are a company in France and you're in the telecommunications business and your P/E in France is 14 and the P/E in the United States for telecom stocks is somewhere around 18, by establishing an ADR program you should receive a higher valuation for your shares.

Second, the simple fact of a non-U.S. company establishing an ADR program here, enabling U.S. investors to buy the shares simply here, usually translates into a higher stock price for the company.

Third, companies establish ADR programs as a means of raising capital in the United States. In many cases, when a company is making an offering, their home market cannot absorb it — for example, YPF, an Argentine oil company, earlier this year did a U.S.$3 billion global offering that was part of a privatization. There was no way YPF was going to be able to raise U.S.$3 billion in the Argentine market. As a result, they raised roughly U.S.$500 million locally, they raised U.S.$2 billion in the United States, and U.S.$500 million in Europe.

Companies also establish ADR programs for other reasons. A great example is Roche, the Swiss pharmaceutical company. Roche established an ADR program for one reason: they have about 40,000 U.S. employees who wanted to invest in the parent company. By establishing an ADR program, the company was able to give their executives in the United States stock options, it was able to offer a 401-K savings plan for their U.S. employees, and the program enabled the U.S. employees to buy Roche ADRs.

C. *Investor Perspective*

From the investor's standpoint, U.S. investors buy ADRs for three main reasons: convenience, cost, and liquidity. From the convenience side, ADRs trade and settle just like any other U.S.

security. There is no difference between buying Glaxo ADRs and buying IBM, AT&T, or General Motors stock. It works exactly the same way, you pay the same commission rates. ADR dividends are paid in U.S. dollars and they settle just like any other U.S. security. So there is virtually no difference between buying and selling an ADR and buying and selling any other U.S. security.

On the cost side, ADRs also offer a lot of advantages as compared to what we call "direct" investing, meaning buying Glaxo shares directly in the U.K. market. There are three major cost advantages from a U.S. investor's standpoint.

First, custody fees are avoided. If I buy Glaxo shares in London, or an institution buys them in London, you have to appoint a global custodian to hold the shares in London. That global custodian could charge you anywhere from ten to forty basis points annually. By buying an ADR, which settles and clears in the United States, U.S. investors avoid that charge.

Second, foreign exchange rates on dividends are better on ADR dividends. Typically, when the depositary bank pays dividends and converts, in Glaxo's case Pound Sterling, into U.S. dollars, because we are converting such a large sum of money, we are able to get a better rate than if you as an investor went to your bank and tried to cash a £10 cheque. So the foreign exchange rates are better in dividends.

Third is what I call "failed trade financing." Because ADRs settle according to U.S. principles and they settle in the United States, very rarely does a trade fail. What I mean by "fail" is if an investor buys the ADRs and they are not delivered on the settlement date, resulting in the failure of the trade. The failed trade rate in the United States for ADRs is less than 0.5%. If an investor buys shares directly in places like Brazil, Chile — not so much in Latin American anymore; they've straightened it out — but still in places like Italy, Spain, China, the failed trade rate could be substantially higher. As a result, the investor would have to finance his position, and that cost could add up over time.

II. *ADR PROGRAMS*

Type	Act	Registration	Disclosure	Cost	Listing	Raise Capital
Unsponsored	1933	F-6	None	0	OTC	No
	1934	12G3-2(b)	None			
Sponsored	1933	F-6	None	$ 5,000	OTC	Not Now
Level I	1934	12G3-2(b)	None	$ 20,000		
Sponsored	1933	F-6	None	$200,000	Exchange	Not Now
Level II	1934	20-F	Detailed	$500,000		
Sponsored	1933	F-1	Rigorous	$400,000	Exchange	Yes - U.S.,
Level III	1934	20-F	Detailed	$900,000		Global
Private	1933	None	Euro-	$100,000	Portal	Yes - U.S.,
DR	1934	12g3-2(b)	Style	$400,000		Global

A. *Unsponsored ADR Programs*

There are essentially two types of ADR programs: unsponsored and sponsored. I am not going to spend a lot of time on unsponsored ADRs. The key thing to remember about unsponsored ADRs is they are absolutely obsolete, and there are a lot of hidden costs and problems associated with unsponsored ADRs. In fact, since 1983, there have only been three new unsponsored ADR programs established.

B. *Sponsored ADR Program*

What has taken their place is what we call sponsored ADRs. Simply, the word "sponsored" means that the company is appointing a U.S. depositary bank and the company is sponsoring their entry into the U.S. capital markets. As a result, there is a service contract in place and the investor can be relatively assured of the type of service and information they are going to receive on an ongoing basis.

1. Level I, II, and III ADR Programs

There are essentially three types of sponsored ADRs: Sponsored Level I, Level II, and Level III.

A Sponsored Level I ADR trades over-the-counter in the United States on the pink sheets. You establish a Level I program by establishing what is known as an information exemption[2] under the Securities Exchange Act of 1934 (the "Exchange Act").[3] Basically, all a company has to do is supply the Securities and Exchange Commission ("SEC") with any material information they produce and distribute locally in their home country and they can obtain an exemption from registration.[4]

A Level I program, because the company is not registered fully with the SEC, cannot be listed on an exchange and a Level I program cannot be used to raise capital. However, many companies have found that by establishing a Level I program, because it's very easy to do and is a low-cost way of entering the U.S. market, they use it as their first step into the U.S. public markets. They establish a Level I program, they start an investor relations exercise, and they start building up a core group of U.S. investors.

Level II is when a company decides to list on one of the exchanges. In order to list on one of the exchanges you have to file a Form 20-F[5] under the Exchange Act, which again means essentially complying or reconciling to U.S. accounting and disclosure requirements. For some companies this could be costly and difficult; for other companies it shouldn't be a problem.

Level III ADRs is when a company decides to make a public offering in the U.S. marketplace. Typically, as was discussed today, this requires filing a Form F-1 with the SEC,[6] which again requires complying with U.S. accounting and disclosure procedures.

We have found, over time, that the vast majority of companies that come into the U.S. market start off with a Level I ADR program and then upgrade over time. The upgrading could take anywhere from six months to ten years, but eventually companies with Level I programs upgrade to either a listing on the NYSE, the ASE, or NASDAQ.

In fact, Glaxo is a prime example. The company started out with a Level I program that lasted for approximately one

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2. Exchange Act Rule 12g3-2(b), 17 C.F.R. § 240.12g3-2(b) (1993).
3. 15 U.S.C. §§ 78a-78ll (1988 & Supp. IV 1992).
4. Exchange Act Rule 12g3-2(b), 17 C.F.R. § 240.12g3-2(b); *see* Mark A. Saunders, *American Depositary Receipts: An Introduction to U.S. Capital Markets for Foreign Companies*, 17 FORDHAM INT'L L.J. 48, 76-77 (1993) (setting out Rule 12g3-2(b) exemption requirements).
5. 17 C.F.R. § 249.220f (1993).
6. 17 C.F.R. § 239.31 (1993).

year. It was able to build up a core group of U.S. investors. Eventually Glaxo upgraded to the NYSE.

If I could just mention one other point on listing, our position, and what we usually recommend to companies, is that they should not get too excited about a Level I program. Their management must fully realize that it's only a starting step and their visibility, unless they have an unbelievably good story to tell U.S. investors, is going to be very limited. Typically, a Level I company can expect to obtain anywhere between three to six percent of its shareholder base in the United States through such a program. What we have found is that when they do a listing and they upgrade it, whether they do a Level II or Level III, their U.S. investor base will materially increase. If a company has four percent U.S. shareholder base with a Level I, they could expect somewhere between ten to fifteen percent with a Level III.

2. Common Misconceptions

As Bill Decker mentioned this morning,[7] we typically run into a lot of misconceptions or misinformation in the marketplace. Many companies do not realize that there are different types of ADR programs. Some are very easy to establish, some are more difficult because of accounting and legal issues; some are very cheap to establish; and some cost significant amounts of money.

The biggest misconception right now in the marketplace is that there is a difference between ADRs and GDRs. There is absolutely no difference between an American Depositary Receipt and a Global Depositary Receipt. They work exactly the same way. What will happen is with a Level III ADR or with a private placement under Rule 144A of the Securities Act of 1933 ("Rule 144A" or "144A"),[8] the underwriter will determine what to call the depositary receipt. If a big portion of the offering is taking place in Europe, the underwriter will call the depositary receipt a GDR, trying to get away from tainting the security by calling it an "American Security." If the majority of the offering takes place in the United States, then the underwriter will call it an ADR.

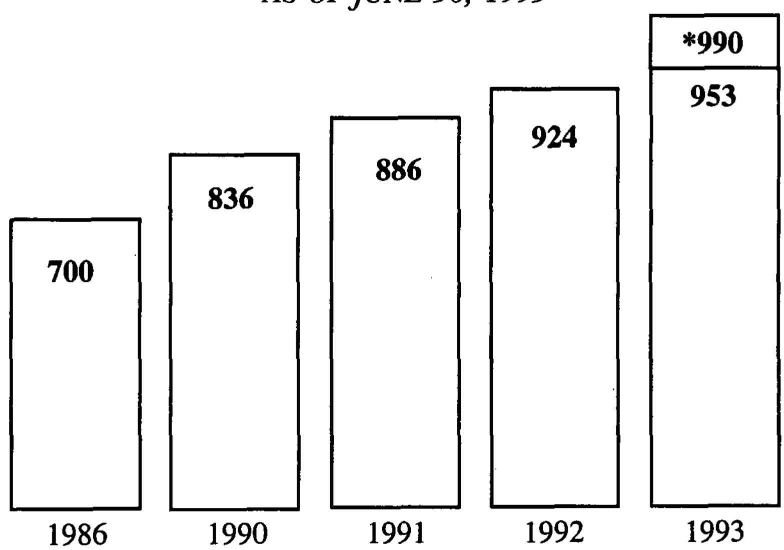
7. *See* Decker, *supra* note 1, at S10 (noting misconceptions non-U.S. companies have concerning registration of securities in United States).

8. 17 C.F.R. § 230.144A (1993).

3. Growth of the ADR Market

Regarding the growth of the market, at the end of 1993, we are projecting that there will be approximately 990 ADR programs. Over the course of 1993, we are projecting that about 110 new ADR programs will be established. The reason why the numbers for 1992 and 1993 don't match up is that a lot of companies are obviously converting from unsponsored to sponsored and some companies go through mergers, bankruptcies, and other reorganizations. But from 1992 to 1993 we are projecting that over 110 new companies will establish ADR programs, which will be a record.

TOTAL NUMBER OF PROGRAMS AS OF JUNE 30, 1993



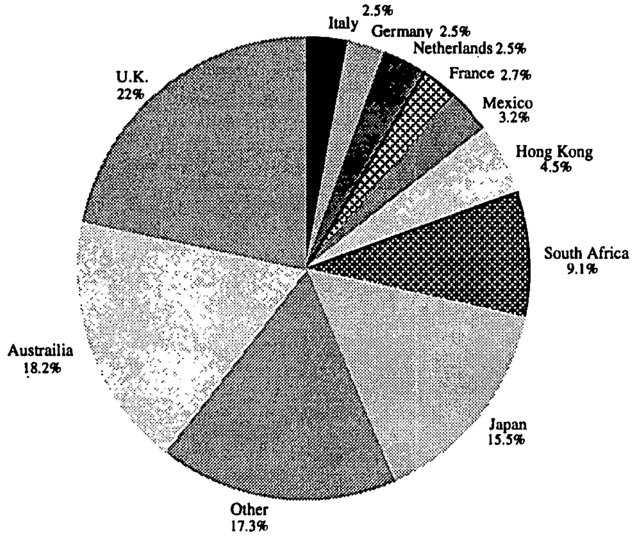
*Year-end projection

■Includes all Depositary Receipt programs except 144A Depositary Receipt programs

The largest ADR markets are the United Kingdom, Australia, and Japan. These three markets represent approximately half of the ADR marketplace. What is of interest is that over the last three years, the fastest growing part of the world for ADR programs in terms of percentage has been Latin America. It started off in Mexico three years ago, and now it has spread to Argentina, Brazil, Chile, Peru, and Colombia. Latin America, for the last three years, has clearly been the fastest-growing segment of the ADR market.

PERCENTAGE OF TOTAL DEPOSITARY RECEIPT PROGRAMS BY COUNTRY AS OF JUNE 30, 1993

As of June 30, 1993 there were 953 Depositary Receipt programs

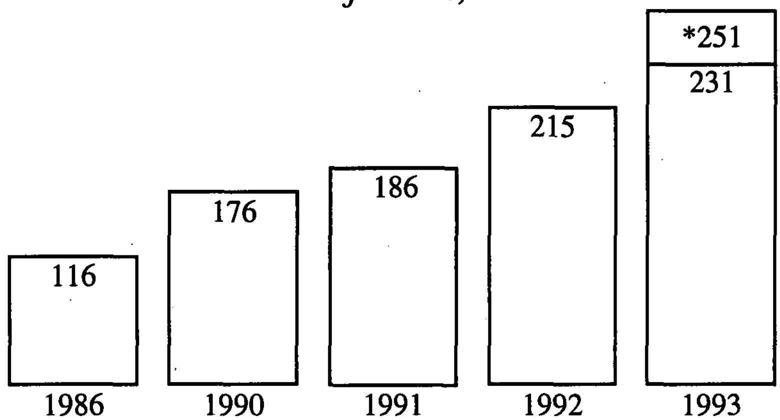


■ Excludes 144A Depositary Receipt programs

Going forward, we expect that, for the next few years, Latin America will remain one of the fastest-growing, but we expect Southeast Asia to eventually overtake Latin America. In fact, earlier this year, Shanghai Petrochemical was the first company out of China to do an ADR offering and listing on the NYSE. We expect that, within the next eighteen months, somewhere between twelve to twenty companies from China will have ADR programs here. In fact, we are currently working on four ADR programs for Chinese companies. Hong Kong is also another fast growth market for ADRs. Out of the top fifty companies in Hong Kong, forty-three have ADR programs, all of which have been established over the last year.

We are projecting that, by the end of 1993, there will be about 251 companies with ADR programs listed here on one of the exchanges. The majority of these companies are listed on the NYSE. Again, the type of ADR program that is used to list on

TOTAL NUMBER OF LISTED DEPOSITARY RECEIPT PROGRAMS ON NYSE, AMEX AND NASDAQ AS OF JUNE 30, 1993



*Year-end projection

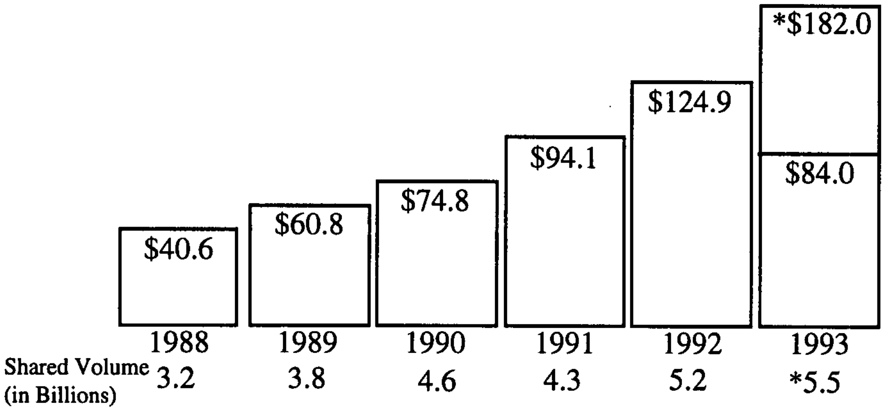
an exchange is either a Level II or a Level III ADR. In order to list, as was discussed by Bill Decker and Frode Jensen, essentially you have to comply with U.S. accounting and disclosure standards, just like any other U.S. company would.[9]

There are a couple of reasons for the rapid pick-up in listings. One is, many companies that established Level I programs two or three years ago had a very favorable experience in the U.S. marketplace and are now upgrading to a listing on an exchange. The second reason is that many companies are simply coming into the market, skipping Level I and Level II ADRs, and doing public offerings straight-away to take advantage of the favorable market conditions that exist today.

For 1993, we are projecting about U.S.$182 billion worth of ADRs will trade here on one of the exchanges. That is up significantly compared to 1992, when U.S.$125 billion worth of ADRs traded. There are a couple of reasons for this. First, which is

9. *See* Decker, *supra* note 1, at S10 (discussing increased attraction of non-U.S. companies to U.S. capital markets and options available for accessing those markets); Frode Jensen, III, *The Attractions of the U.S. Securities Markets to Foreign Issuers and the Alternative Methods of Accessing the U.S. Markets: From a Legal Perspective*, 17 FORDHAM INT'L L.J. S25 (1994) (discussing alternative methods for non-U.S. companies to access U.S. capital markets); *see also* Regulation S-X, 17 C.F.R. § 210.4-01(a)(2) (1993) (requiring either complying with U.S. GAAP or reconciling with U.S. GAAP).

ANNUAL DOLLAR VOLUME OF DEPOSITARY RECEIPTS LISTED ON NYSE, AMEX AND NASDAQ (TRADING VOLUME IN BILLIONS OF DOLLARS)



*Year-end projection

■ Trading volume data is for Depositary Receipts listed on exchanges only. During the first six months of 1993, this accounted for 231 of tthe total 953 programs.

pretty obvious, there are more listings. The more listings, the more trading volume. But what I think is more important is that we have seen a clear trend over the last few years where domestic portfolio managers — of pension money, mutual funds, etc. — are starting to invest internationally by using ADRs. They are not buying shares directly overseas, but their first steps into this market for traditional domestic portfolio managers will always be through the ADR mechanism. We also see a lot of retail interest in ADRs. Approximately 30% of the ADR trading volume is by retail investors.

This chart below shows some of the most actively traded ADRs in the United States. About U.S.$16 billion of Royal Dutch ADRs were traded in the United States last year. One of the things I always hear is that large institutional investors don't buy ADRs, that only retail investors buy ADRs. Well, I don't know about you, but my family clearly does not buy U.S.$15 billion worth of securities. So the message is that large institutional investors do buy ADRs and they actively trade ADRs.

For 1993, we are projecting that there will be about thirty-five public offerings, Level III-type ADRs, which is up significantly since 1992. There are a couple of reasons. One is priva-

*TOP 20 SPONSORED DEPOSITARY RECEIPTS**
AS OF JUNE 30, 1993

Company	Country	Share Volume	Dollar Volume	Exchange
Glaxo Holdings	U.K.	274,799,000	$5,253,110,494	NYSE
Telefonos de Mexico Ser L	Mexico	254,317,200	12,930,880,394	NYSE
Royal Dutch Petroleum	Netherlands	174,911,200	15,591,366,306	NYSE
Hanson PLC	U.K.	160,747,800	2,879,921,644	NYSE
British Petroleum	U.K.	116,782,000	6,089,377,100	NYSE
Ericsson Telephone "B" Shares LM	Sweden	88,625,500	3,256,187,231	NASDAQ
SmithKline Beecham	U.K.	58,637,400	1,768,871,875	NYSE
Wellcome PLC	U.K.	52,861,600	646,370,044	NYSE
Memorex Telex	Netherlands	49,692,800	22,747,031	NASDAQ
Unilever	Netherlands	45,730,700	5,028,425,044	NYSE
Senetek PLC	U.K.	45,146,100	117,389,408	NASDAQ
News Corporation	Australia	45,115,700	1,854,475,500	NYSE
YPF S.A.	Argentina	43,407,400	957,675,763	NYSE
Reuters Holdings	U.K.	42,473,300	2,583,684,525	NASDAQ
Phillips	Netherlands	38,353,100	532,210,944	NYSE
Imperial Chemical Industries	U.K.	36,586,300	2,235,510,356	NYSE
TOTAL "B" Shares	France	36,251,800	848,214,713	NYSE
Repsol	Spain	28,898,900	706,565,350	NYSE
Telefonica de Espana	Spain	27,472,200	903,727,956	NYSE
Automated Security (Holdings)	U.K.	27,202,800	128,727,131	NYSE

* by Share Volume

tizations; many countries around the world are going through a privatization exercise, selling off their state enterprises and listing their securities around the world. They do that typically through a public offering in the United States. The other reason is that non-U.S. companies are simply taking advantage of the favorable markets here in the United States, so they're raising capital here. And, in many cases, the capital they are raising here is at a much better cost than it would be in their home country.

For 1993, we are projecting approximately U.S.$8 billion in new capital will be raised by non-U.S. companies. Again, that is up significantly compared to last year. We have also tended to see the size of the offerings increase over the last year or two. As I said, YPF raised U.S.$2.3 billion, Wellcome PLC raised U.S.$1.5 billion last year, so some of these offerings are quite big through ADRs.

III. *RAISING CAPITAL IN U.S. MARKETS*

There are essentially two ways a non-U.S. company can raise capital in the United States: they can make a public offering or make a private placement under Rule 144A.[10]

A. *Public Offerings*

The advantages of doing a public offering are simple. By doing a public offering, the company is going to be treated like any other U.S. company that is traded in the public markets. These issues are going to have access to the fullest possible investor base. Finally, there are virtually no restrictions on the resale of the securities in the United States. So they are taking optimal advantage of the U.S. public markets by making a public offering.

However, public offerings are not without their disadvantages. The lead-in time may be prohibitive. As Bill Decker mentioned,[11] it can be done in six months; but compare that to a Rule 144A offering, which can be done in two months or less.

Secondly, costs are higher. Because a public offering requires SEC registration, the cost can be substantial for some companies, depending on their internal accounting records, acquisitions they have made in the past, etc. You can easily expect if you are doing a public offering for the bill to run anywhere between U.S.$500,000 to U.S.$1 million.

Here are some examples of some recent public offerings dating back to 1988. What I think is most interesting is that after companies did offerings, their number of ADRs outstanding usually increased dramatically.

If you look at Vodafone, they did a public offering in 1988 of 4.3 million ADRs. Currently, they have about 25 million ADRs outstanding, which shows you how much after-market support there is for the offering.

I used to always hear, "Well, we don't want to enter the U.S. markets because we're afraid of flowback." Flowback is when a

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10. *See* 17 C.F.R. § 230.144A (1993); *see also* Decker, *supra* note 1, at S13 (discussing public offering, private placement and Rule 144A options for non-U.S. companies); Jensen, *supra* note 9, at S29 (discussing public offering and Rule 144A options for non-U.S. companies).

11. *See* Decker, *supra* note 1, at S21 (discussing time-frame for non-U.S. companies preparing for public offerings in United States).

SAMPLE PUBLIC OFFERINGS

Offer Date	Company	Dollar Amount	ADRs Offered	ADRs Outstanding 08/01/93
10/25/88	Vodafone Group	$129,489,000	4,338,000	23,434,174
12/05/88	British Steel	526,050,000	22,500,000	33,911,505
12/08/88	Hong Kong Telecom	123,147,500	7,037,000	29,066,852
05/17/89	Repsol	181,527,500	12,650,000	53,032,324
06/30/89	Anangel-American	56,925,000	3,450,000	6,710,016
07/20/90	Compania de Telfonos de Chile	110,163,760	6,499,337	11,899,597
06/06/91	Elan	66,000,000	2,000,000	30,254,755
06/13/91	Elf Aquitaine	205,488,000	7,200,000	18,379,028
10/31/91	Total	264,928,000	13,600,000	38,566,510
04/08/92	Empreas ICA	326,485,000	19,205,000	20,875,979
07/27/92	Wellcome PLC	1,086,715,000	71,260,000	39,676,996
05/04/93	Buenos Aires Embotelladora	38,362,500	1,650,000	6,608,687
07/07/93	YPF S.A.	2,375,000,000	125,000,000	125,694,305

company does a public offering or a private placement in the United States, and then over a period of time the U.S. investors sell and all the shares go back into the home country. That's referred to as flowback. Flowback has not been an issue, has not been a problem, over the last couple of years for a few reasons.

One is that the investment banks have learned how to better place their shares so that they're not selling them or underwriting them to investors who instantly sell them for a profit and sell the shares back into the home country. Secondly, and probably more importantly, there is a much bigger investor base now that is willing to buy non-U.S. securities than there was five years ago. As a result, after the offering is completed, if an investor wants to sell his ADRs, rather than canceling them and selling the shares back in the home country, he simply sells his ADR to another U.S. investor, so the shares stay in the U.S. marketplace.

B. *Private Placement Offerings under Rule 144A*

Let me describe Rule 144A in laymen's terms.[12] Basically, a company can make a private placement to Qualified Institutional Buyers ("QIBs") here in the United States.[13] Because it is

12. *See* 17 C.F.R. § 230.144A (1993); *see also* Decker, *supra* note 1, at S14 (discussing Rule 144A); Jensen, *supra* note 9, at S35 (discussing Rule 144A).

13. *See* 17 C.F.R. § 230.144A(a) (1993) (defining "qualified institutional buyer" for

a private placement the company does not have to register with the SEC.[14] They do usually issue an offering memorandum that describes the company and other factors that are relevant to the offering, and some financial information as well, but they do not have to register or conform to U.S. accounting or U.S. disclosure requirements.[15]

Once the offering is done and the private placement offering is completed to these QIBs, the so-called large investors can trade these 144A depositary receipts among themselves. They don't have to wait two or three years to get out of it;[16] they're not restricted in that sense; they can sell their ADRs to another QIB — or, probably more importantly, under Regulation S,[17] they can cancel the ADR and sell the actual shares back into the home country.

Typically, a 144A offering will be for a company that is not in a position to register with the SEC in the United States, or is making a worldwide global offering and simply wants to raise a small amount of money in the United States. A "small amount of money" could be anywhere from U.S.$30 to U.S.$50 million. Once they get past the U.S.$50 million mark, it becomes difficult to place the shares under 144A, and more than likely the company will do a public offering if they want to enter the U.S. market.

A lot of companies also use Rule 144A as a stepping stone into the U.S. market. What I mean by that is once a company does a 144A offering, they can either at a later stage upgrade through listing a different ADR program on the NYSE, or they can do what is known as an exchange offer, where essentially

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purposes of Rule 144A). Qualified Institutional Buyers under Rule 144A include: insurance companies (as defined in section 2(13) of the Securities Act of 1933, 15 U.S.C. § 77b(13) (1988)); investment companies (registered under the Investment Company Act, 15 U.S.C. § 80a (1988)); business development companies (as defined in section 2(a)(48) of the Investment Company Act, 15 U.S.C § 80a-2(48) (1988), or section 202(a)(22) of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-2(a)(22) (1988)); and several other entities and individuals. 17 C.F.R. § 230.144A (1993).

14. *See* 15 U.S.C. § 77d(2) (1988). Section 77d(2) of the Securities Act of 1933 provides that "[t]he provisions of section 77e [requiring registration] of this title shall not apply to . . . transactions by an issuer not involving any public offering." *Id.*

15. *See* Decker, *supra* note 1, at S14 (discussing preparation of offering circular for private placement).

16. *See* Jensen, *supra* note 9, at S36 (discussing benefits Rule 144A transactions).

17. 17 C.F.R. §§ 230.901-904 (1993).

they take their privately placed securities, register them with the SEC, and the securities become freely traded on one of the exchanges.

Private placements under 144A offer an issuer many advantages. First, a placement under 144A involves a relatively short lead-in time of only a couple of months. Second, 144A private placements do not require SEC registration, so the cost is substantially lower than doing a public offering.[18] I should not say "substantially lower" any longer. There have been some 144A deals that have been done where it would have been more cost advantageous to do a public deal rather than a 144A deal.

There are, however, certain disadvantages to Rule 144A. It is a private placement; you only can sell your securities to QIBs. Even though 144A was intended to create a resale market among these large institutional investors, the fact of the matter is the market has not developed to the extent that people thought it would. Companies can use Rule 144A to raise a small amount of capital, but they are not going to be able to build a trading market here under 144A.

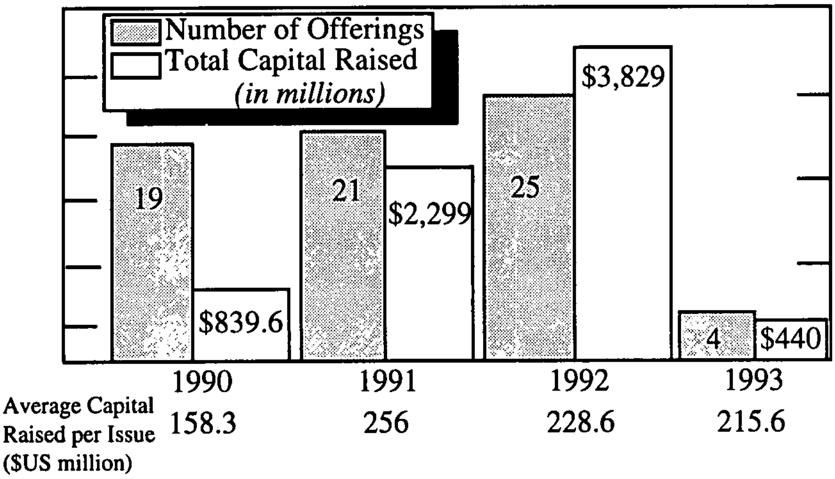
One of the innovations that has occurred on this side to help overcome the shortcomings of a 144A offering, especially as it relates to restrictions on resales and liquidity, is that now, typically, companies also establish what is known as a Level I ADR for the U.S. public markets that trades side-by-side with a 144A program. You have to be careful when you take this approach that you have the proper safeguards built into both the Level I and the 144A facility so that there's no leakage between the two programs.

In 1993 the 144A market basically died. In 1991 and 1992 it was pretty substantial. In 1992, about U.S.$3.8 billion was raised in equity under 144A ADR offerings. This year it is probably going to be somewhere around U.S.$500 million. The reason is that companies are learning that if they really want to take advantage of the U.S. markets, they have to do a public offering.

There are some companies for whom it still makes good sense to do a 144A offering, but more and more companies are realizing that, "Yes, we could raise some money in the United States, but we're not going to be able to build a liquid market for

18. *See supra* note 14 and accompanying text (noting that registration is not required in private placements).

144A DEPOSITARY RECEIPT MARKET



■ In the first six months of 1993, there were 5 Depositary Receipt private offerings; 4 of which were Rule 144A.

our shares here under 144A." So they are doing public offerings instead.

Here are some sample 144A deals that have happened over the last couple of years.

SAMPLE 144A TRANSACTIONS

Date	Company	Amt. ($mm)	Industry	Type of DR Offering
12/90	U.K. Generating Cos.	575	Utility	U.S. Only
3/91	U.K. Regional Electric Cos.	175	Utility	U.S. Only
4/91	Vitro	37	Glass	U.S. Only
5/91	Samsung Electronics	35	Electronics	Global
6/91	STET	25	Telecommunications	U.S. Only
12/91	Grupo Situr	51	Hotel/Leisure	Global
3/92	Telecom Argentina	270	Telecommunications	Global
4/92	Australian Consolidated Press	23	Publishing	U.S. Only
4/92	Cemex	461	Cement	Global
5/92	Reliance Industries	150	Conglomerate	Global
6/92	Asia Cement	61	Cement	Global
10/92	Roche Holdings	275	Chemical	U.S. Only
10/92	Philippine Telephone	316	Telecommunications	Global
7/93	Woolworths Limited	27	Specialty Retailing	Global

IV. *ROLE OF THE DEPOSITARY*

The last thing I want to talk to you about is the role of the depositary. A depositary bank, such as The Bank of New York, has basically three roles.

First, we act as the depositary bank. That means that we are responsible for assisting the brokers who trade ADRs — such as Merrill Lynch, Goldman Sachs, First Boston — in issuing and canceling ADRs. As I described earlier, when somebody buys Glaxo shares in London and they decide to issue ADRs, they deposit them with The Bank of New York, and we issue the ADRs. That function is called a depositary function. Those types of transactions account for about ten to fifteen percent of the trading volume in ADRs.

Second, the depositary bank basically acts as the non-U.S. company's transfer agent in the United States. As transfer agent, the depositary bank is responsible for maintaining shareholder records, disbursing dividend payments, sending out proxy notices, etc. So the same type of functions we would perform for a U.S. company as a transfer agent, we perform for a company with an ADR program.

The last function of the depositary bank is that of an administrator. Basically, we help the company understand how to reach U.S. investors and how to promote their securities in the U.S. market; we help them put on "road shows" in the United States, i.e. investor presentations;[19] and, more importantly, we are constantly supplying the company with information regarding their ADR program — which brokers are trading their ADRs, what price they're trading at, how many ADRs are outstanding, and who their shareholders are.

CONCLUSION

In conclusion, over the next few years you are going to see more and more companies enter the U.S. market by using ADRs. Just as important, more and more U.S. investors will also be buy-

19. *See* RICHARD JENNINGS ET AL., SECURITIES REGULATION 177 (7th ed., 1992). During the "road show," management and the lead underwriter tour the country making presentations to educate prospective institutional investors regarding the prospects of the issuer and the merits of the particular offering. *Id.*

ing or starting to diversify their portfolios internationally by using ADRs. Thank you.