Unsponsored ADR programs

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Unsponsored ADR programs and their implications for affected issuers

Recent changes in U.S. securities regulations have made it possible for unsponsored American Depositary Receipts (ADR) programs to be created, often without the consent or even knowledge of a foreign private issuer (“issuer”). This Whitepaper explains the process by which unsponsored ADR programs are created and the primary implications for affected issuers. We conclude with J.P. Morgan’s position on this important issue.

Sponsored versus unsponsored ADR programs

ADRs enable U.S. investors to conveniently invest in a foreign company through a dollar-denominated instrument that trades and settles like a U.S stock. Traditionally, most ADR programs are sponsored (i.e., such programs were created with an issuer’s consent and participation). Sponsored ADR programs are either listed on a U.S. stock exchange or are traded in the over-the-counter markets (OTC). Additionally, sponsored programs are managed on behalf of an issuer by a single depositary bank, such as J.P. Morgan. Under a sponsored ADR program, the issuer in conjunction with its depositary bank determines the terms and conditions of the program, such as the rights granted to the holders of these securities. A sponsored OTC-traded ADR is a Level I facility; an ADR listed on the NYSE or NASDAQ is either a Level II or Level III program, the latter being employed for capital raising in addition to establishing a U.S. listing.

Unsponsored ADR programs are created by one or several depositary banks, often without the involvement of an issuer. Unsponsored ADRs can trade in the U.S. OTC market only, similar to a sponsored Level I program. For a depositary bank to establish an unsponsored ADR program, the issuer must be exempt from the registration and reporting requirements of Rule 12g3-2(b) under the U.S. Securities Exchange Act of 1934 (“Exchange Act”). Such exemption requires that an issuer meet certain conditions, which, once established, must be subsequently maintained for the exemption to remain in effect.

SEC rule change spurs creation of unsponsored ADRs

The U.S. Securities and Exchange Commission’s (“SEC”) recent amendments to Rule 12g3-2(b), which became effective on October 10, 2008, have eliminated the application process that was previously required to establish exemption from the registration and reporting requirements of the Exchange Act. This automatic exemption (for qualifying issuers) has resulted in a spate of unsponsored ADR programs being unilaterally established by depositary banks.

The SEC’s rule amendments are intended to ease access to foreign equities by U.S. investors. These amendments also streamline and modernize the requirements for reporting material information, among other beneficial changes for issuers. However, it is J.P. Morgan’s opinion that unsponsored ADR programs should be opened only with an issuer’s consent and only in cases where the program will be beneficial to the issuer and where there is potential investor interest.

Implications of unsponsored ADRs

As an issuer is not involved in the creation or the subsequent maintenance of an unsponsored ADR program, it has limited influence on the treatment of ADR holders. Moreover, more than one unsponsored program can be

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1 For information about Level I ADR programs, please refer to J.P. Morgan’s November White Paper, which can be found on our Web site, adr.com.
2 For information about Rule 12g3-2(b) and the most recent amendments to this rule, please refer to the SEC’s relevant rule release or to J.P. Morgan’s September 9, 2008, white paper on this subject, which can be found on our website, adr.com.
opened in a single issuer by competing depositary banks. Shareholder services vary between depositary banks, thus investor confusion could arise where multiple unsponsored programs exist for the same issuer. For example, U.S. dollar disbursements may differ for the same payment, depending on the foreign exchange rate applied by each of the issuing depositary banks to the entitlements received in local currency. Additionally, depositary banks charge investors for various services according to their respective fee schedules, potentially frustrating ADR holders expecting consistent treatment in relation to holding the same security.

A sponsored ADR program through a single depositary bank helps an issuer ensure that ADR holders are treated consistently and with active participation from the issuer. Once an issuer establishes a sponsored ADR, existing unsponsored programs are terminated, with the outstanding ADRs absorbed into the new facility. J.P. Morgan is well positioned to guide an issuer interested in converting an unsponsored ADR program into a sponsored ADR program.

J.P. Morgan's position: a transparent and collaborative approach

J.P. Morgan is supportive of the SEC’s efforts to provide easier access to foreign equities by U.S. investors through the amendments to Rule 12g3-2(b). However, the implementation of numerous unsponsored ADR programs without, in many instances, the consent or knowledge of an issuer is neither collaborative nor transparent. Since creating the first ADR in 1927, J.P. Morgan has remained focused on developing strong, long-lasting relationships and maintaining close communications with issuers. Our overarching business philosophy has not changed as a result of the aforementioned SEC rule amendments.

Some depositary banks have unilaterally opened unsponsored ADR programs based solely on an issuer qualifying for automatic registration and reporting exemption, among other requirements of the recently amended Rule 12g3-2(b). However, ADR programs are not appropriate for all issuers, in our opinion. The potential to attract U.S. investors is one of several factors to consider before initiating an ADR program. Additionally, J.P. Morgan believes that an ADR program—even one that is unsponsored—should be a product of partnership and understanding.

Please note that this Whitepaper is a summary presented for general informational purposes only. It is not a complete analysis of the matters discussed herein and should not be relied upon as legal advice.

For more information, please contact your J.P. Morgan representative.