



# The Role of the Depository Bank

**A resource for issuers in U.S. and global securities markets**





# The role of the depositary bank

A Depositary Receipt (DR) program is an effective option for non-U.S. companies seeking to make global equity offerings. Issuers establishing DR programs may benefit from a broadened investor base, potentially increasing liquidity as a result of an expanded market, and enhanced visibility. From the investor perspective, DRs have long been a popular instrument in worldwide capital markets, particularly where eliminating custody and cross-border safekeeping charges is a key concern.

Depositary Receipts (DRs) were created in 1927 to aid U.S. investors seeking to purchase shares of non-U.S. corporations. Since that time, DRs have grown into widely accepted, flexible instruments that provide issuers worldwide with access to investors outside their home markets. Historical and recent data point to the growing size of this opportunity. According to the U.S. Federal Reserve, total U.S. investment in non-U.S. equities including DRs and non-U.S. shares have steadily increased over the last 16 years, rising from \$279 billion in 1991 to an all-time record high of \$4.1 trillion in the first quarter of 2007. Meanwhile, mid year 2007 DR trading statistics reinforce the long-term trend of constant growth in cross-border trading. Specifically, year-to-date capital raised in the form of DRs by non-U.S. companies through June 2007 reached an all-time high of \$23.0 billion, a 42% increase over the first half of 2006.

<b>Role of the depositary</b>	<b>Role of the issuer</b>
Consult on DR facility structure	Determine financial objectives
Appoint custodian	Appoint depositary, lawyers, investment bank and accountants
Assist with DR registration requirements	Determine program type
Coordinate with lawyers and investment bankers to ensure that all implementation steps are completed	Obtain approval from board of directors shareholders and regulators as needed
Prepare and issue DRs	Provide financial information to accountants
Enlist market makers, if applicable	Develop investor relations plan
Announce program establishment to brokers and traders	

## **Roles and relationships for the issuer and the depositary**

In order to establish any type of DR program, the issuer develops a team of advisors that typically includes investment bankers, lawyers and accountants. The issuer also selects a depositary bank, a key partner that enlists the services of a local market custodian to handle the implementation of the program.

Once the issuer and its advisors have evaluated the company's unique needs and have determined the type of DR program best suited to its objectives, the issuer and the depositary execute a Deposit Agreement that sets forth the terms of the DR program. Based upon the contract, the depositary performs certain specific services on behalf of the issuer and the DR holders. Many of these same parties play key roles in the long-term development and day-to-day management of

the issuer's DR program. The depositary bank remains a critical liaison between the issuer and brokers and custodians, while the functions of lawyers and accountants become focused on periodic reporting. Generally, investment bankers are most involved with the ongoing management of a DR program if the issuer is going back to the market.

## **How to evaluate a depositary bank**

The depositary bank plays a critical role for an issuer that wishes to expand its access to capital, broaden its investor base globally and take advantage of all the benefits of depositary receipts. The issuer and the depositary enter into a relationship that extends through the offering process and implementation stages and continues for the ongoing maintenance of a successful DR program.

<b>Role of the depositary</b>	<b>Role of the issuer</b>
Maintain register of DR holders, serving as registrar and transfer agent.	Communicate with depositary about DR program and potential program changes
Issue and cancel DRs	
Process corporate actions	
Act as paying agent, processing dividend payments or other entitlements for DR holders	
Provide ongoing account management support to the issuer	
Coordinate proxy process for DR holders	
Offer value-added services such as IR counsel	

As a guideline for evaluating depositary banks, the issuer should consider the resources and corporate culture of the provider, as well as its core competencies and value-added services.

**Key questions to ask a depositary bank**

- (1) How extensive is the depositary bank's expertise in securities processing?
- (2) Can the depositary bank offer your company a complete range of banking and financial products?
- (3) How is the depositary positioned with investors and other global market participants?
- (4) What peers in your region and worldwide exemplify how the depositary has managed liquid DR programs?
- (5) How many years of experience does the organization have in serving DR issuers in your region?

- (6) What awards has the depositary won that represent a third party endorsement of its superiority over its competitors?

**The depositary's commitment to investor relations**

The breadth of value-added services offered by a depositary can enhance a company's internal IR effort and should be a crucial consideration for the issuer in selecting a provider. Citi pioneered the depositary's role of IR counsel, delivering the expertise and resources required for its sponsored issuers to achieve their international IR goals.

For example, where appropriate, a depositary's IR counsel may work closely with the issuer in formulating IR strategic plans and identifying, targeting and accessing new investors. IR counsel may also advise the issuer on financial media relations, non-deal road shows, IR website development

and selection of outside IR firms. The depositary may also provide shareholder intelligence tools delivering comprehensive share ownership and peer ownership data and analytical flexibility.

**Features and benefits of depositary receipts**

A DR is a negotiable instrument issued by a U.S. depositary bank evidencing ownership of shares in a non-U.S. corporation. Each DR denotes Depositary Shares (DSs), representing a specific number of underlying shares on deposit with a custodian in the issuer's home market. The term "DR" is commonly used to mean both the physical certificate and the security itself.

DRs are generally subject to the trading and settlement procedures of the market in which they trade. The different types of DRs are frequently identified by the markets in which they are available or the rules and regulations associated with the structures. For example:

- American Depositary Receipts (ADRs) are DRs that are publicly available to investors in the U.S.
- Global Depositary Receipts (GDRs) are DRs that are offered to investors in two or more markets outside the issuer's home country, usually pursuant to Rule 144A and Regulation S under the U.S. Securities Act of 1933.

DRs can be publicly offered, privately placed or issued pursuant to a global offering. The method of sale defines the segment of investors that can purchase the securities. In the U.S., publicly-offered securities are available to the broadest spectrum of investors and trade either on a national stock exchange (such as NASDAQ, the NYSE or Amex), or in the Over-the-Counter (OTC) market. Privately-placed securities are typically sold to Qualified Institutional Buyers (QIBs), including institutions that own and invest at least \$100 million in securities of non-affiliates and registered broker-dealers that own or invest on a discretionary basis at least \$10 million in securities of non-affiliates. A global offering often has a Rule 144A component as well as a placement to non-U.S. investors pursuant to Regulation S.

Benefits of a DR program specific to issuers and investors are highlighted in Table 3.

DRs potentially may play a critical role in different types of cross-border transactions such as privatizations and mergers and acquisitions.

#### Privatizations

The privatization of state-owned assets is an important undertaking for governments worldwide as countries seek to restructure their economies and reduce fiscal deficits. Infrastructure and service enterprises such as telecommunications, utilities, airlines and petrochemicals are among those commonly targeted for privatization.

<b>DRs enable issuers to:</b>	<b>DRs aid investors by:</b>
Access capital outside the issuer's home market	Facilitating diversification into non-U.S. securities
Build company visibility in the U.S. and/or internationally	Trading, clearing and settling in accordance with practices of the investor's home market
Broaden and diversify their shareholder bases	Eliminating cross-border custody safekeeping charges
Expand their opportunity to increase local share price as a result of global demand/trading	Enhancing accessibility of research, and of price and trading information
Enlarge the market for the company's shares, potentially increasing liquidity	Allowing easy comparison to securities of similar companies trading in the investor's home market
Adjust share price levels to those of peers through DR Ratio	Permitting dividend payments in US\$ and corporate action notifications in English (for ADRs)
Facilitate merger and acquisition activity through use as acquisition currency	Enabling uniform proxy and corporate action processing
Develop stock option plans and stock purchase plans for employees outside the issuer's home market	Providing opportunities to move to other liquid markets

DRs have been used successfully by governments seeking to privatize state-owned enterprises. Privatizations require a successful offering of securities to investors, and DRs provide an effective mechanism both to increase private ownership and to raise capital overseas.

#### Mergers and acquisitions

Depositary Receipts can enhance the ease of trading and settlement related to cross-border mergers and acquisitions (M&A transactions), and they also can facilitate the execution of corporate actions such as payment of dividends, structuring of rights offerings and solicitation of votes. DRs enable issuers to address investor demands without the need to build an independent U.S. shareholder support

infrastructure, or to modify the equity issuance and trading patterns of the home market. Types of M&A transactions that have made successful use of DRs include spin-offs of non-U.S. subsidiaries, equity-based acquisitions of U.S. business entities and equity-based acquisitions of non-U.S. business entities.

#### Program alternatives

Issuers base the structure of a DR program on their particular objectives. An issuer's aims in selecting the best DR alternative may include: expanding its shareholder base, gaining international recognition for the company name and for its products and services, using DRs as a capital-raising tool and providing a convenient investment vehicle for its international employees.

**Table 4 DR program alternatives to broaden shareholder base with existing shares**

	<b>Over-the-counter Level I</b>	<b>Exchange-traded Level II</b>
<b>Description</b>	Unlisted program in the U.S.	Listed program on a recognized U.S. exchange
<b>Trading</b>	Quoted in the Pink Sheets and/or on the OTC Bulletin Board	NYSE, Amex or NASDAQ

**Setting the ratio**

A primary step in establishing a DR program is determining the ratio of underlying shares to Depositary Shares (DSs). The share-to-DS ratio is established as a multiple or fraction of the underlying shares and the ratio can influence the price-trading range. In setting the ratio, the issuer should consider:

- Industry peers: To the extent that securities of companies in the issuer’s industry generally trade in a certain price-range, the issuer may want to conform to industry norms in the market where the DR will be listed
- Exchange options: Each exchange has average price ranges for the shares listed and, generally speaking, issuers may want to conform to that range
- Investor appeal: U.S. institutional and retail investors are more likely to buy shares which they perceive as well priced and valued fairly.

While many DR programs are established with a 1:1 ratio (one underlying share equals

one DS), current DR programs have ratios ranging from 100,000:1 to 1:100. The depositary will work with issuers to determine the most appropriate ratio at the inception of the DR program. The ratio can be adjusted at a future date to address changes in market conditions.

**Types of depositary receipt programs**

In the U.S., DRs can be:

- Listed on a U.S. exchange: the NASDAQ Stock Market (NASDAQ), the New York Stock Exchange (NYSE) or the American Stock Exchange (Amex) (Level II)
- Issued as a public offering of securities on a U.S. exchange (Level III)
- Traded Over-the-Counter (OTC) through the OTC Bulletin Board and/or the Pink Sheets (Level I)
- Privately placed with QIBs in the Rule 144A market (RADR).

In global markets, DRs can be:

- Privately placed outside the U.S. with non-U.S. persons in accordance with the U.S. Securities Act of 1933 (Reg S). Note that

Reg S programs are often offered in global markets along with 144A programs in the U.S. market.

- Issued to raise capital via a global offering. (GDRs, RADR and Reg S offerings).

**Program alternatives**

**U.S.-listed DR programs**

Listing on one of the U.S. national exchanges can promote more active trading in American Depositary Receipts (ADRs) than a Level I, and increase the issuer’s visibility within the U.S. Level II ADRs are more widely covered by U.S. analysts and the financial media, providing investors with increased information about the issuer and its securities.

Issuers can use ADRs to access institutional investors that may be prohibited or limited by their respective charters, or by regulation, from investing in non-U.S. securities purchased in the issuer’s home market. U.S. investors may prefer to purchase ADRs rather than shares in the issuer’s home market because the DR securities trade, clear and settle according to U.S. market conventions.

To list its ADRs, the issuer must comply with the requirements of the relevant exchange. The issuer must register under the Securities Act of 1933, and under the Securities Exchange Act of 1934, file the initial registration statement and periodic reports. Non-U.S. issuers that are listing their securities must reconcile all financial statements to U.S.

Table 5

## DR program alternatives to raise capital with new shares

	Public offering Level III	Private placement-U.S. Rule 144A ADR (RADR)	Private placement – Global Global Depositary Receipt (GDR)
<b>Description</b>	Offered and listed on a recognized U.S. exchange.	Private placement in the U.S. to Qualified Institutional Buyers (QIBs)	Global private placement in two or more markets outside the issuer's home market May include RADR and/or Reg S* offering
<b>Trading</b>	NYSE, Amex or NASDAQ	Quoted on PORTAL in the U.S.	London Stock Exchange, Luxembourg Stock Exchange, e.g. for non-U.S. component, and/or PORTAL if there is a U.S. tranche.

\* Reg S programs are often offered in global markets along with 144A programs in the U.S. market

Generally Accepted Accounting Principles (U.S. GAAP). Financial reporting for individual business segments need not be reconciled to U.S. GAAP. Listing securities exempts non-U.S. issuers from complying with various state securities regulations.

In a Level III program, the issuer offers new shares to U.S. investors in ADR form. A public offering provides the issuer with the ability to raise capital by accessing the broadest U.S. investor base. In order to conduct an initial public offering in the U.S., the issuer must: 1) submit Form F-1 to the SEC to register the underlying securities to be offered; 2) fully reconcile its financial statements to U.S. GAAP (or include U.S. GAAP financials); and 3) with the depository, submit Form F-6 to the SEC to register the ADRs. In establishing a Level III ADR program, the issuer also selects an investment bank to advise on and underwrite the offering and to market the ADRs to U.S. investors. After the offering has been completed, the program is maintained as a

listed facility and generally can accept ongoing deposits from investors. An issuer may also raise capital in subsequent offerings. In such a follow-on offering the issuer will file a Form F-2 or Form F-3 with the SEC.

#### **Private placements**

Rule 144A DRs, or RADRs, are DRs that are privately placed in the U.S. RADRs are traded pursuant to Rule 144A which, adopted in 1990, greatly increased the liquidity of privately-placed securities by allowing qualified institutional buyers (QIBs) to resell these securities privately to other QIBs without a holding requirement or other formalities.

A Reg S Depositary Receipt Program is a private placement in global markets other than the U.S. market. Regulation S sets forth the conditions under which offers and sales of securities outside the U.S. are exempt from SEC registration requirements. This regulation was adopted by the SEC in 1990 in conjunction with the adoption of Rule 144A.

#### **Global offerings**

Global Depositary Receipts (GDRs) allow an issuer to raise capital simultaneously in two or more markets through a global offering. Global offerings allow issuers to access shareholders in capital markets outside the issuer's home market. GDRs use a global settlement convention linking DTC with Euroclear and Clearstream to provide global clearing and settlement, ultimately promoting increased liquidity through cross-border trading.

GDRs can be issued in either the public or private markets in the U.S. or other countries. Most GDRs include a U.S. tranche, which can be privately placed under Rule 144A or placed in a registered offering, and an international tranche placed pursuant to Reg S outside the U.S. – typically in the Euromarkets. GDRs placed in Europe are generally listed on the Luxembourg or London Exchanges, or quoted on SEAQ International (Stock Exchange Automated Quotation System), a service of the London Stock Exchange.

Recently, several additional listing destinations have become increasingly viable, potentially expanding the opportunities for DR issuers. These include the AIM, operated by the London Stock Exchange targeting smaller companies, the Singapore Exchange Limited, and the Dubai International Financial Exchange.

The evolution of regionally-specific DRs evidences the flexibility of the GDR structure, allowing issuers to select the investor base they wish to access and broaden their shareholder base into new markets. An issuer could establish a GDR program that taps only European, Asian and/or Latin American investors and does not offer shares in the U.S. Over time, the GDR program could be enhanced to reach additional markets and investors.

### ***Upgrading a GDR to a publicly-listed program***

A non-U.S. company may decide to list its DRs subsequent to its global Rule 144A and Reg S offering. Upgrading from a GDR to a U.S.-listed ADR program is a viable option for companies wishing to achieve greater global reach and visibility. Although the Reg S tranche easily can be moved to a listed facility 40 days after the Reg S offer, a Rule 144A tranche cannot. Furthermore, a Rule 144A facility cannot actively coexist with a listed program. In order to upgrade the Rule 144A facility to a listed program, the issuer first needs to file a form F-4 registration statement

pursuant to the 1933 Act. After the F-4 registration statement is filed, a registered exchange offer with the QIBs may be undertaken. Under certain circumstances, and if the Rule 144A program is “seasoned” (i.e. if the two-year period since the last deposit by the company or any of its affiliates in the Rule 144A program has expired), the issuer may opt for a private exchange using a certification process rather than a registered exchange under the 1933 Act.

## **Issuers establishing DR programs may benefit from a broadened investor base, potentially increasing liquidity as a result of an expanded market, and enhanced visibility.**

### **Issuance and cancellation of DRs**

Based upon availability and market conditions, an investor may acquire a DR either by purchasing existing DRs, or by converting shares purchased in the issuer’s home market to DRs. New DRs are issued subsequent to the deposit by an investor or broker of shares with the depositary’s local market custodian. The depositary then issues DRs, which represent the shares on deposit, to the investor or broker. This is referred to as an issuance of DRs.

Conversely, market conditions may prompt an investor to cancel the DRs and sell the underlying ordinary shares in the relevant home market. Upon receipt from the investor of the DRs and of cancellation instructions, the depositary cancels the DRs and notifies its

custodian to release the underlying shares according to the investor’s instructions. The broker may then either safekeep or sell the ordinary shares in the local market.

### **Liquidity**

For many DR market participants, liquidity – the consistent breadth and depth of trading activity – is considered the best measure for long-term success of a DR program. Without the ability to move into and out of positions of

sufficient size, institutions are reluctant to add the security to their managed portfolios.

Likewise, brokers prefer to deal in liquid issues, and both sell-side and buy-side analysts prefer to cover liquid securities with high standards of financial disclosure providing an important added protection. Liquidity is a self-perpetuating cycle which is difficult to establish. Once established, however, it can be facilitated and maintained through a strong investor relations (IR) effort and the resources of the depositary bank and other partners.

The findings of Citi’s “The Liquidity Premium” study (published in 2007 by the Rutgers University School of Law, Business Law Journal) built upon recent academic research showing that firms cross listed on a

U.S. exchange, such as the NYSE or NASDAQ, benefit from, on average, a sustainable valuation premium of 33% over companies that do not cross list. The Citi study demonstrated that, on average, companies with liquid DRs, whether cross-listed or direct-listed, had higher valuations, as measured by their price-to-book-value ratios (P/BVs), than those with less liquid DRs.

### **Limited two-way market**

Several countries maintain restrictions on the issuance of DRs. In this “limited two-way market”, after withdrawal and sale of ordinary shares from the DR facility, the shares are subject to limitations on redeposit into the DR facility. Deposits may only occur up to a certain limit. Once that limit is reached, the DR facility is closed for re-issuance. In contrast, most countries have a free two-way market, where foreign investors may purchase at any time outstanding ordinary shares in the local market for deposit into the DR facility.

Relaxed restrictions may benefit issuers through:

- Increased possibility for immediate issuance of DRs.
- Enhanced liquidity over time. Ability to issue and cancel the company’s DRs potentially enhances trading activity. Associated advantages are higher investor demand and higher valuation.

- Decreased risk resulting from lower share-price volatility. Due to larger pool of a company’s stock, changes in supply and demand yield smaller price changes.
- Broadened opportunity for non-U.S. investment in local market.

The DR premium is the differential between the ordinary share price in the local currency and the price of the DR, which is quoted and traded in U.S.\$\$. Historically, when the U.S. market outperforms the non-U.S. market, the premium grows. When the local market outperforms the U.S. market, the premium shrinks. The limited two-way market promotes cross-border liquidity up to a point, but does not significantly reduce the size of the DR premium compared to a one-way market.

### **U.S. securities regulations and DRs**

Issuers of DRs must comply with the regulations of the markets in which their DRs are issued. In the United States, the Securities and Exchange Commission (SEC) was created as an independent agency of the U.S. government to enforce federal securities laws, governing securities offerings, trading practices and persons dealing in the securities markets. The SEC protects U.S. investors and U.S. markets by requiring disclosure of material facts concerning issuers making public offerings of securities. The SEC is empowered to issue regulations and enforce provisions

of both federal securities laws and its own regulations.

Two key U.S. securities laws with which DR issuers must comply are:

- The Securities Act of 1933, as amended (the “Securities Act”)
- The Securities Exchange Act of 1934, as amended (the “Exchange Act”).

In short, the primary intention of the Securities Act is to provide investors with full and fair disclosure of material information regarding an issuer in connection with the offer and sale of its securities. The Exchange Act is different in that its primary intention is to provide investors trading securities in the secondary market with access to full and fair disclosure of material information about an issuer on an ongoing basis.

There have been two significant legislative moves in the past several years to heighten corporate governance compliance by issuers in the U.S, impacting non-U.S. issuers in different ways. These include

- Regulation Fair Disclosure (Regulation FD), enacted in 2000
- Sarbanes Oxley Act, enacted in 2002.

With the arrival of the more stringent regulatory climate in the U.S., some DR issuers understandably felt a need to reassess the burdens compared to the benefits of their U.S. listings. Many did not see the U.S. regulatory climate as an obstacle, given that

most countries have tightened their compliance rules in recent years. In fact, quite a few equities markets outside the U.S. have equally strict, and perhaps even stricter, corporate governance requirements. Some investor relations experts argue that more stringent standards represent an opportunity for companies to differentiate themselves. When investors calculate the risk/reward equation, there's a greater "comfort factor" with companies known to have cleared certain regulatory hurdles.

The SEC has noted issuer concerns regarding some of the burdens caused by recent corporate governance legislation. For example, the SEC has applied and is continuing to evaluate certain exemptions for non-U.S. companies from provisions of the Sarbanes Oxley Act. In addition, a series of reforms came into effect in December 2005 impacting the securities offering process in the U.S. These measures are expected to simplify access to the U.S. capital markets for both U.S. and non-U.S. companies, including those issuing DRs.

## Conclusion

Depository receipts are a winning proposition for global financial markets, benefiting non-U.S. issuers and international investors alike. For issuers, a DR program can serve to broaden and diversify a company's shareholder base, enlarging the market for its shares and potentially increasing liquidity. DRs are attractive to investors worldwide that are looking to eliminate cross-border custody safekeeping charges, and enhance the accessibility of research and price and trading information.

The depository is a key partner for the issuer, both in establishing a DR program and in developing the DR program on an ongoing basis. The role of the depository in program establishment includes advising on DR facility structure, and coordinating with lawyers and investment bankers to ensure that all implementation steps are completed. On an ongoing basis, the critical role of the depository includes issuing DRs and providing ongoing account management support to the issuer.

A crucial consideration for the issuer in selecting its depository is the depository's program of value-added services, which should be designed to bolster the company's active, consistent IR effort.

### **About Depository Receipt Services**

Depository Receipt Services, a business within Citi markets and banking, is a leader in bringing quality issuers to U.S. and global capital markets, and in promoting depository receipts (DRs) as an effective capital markets tool. Citi began offering DRs in 1928 and today is widely recognized for providing non-U.S. companies with access to the powerful global platform Citi has to offer. For information about DRs visit [www.citi.com/adr](http://www.citi.com/adr).

### **About Citi**

Citi markets and banking is the most complete financial partner to corporations, financial institutions, institutional investors and governments in the world. As a global leader in banking, capital markets, and transaction services, with a presence in many countries dating back more than 100 years, Citi enables clients to achieve their strategic financial objectives by providing them with cutting-edge ideas, best-in-class products and solutions, and unparalleled access to capital and liquidity.

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10/2007

