Securities Regulation Daily Wrap Up, ENFORCEMENT—Broker will pay $35M for improper ADR practices, (Aug. 18, 2017)

Securities Regulation Daily Wrap Up

Click to open document in a browser

By Amy Leisinger, J.D.

The SEC charged a broker with violating the federal securities laws by requesting and receiving American Depositary Receipts without possession of the requisite underlying foreign shares. According to the Commission, the broker obtained the ADRs pursuant to pre-release agreements and lent them out without owning or ensuring that customers owned the foreign shares represented by the ADRs. In addition to a cease-and-desist order, the broker agreed to be censured and to pay more than $35 million in disgorgement, interest, and penalties to settle the charges (*In the Matter of Banca IMI Securities Corp.*, Release No. 33-10401, August 18, 2017).

"U.S. investors who invest in foreign companies through ADRs have a right to expect market professionals to create new ADRs only when they are backed by foreign shares so that the new ADRs are not used to game the system," said SEC New York Regional Office Senior Associate Director Sanjay Wadhwa.

ADRs. ADRs are U.S. securities that directly represent shares of foreign companies and allow U.S. investors to invest in those companies without having to purchase shares in foreign markets. For all issued ADRs, there must be a corresponding number of foreign shares held in custody at a depositary bank. Under "pre-release agreements," brokers can obtain newly issued ADRs without depositing corresponding shares, provided that the broker owns or takes reasonable steps to determine that a customer owns the required foreign shares. In these circumstances, the broker or the customer becomes the temporary custodian of the ordinary foreign shares that would otherwise have been delivered to the custodian.

Improper ADR practices. According to the SEC, Banca IMI Securities Corp. (BISC), a wholly owned U.S. subsidiary of Italian bank Intesa Sanpaolo SpA, obtained pre-released ADRs and lent them to counterparties without satisfying the proper requirements. Contrary to the provisions in the agreements governing the pre-release transactions, the Commission alleged, individuals on Banca's securities lending desk obtained pre-released ADRs and lent them out without taking reasonable steps to determine whether they were backed by ordinary shares as required. Banca's improper handling of ADRs for several years made it possible for the ADRs to be used for inappropriate short selling and/or profiting without tax withholding around dividend record dates, the SEC found.

By this conduct, the SEC alleged, Banca violated the antifraud provisions Securities Act Section 17(a)(3) and failed to supervise its securities lending desk personnel to ensure compliance with the firm's obligations in connection with pre-release transactions, including ownership determinations regarding of the underlying shares.

Sanctions. Without admitting or denying the SEC's findings, Banca agreed to cease and desist from further violations and to be censured. In addition, the firm agreed to pay just over $18 million in disgorgement and more than $2.3 million in interest. Banca also consented to pay a $15 million civil penalty. In determining to accept the settlement offer, the Commission noted the remedial acts undertaken by the firm and cooperation afforded the SEC staff, including Banca's voluntary notation of documents likely to be of interest.

The release is No. 33-10401.

LitigationEnforcement: BrokerDealers Enforcement FraudManipulation InternationalNews