

## **OTCQX International provides access for U.S. Trading to Foreign Issuers**

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Non-U.S. companies are often eager to gain access to U.S. public markets to trade their securities and enhance both their liquidity and the company's profile. At the same time, a number remain cautious and have concerns regarding the rigors of the registration process with the U.S. Securities and Exchange Commission (SEC) and the possible burdens and exposure associated with the ongoing reporting requirements under U.S. securities laws. Increasingly, non-U.S. companies that are traded on a qualified non-U.S. exchange have found OTCQX International a desirable route for accessing U.S. trading markets.

This article provides a brief overview of the key steps for qualified non-U.S. companies to "list" their securities for trading with U.S. investors.<sup>1</sup> It is widely

understood that a non-U.S. company undertaking a public offering of securities in the United States or listing its shares on a U.S. exchange will be subject to the periodic reporting requirements under the Securities Exchange Act of 1934 (Exchange Act). A private placement of securities may be exempt from these registration and reporting requirements; however, even in the case of a Rule 144A offering (which is restricted to qualified institutional buyers (QIBs)), there will be limited liquidity in a circumscribed trading market for the securities. Therefore, an increasingly popular and efficient mechanism for non-U.S. issuers to establish trading for their shares in the United States, and thereby access the most liquid global market, is through a listing with OTCQX International.<sup>2</sup>

OTCQX, run by OTC Markets Group (OTC Markets) is a fully electronic interdealer quotation system that provides investors and broker-dealers access for trading through online and full service brokerage firms in the United States. It has two international tiers: OTCQX International and OTCQX International Premier (collectively, OTCQX International). Trades on OTCQX International are settled and cleared in U.S. time and in U.S. currency. OTCQX International is widely perceived as the preeminent over-the-counter (OTC) securities marketplace for qualified, non-U.S. companies. Many non-U.S. companies have joined the marketplace seeking to develop or maintain an active U.S. investor base without necessarily incurring the burden and expense of the disclosure and compliance obligations imposed by U.S. market listing rules and the Exchange Act, including the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley). OTCQX International is designed to be used by non-U.S. companies that satisfy the listing requirements of qualified

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address to qualify its securities for trading on OTCQX International. Readers are advised to consult with their legal advisers. This note follows the convention of referring to quotation on OTCQX as a listing, even though the SEC does not consider OTCQX to constitute a securities exchange.

<sup>2</sup> The OTC market for domestic issuers, referred to as the "Pink Sheets" market, tends to attract a different category of issuer, and has different criteria for listing, than OTCQX International, which is

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<sup>1</sup> This note does not constitute formal legal advice and does not discuss all of the legal questions that a company must

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directed at non-U.S. issuers that are listed on a qualified non-U.S. exchange.

international stock exchanges and comply with local disclosure and reporting obligations in their home countries.

As of January 31, 2014, there were 337 non-U.S. private issuers listed on OTCQX International. The roster of OTCQX companies includes significant Australian and Canadian mining and natural resource companies as well as European, Latin American, Chinese and Israeli issuers. In order to list its securities on OTCQX International, a non-U.S. company must have either a Level 1 American Depository Receipt facility (ADR Facility) or ordinary or common shares of capital stock eligible for Depository Trust Company (DTC)<sup>3</sup> treatment.

Many non-U.S. companies have found OTCQX International to be a convenient and inexpensive way to tap into the vast U.S. retail market and thereby create more liquidity for their shares. With more than 200 market makers providing liquidity during U.S. market hours and connectivity

to primary market trading, OTCQX International facilitates trading by eliminating the burdens of complex cross-border trading, currency conversions and international clearing imposed on investors.<sup>4</sup>

Non-U.S. companies can subject themselves to the requirement of registration under the Exchange Act by listing their securities on a U.S. stock exchange, doing an initial public offering of their securities in the United States, having more than 500 shareholders worldwide (with more than 300 in the United States) and more than \$10 million in assets, or having 500 U.S. shareholders regardless of asset size.<sup>5</sup> Under Exchange Act Rule 12g3-2(b), a non-U.S.

private issuer will be automatically exempt from registration under the Exchange Act if the issuer is not and does not become a Section 12 company and, therefore, is not required to file or furnish reports under the Exchange Act; currently maintains a listing on a non-U.S. stock exchange that constitutes the primary trading market for the issuer's listed securities; and has published, in English, certain information required to be made public in its home jurisdiction. Fulfilling the 12g3-2(b) exemption is a prerequisite for a non-U.S. company that wishes to have its securities, or ADRs representing its securities, listed on OTCQX International without registering under the Exchange Act.

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A question asked by many non-U.S. private issuers entering the U.S. marketplace is the degree of legal exposure they may encounter under U.S. securities laws. Overall, there is a circumscribed, but very manageable, increase in a non-U.S. issuer's exposure associated with listing on OTCQX International, assuming it is properly structured and maintained. For instance, the principal liability regime under the Securities Act

<sup>3</sup> DTC provides clearing and settlement services by making "book-entry" changes to ownership of securities. For more information on eligibility of securities for DTC treatment, see <http://www.dtcc.com>

<sup>4</sup> Examples of large companies trading ADRs on OTCQX International Premier include Adidas, BASF, easyJet plc, Gazprom Neft, Imperial Tobacco Group PLC, Roche Holding Ltd., Allianz, AXA, Wal-Mart De Mexico S.A.B. de C.V., Deutsche Telekom AG, Marks & Spencer Group Plc, AkzoNobel N.V. and Air France-KLM. Among the financial institutions listed on OTCQX International are Grupo Financiero Banorte, S.A.B. de C.V., a commercial bank from Mexico; and BNP Paribas, the largest bank in France.

<sup>5</sup> Companies, whether domestic or foreign, that are subject to registration under the Exchange Act are often referred to as "Section 12 companies," which is the section of the act that sets forth periodic reporting obligations for those companies.

of 1933, as amended (Securities Act), is only triggered when an offer and sale of securities is involved (this regime is referred to as Section 11 or Section 12 liability).

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*Experienced U.S. counsel can assist a company in preparing the application materials and processing the application through to completion.*

Since listing on OTCQX International does not require an issuer to file a registration statement or issue a prospectus, these Securities Act sections will not apply merely as a result of having securities listed on OTCQX International.<sup>6</sup>

<sup>6</sup> We do note that there may be some potential for exposure under the Exchange Act for non-U.S. companies listing securities on OTCQX International. Exchange Act Rule 10b-17 may apply even to non-U.S. companies that are not listed on a U.S. securities exchange or registered under the Exchange Act. Rule 10b-17 imposes liability for failure to give appropriate notice of a dividend or other distribution, a stock split or reverse split or a rights or other subscription offering relating to any publicly traded class of securities. However, this type of exposure

All issuers, foreign or domestic, must be mindful of the possible reach of the antifraud provisions of U.S. securities laws. A non-U.S. company would not necessarily face increased potential liability under the anti-fraud provisions of the Exchange Act solely as a result of listing on OTCQX International. Under Section 18 of the Exchange Act, issuers are liable for false and misleading disclosures in Exchange Act filings. Issuers listing on OTCQX International will not be required to make filings under the Exchange Act. In addition, disclosures made available in English under Rule 12g3-2(b) do not carry Section 18 liability.

Accordingly, a non-U.S. company will be unlikely to be exposed to Section 18 liability merely by listing on OTCQX International.

Section 10(b) and Rule 10b-5 under the Exchange Act impose liability on any issuer for manipulative and deceptive practices in the U.S. securities markets. These provisions may apply to non-U.S. companies listed on OTCQX International depending on the circumstances of the subject transaction. The question of the

can be easily managed with timely diligence and proper legal advice.

scope of liability of non-U.S. issuers under the Exchange Act anti-fraud provisions is an area of law that is somewhat in flux at present due primarily to developing case law and legislation.<sup>7</sup> Nonetheless, claims based upon the anti-fraud provisions are rare in the overall market and an issuer's risks can be successfully managed with proper disclosure and legal advice.

As noted, companies listed on OTCQX International are divided into two tiers — OTCQX International Premier and OTCQX International. To be listed on OTCQX International, a non-U.S. company, as of the

<sup>7</sup> Court decisions have severely restricted the circumstances under which non-U.S. companies can be liable under these provisions. In *Morrison v. National Australia Bank*, the U.S. Supreme Court found that these anti-fraud provisions apply "only in connection with the purchase and sale of a security listed on a [U.S.] stock exchange, and the purchase and sale of any other security in the United States." However, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 did inject an element of uncertainty by codifying the approach taken by courts prior to the *Morrison* decision, the so-called "conduct and effects" test. Under the conduct and effects test, non-U.S. companies could be liable under Section 10(b) and Rule 10b-5 based on their conduct in the United States or the effects of their conduct in the United States. The impact of this legislation on the *Morrison* approach is still not clear.

end of its last fiscal year, must have \$2 million in total assets and one of the following: \$1 million in net tangible assets, \$500,000 in net income, \$2 million in revenue or a global market capitalization of at least \$5 million. Listing on OTCQX International Premier requires a non-U.S. company to meet the financial requirements of the Worldwide Listing Standards of the New York Stock Exchange and, as of the end of its last fiscal year, to have \$2 million in total assets and either \$100 million in revenues, a global market capitalization of at least \$500 million, aggregate cash flows for the last three years of \$100 million and a minimum cash flow in each of the two preceding years of \$25 million; or \$75 million in revenue and a global market capitalization of at least \$750 million.

In addition to meeting one of the applicable quantitative tests summarized above, to be listed on OTCQX International, a non-U.S. company must establish an ADR Facility or have ordinary or common shares eligible for DTC treatment. SEC requirements for establishing an ADR Facility are significantly less burdensome than those for a registered offering and there is no

requirement that the issuer comply with the corporate governance provisions of Sarbanes-Oxley. To establish the ADR Facility, the non-U.S. company must qualify for the Rule 12g3-2(b) exemption discussed above, enter into a deposit agreement with an ADR depository (Depositary) in the United States and designate a depository in the issuer's home jurisdiction to receive the shares underlying the ADRs and have the Depositary issue depositary receipts representing the shares underlying the ADRs to U.S. investors. In addition, the issuer and the Depositary must file a Form F-6 with the SEC.

The issuer also must have a proprietary quote published by a market maker, which is required to make a filing with FINRA's OTC compliance unit before the stock can be quoted on a permanent basis. The review and clearance process can take several weeks.

The issuer must also be listed on a qualifying international stock exchange for a minimum of 40 days,<sup>8</sup> be eligible for the

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<sup>8</sup> See the List of Qualifying Non-U.S. Exchanges on the OTCQX International (<http://www.otcqx.com/qx/home>).

Rule 12g3-2(b) exemption and compliant with the rule or have securities registered under the Exchange Act, be included in a recognized securities manual (published by Standard & Poor's (S&P) or Mergent (formerly known as Moody's)) to deal with state securities law compliance<sup>9</sup> and appoint a principal American liaison (PAL) to assist with admission and ongoing compliance.<sup>10</sup>

An important efficiency of an OTCQX International listing is that non-U.S. issuers are not required to prepare and disclose any further materials solely by reason of the listing. In summary, the required disclosure consists of the materials the issuer provides to its home stock market, its shareholders and the public.

Qualified U.S. counsel can assist a company in preparing the application materials and processing the application through to completion. In a

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<sup>9</sup> Each state has its own securities laws and regulations (Blue Sky Laws) that require certain filings and disclosures. Listing in either the S&P or Mergent's Blue Sky manual will ensure compliance with most state law disclosure rules.

<sup>10</sup> An issuer can appoint as its PAL any attorney, investment bank or ADR depository included on the PAL List (<http://www.otcqx.com/qx/home>) published on the OTCQX International website, or as otherwise qualified.

number of instances, approval of listing can be obtained in several weeks following the submission of the application materials.

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