SEC fines Citibank $38m for mishandling ADRs

By Editorial Staff *Thu, Nov 8, 2018*

Citibank improperly pre-released ADRs to brokers in thousands of transactions, the SEC found, when neither the broker nor its customers had enough foreign shares. This led to inappropriate short selling and dividend arbitrage.

Citibank N.A. has agreed to pay $38.7 million to settle charges of improper handling of "pre-released" American Depositary Receipts (ADRs), the Securities and Exchange Commission (SEC) said in a bulletin this week.

U.S. securities that represent foreign shares of a foreign company, known as ADRs, must be matched by an equal number of foreign shares in custody at a depositary bank. They are subject to a practice called "pre-release."

Pre-release allows ADRs to be issued without the deposit of foreign shares if a broker or its customer owns the required number of foreign shares and if the brokers receiving them have an agreement with a depositary bank.

But Citibank improperly pre-released ADRs to brokers in thousands of transactions, the SEC found, when neither the broker nor its customers had enough foreign shares. This inflated the number of a foreign issuer's tradable securities, which led to inappropriate short selling and dividend arbitrage.

The SEC action against Citibank was its second against a depositary bank and sixth against a bank or broker amid an ongoing investigation into abusive ADR pre-release practices.

"Banks and brokerage firms profited while ADR holders were unaware of how the market was being abused," said Sanjay Wadhwa, senior associate director of the SEC New York regional office.

Without admitting or denying the charges, Citibank agreed to pay more than $38.7 million, including a return of more than $20.9 million in profits from the illegal practices, $4.2 million in interest, and a $13.5 million penalty, the SEC release said. The SEC order acknowledged Citibank's remedial acts and cooperation.

Andrew Dean, Joseph P. Ceglio, William Martin, Elzbieta Wraga, Philip Fortino, Richard Hong, and Adam Grace of the SEC's New York office conducted the investigation under Wadhwa's supervision.