Issuer Services

Blue Sky Laws: A Guide for Issuers

In addition to U.S. federal securities regulations, blue sky laws are state securities laws designed to protect investors against fraudulent sales practices and activities. The term 'blue sky' comes from a statement made by a Kansas Supreme Court justice about "speculative schemes which have no more basis than so many feet of blue sky." In 1956, with the passage of the Uniform Securities Act, a template was established that most states follow today in drafting their respective laws.

Overview:

While blue sky laws vary from state to state, most typically require companies offering or selling securities, including American Depositary Receipts (ADRs), to register them before they can be eligible for purchase in a particular state, unless a specific state exemption is available. The laws also license brokerage firms, their brokers and investment adviser representatives to participate in transactions in the respective states. Assuming the brokers involved in a transaction meet the state's licensing requirements, the following are the different ways issuers can achieve relief from compliance with additional state registration requirements.

Exemptions for "Federally Covered Securities" ("NSMIA"):

In 1996 Congress enacted the National Securities Market Improvement Act (NSMIA) to promote capital market efficiency and delineate where federal law supersedes state law in terms of regulating securities. Specifically, this law established 'federally covered' securities that are exempt from state compliance requirements, such as:

1. Securities listed on the New York Stock Exchange, Nasdaq Stock Market and Chicago Stock Exchange, among other national exchanges with equivalent listing standards, as defined by the SEC. Equivalent securities (rights and warrants) and related senior securities (debt and preferred shares) are also considered exempt.
2. Securities issued by 1940 Act registered investment companies.
3. Specific securities issued by the Government/Federal Reserve, securities issued by an out-of-state municipal issuer, and private transactions covered under Regulation D of the Securities Act of 1933.

Based on the above exemptions, the only Depositary Receipt securities that would require blue sky compliance in different states are certain OTC traded securities including Level 1 ADRs, because they are not traded on an exempt exchange or platform. For these securities, state regulation compliance or an exemption are needed to be able to offer securities to each state's residents. Without them, liquidity could be hampered due to a restricted investor base. However, there is relief for Level 1 issuers based on the following additional exemption criteria.

Unsolicited Transactions:

An exemption to state laws is available if brokers receive unsolicited buy or sell requests directly from clients. However, the broker has to ask each customer to acknowledge in writing the unsolicited nature of their order and maintain such records in case of a legal dispute. Due to this burden, some broker-dealers simply avoid non-exempt securities.

Manual Exemption:

A more concrete blue sky exemption exists for secondary market transactions (i.e., excluding new issuances) under a 'manual exemption' clause accepted by most states. This allows transactions in non-registered securities including Level 1 ADRs if the issuer publishes information in a nationally recognized manual, such as Mergent. Specifically, the publication should include information on the issuing company's executive structure (officers and directors) along with the balance sheet and income statement for either the current year or the preceding year. All states and territories, except Alabama, Illinois, Kentucky, Louisiana, New York, Pennsylvania, Tennessee and Virginia, recognize the manual exemption in some form.

Further relief is available to the issuer for the following states:

1. Illinois – Foreign Private Issuers are considered exempt from state registration requirements if they are Rule 12g3-2 (b) compliant, (a prerequisite for establishing an unsponsored ADR program).
2. New York – All Securities including ADRs sold by a state-registered broker-dealer are considered automatically exempt.

For further details on each state's stance on manual exemptions, refer to this link: Manual Exemptions.

As of July 2020, the OTCQX Market has Blue Sky status in 37 states and the OTCQB Market in 33 states. The states are: Alaska, Arkansas, Colorado, Connecticut, Delaware, Georgia, Hawaii, Idaho (OTCQX only), Indiana,

Iowa, Kansas (OTCQX only), Kentucky, Louisiana, Maine, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, New Mexico, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Dakota, Tennessee, Texas, Utah, Vermont (OTCQX only), Virginia (OTCQX Only), Washington, West Virginia, Wisconsin and Wyoming.
All these states except for Kansas and Vermont also recognize the OTCQB Venture Market under the manual exemption.

About Citi's Depositary Receipt Services:

Citi Depositary Receipt Services is a leader in bringing quality issuers to global capital markets and in promoting DRs as an effective capital markets tool. Citi began offering DRs in 1928 and today is widely recognized for providing issuers with its powerful global platform, facilitating access to a global network that issuers can use to build and grow their DR program.

In support of a depositary receipt program, Citi Depositary Receipt Services provides issuers with access to the following value-added resources:

- Global sales and equity distribution network with access to large and mid- tier institutional investors.
- Dedicated Account Management team – enabling a single point of contact for comprehensive support.
- Specialized Structuring and Implementation team that facilitates the efficient execution of transactions.
- Innovative Product Management team to develop solutions for enhanced access to markets and investors.
- Investor Relations (IR) counsel – a team of former in-house corporate IR executives who consult and support clients in all aspects of their global IR objectives.

Citi's commitment to provide issuers with access to a comprehensive suite of value-added resources, including a combination of global reach and local expertise, access to an industry-leading global equity distribution network and specialized global investor relation support, help Citi win key depositary bank mandates.

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