Public Offerings of Securities in the United States by Mexican Companies: U.S. Securities Law

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There are several reasons why Mexican companies go to the U.S. market and subject themselves to the regulatory regime of being a public company in the United States. The process of an Initial Public Offering (IPO)\(^1\) of a Mexican company in the United States and the continuous reporting requirements must be considered. Another consideration when entering the U.S. market is where the Mexican countries will be in the future.

I. MEXICAN COMPANIES CONDUCTING PUBLIC OFFERINGS IN THE UNITED STATES

The initial question is why do Mexican companies go public in the United States? The reasons are found in the state of the Latin American securities markets and the lower cost of capital in the United States. Also, the preference of Mexican companies to enter the markets is fueled by three elements: liquidity, transparency, and oversight of the U.S. markets. These markets are more liquid and more transparent. The oversight and enforcement regimes are elements that investors view favorably. Also involved are corporate governance issues. The continued working assumption is that there is a "Mexico discount". Not withstanding the country risk or the corporate governance risk, the same company that is listed on the Mexican Bolsa\(^2\) or has its American Depositary Receipts (ADRs)\(^3\) listed on the New York Stock Exchange (NYSE)\(^4\) is going to get better pricing for its securities on the NYSE. This is a result of the three elements: liquidity, transparency, and oversight. Companies are raising capital for the purpose of capital increases. One advantage of capital increases is that companies will seek to use U.S. listed securities as acquisition currency.

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1. An Initial Public Offering is the first sale of stock by a company to the public. IPOs are often smaller, newer companies seeking equity capital to expand their businesses.
2. The Mexican Stock Exchange [Bolsa Mexicana de Valores (BMV) or Bolsa] is a private institution, legally incorporated as a limited company with variable capital that operates under a concession from the Ministry of Finance and Public Credit and is governed by the Securities Market Act.
3. American Depositary Receipts A stock representing a specified number of shares in a foreign corporation. ADRs are bought and sold in the American markets just like regular stocks. An ADR is issued by an U.S. Bank, consisting of a bundle of shares of a foreign corporation that are being held in custody overseas. The foreign entity must provide financial information to the sponsor bank. 56 FR 24420,24421.
4. New York Stock Exchange - The largest stock exchange in the United States. It is a corporation, operated by a board of directors, and it is responsible for setting policy, supervising Exchange and member activities, listing securities, overseeing the transfer of members' seats on the Exchange and judging whether an applicant is qualified to be a specialist.
A Company that raised capital for the advantage of a capital increase is Grupo México. In the last year, Grupo México, a mining company, acquired ASARCO. At the time, Grupo México was not public and had to make the ASARCO acquisition through a cash offer. Had Grupo México been a public company, it might have been able to make the acquisition at a much lower cost of capital. This will likely be the driving force behind Mexican companies seeking to go to the U.S. market. In the future, Mexico may increase its use of shares and ADRs for executive compensation, which is a significant factor in U.S. companies.

II. THE PUBLIC OFFERING PROCESS

When Mexican companies issue their equity securities publicly in the United States, they do so in the form of ADRs, which are negotiable securities issued by an U.S. commercial bank. An ADR facility, in which the bank holds shares through a custodian in Mexico, issues depository receipts. These receipts, denominated in dollars, are then tradable on the NYSE. The principle drivers may vary in different countries. In Mexico, ADRs facilitate clearance and settlement. There are certain advantages for investors in terms of the depository. Such advantages include converting dividends into dollars and direct payment to U.S. investors. On the other hand, there are some adverse consequences of the ADR system including disenfranchisement of U.S. shareholders. In addition, U.S. shareholders do not have the opportunity to participate in shareholder meetings, shareholder voting, rights, or offerings.

The first step in the IPO process is to register the securities. The shares, as well as the ADRs, must be registered with the Securities and Exchange Commission (SEC). This is achieved by filing a registration statement, consisting of a prospectus that includes a full disclosure on the company. After drafting the disclosure, the registration statement must be filed with the SEC. Then, the SEC has four to six weeks to review the registration statement, comment on it, and amend the document as needed. Finally, the statement is re-filed. Although a lengthy process, securities can't be sold or a sale of securities consummated in the United States without an effective, SEC approved registration statement.

Another essential element of the registration statement is the prospectus. The primary component of the prospectus is form 20-F, which is the foreign issuer

5. Grupo México is Mexico's largest mining group. The Group principally engages in the mining and processing of copper, zinc, silver, gold, molybdenum and lead.

6. ASARCO was originally a consolidation of a number of lead-silver smelting companies, the Company has evolved over the years into an integrated producer of copper, and other metals. Grupo México S.A. de C.V. acquired. ASARCO's common stock in November 1999 and ASARCO now operates as a wholly owned subsidiary of Grupo México.

7. Securities and Exchange Commission (SEC) was created by Congress to regulate the securities markets and protect investors. The SEC enforces the Securities Act of 1933. The statutes administered by the SEC are designed to promote full public disclosure and protect the investing public against fraudulent and manipulative practices in the securities markets.

8. Form 20-F is an integrated form used both as a registration statement for purposes of registering securities of qualified foreign private issuers or as an annual report under the Securities Exchange Act of 1934. To conform to the International Organization of Securities Commissions (IOSCO), foreign issuers filing Registration Statements are required to use the new Form 20-F implemented September 30th, 2000.
equivalent of a 10-K° for an U.S. company. Form 20-F contains the same requirements for disclosure as the United States, with a few notable exceptions. The first exception is executive compensation. Unlike in the United States, foreign issuers are not required to disclose executive compensation of each of their officers and directors unless it is required in the home country. Further, it is used as an annual report for foreign issuers going forward once they have gone public in the United States. Another key element of the prospectus and registration requirement is the financial statement. There is a requirement that financial statements be reconciled with generally accepted U.S. accounting principles. The financial statement requirement slows down the process and is difficult for foreign companies especially Mexican companies. Also involved in the process are accountants from the local branch of one of the big six accounting firms. Inevitably, it is more time consuming and more difficult to get the financial statements of a foreign or Mexican company into a satisfactory state to be signed off on by the SEC.

UNDERWRITING

The underwriting process is another feature of the IPO process. The offering is made through an underwriting process by a U.S. financial institution or by U.S. and Mexican financial institutions as joint sponsors. Also, there are liabilities associated with underwriting an offering. One of the requirements the underwriters impose on issuers is a “comfort” letter° from their auditors. They also receive a 10-B-5 letter" from their U.S. or Mexican lawyers. A 10-B-5 letter from the institution’s lawyers states that the prospectus has been read and contains no material misstatements. The letter is something the accounting firms and law firms take seriously, despite its hindrance to the process.

LISTING A COMPANY IN THE U.S.

Once a company has done the IPO and raised their initial capital, it becomes listed. As long as a company is listed on an exchange in the United States it will be subject to ongoing reporting requirements, which are similar, but not the same as, reporting requirements for U.S. companies. The company files an annual report on Form 20-F, which is similar to a 10-K for an U.S. company. An U.S. company is not required to file quarterly reports but file a 10-Q, which contains an abbreviated full disclosure of the 10-K. While Mexican companies that are public in the United States only need to file Form 6-K. The Mexican companies disclose the

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9. Form 10-K is a company’s annual audited report filed with the Securities and Exchange Commission, due within 90 days of the end of the company’s fiscal year.
10. Comfort Letter an accounting firm’s statement provided to a company preparing for a public offering, confirming that un-audited financial data in the prospectus follows Generally Accepted Accounting Principles (GAPP), and that no significant changes have occurred since the report was prepared.
11. 10B-5 is a provision in the federal securities laws that prohibits fraudulent and misleading activities in securities transactions
12. Form 10-Q is a company’s quarterly report filed with the Securities and Exchange Commission, due within 45 days of the end of the company’s quarter.
13. Form 6-K report is used by certain foreign private issuers to furnish information: (i) required to be made public in the country of its domicile; (ii) filed with and made public by a foreign stock exchange on which its
information required in Mexico (quarterly earnings statements). This is less than the disclosure requirements of U.S. companies.

There are other advantages of going public in the United States. In the US, shareholders are required to file reports on schedules 13-(D)\textsuperscript{14} and (G)\textsuperscript{15} when they acquire ownership interest in a company of more than 5%. This is similar to the tender offer and takeover rules in the United States. The Mexican companies are subject to the tender offer regime in the United States.

THE LIABILITY REGIME

Another key element of the offering process is the liability regime. In the Securities Act of 1933\textsuperscript{16}, the public offering registration statement contains a liability for both the Issuer Company and the signatories of the registration statement. The signatories typically include the CFO, the CEO, the directors of the company, the underwriters, any experts that have provided their opinion in the registration statement, and the auditors. The liability under Section 11 of the 1933 Securities Act\textsuperscript{17} is absolute and strict for the issuers. The underwriters and the directors have a due diligence defense, which encourages the use of "comfort" letters.

III. THE FUTURE OF THE OFFERINGS PROCESS

The offerings process is quite burdensome for Mexican and other foreign companies. Mexican regulators are moving in the direction of full disclosure. In the future, it is conceivable that the Mexican disclosure regime will be equally, as burdensome, or similar, and international standards will converge. In the meantime, there remains a "Mexico discount". It is unknown whether Mexican companies will move towards acting more like U.S. companies. Although foreign private issuers are able to rely on a slightly lower threshold of disclosure, in the future they may file 10-Ks and quarterly reports. Canadian companies have already begun to file 10-Ks. The communication with analysts on a regular basis is another area that continues to evolve. As well, the investor community in Mexico is increasing. Conceivably, a growing number of Mexican companies will start looking like U.S. companies. In addition, Mexican companies are producing financial statements in accordance

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  \item securities are traded; or (iii) distributed to security holders. The report must be furnished promptly after such material is made public. The form is not considered “filed” for Section 18 liability purposes. This is the only information furnished by foreign private issuers between annual reports, since such issuers are not required to file on Forms 10-Q or 8-K.
  \item Schedule 13 (D) discloses beneficial ownership of certain registered equity securities. Any person or group of persons who acquire a beneficial ownership of more than 5% of a class of registered equity securities of certain issuers must file a Schedule 13(D) reporting such acquisition together with certain other information within ten days after such acquisition.
  \item Schedule 13 (G) is an abbreviated version of Schedule 13(D). It is only available for use by a limited category of "persons" (such as banks, broker/dealers and insurance companies) and only when the securities were acquired in the ordinary course of business and not with the purpose or effect of changing or influencing the control of the issuer.
  \item Securities Act of 1933 requires issuers to file registration statements with the Commission, setting forth information, before offering their securities to the public.
  \item Section 11 of Securities Act 1933. 15 USCS § 77k.
\end{itemize}
with generally accepted U.S. accounting principles. Although this is not yet the norm in all Mexican companies, it is possible they will move in that direction.

Another trend is the branching out of Mexican companies. For example, Telmex\(^\text{18}\) recently spun off their cellular subsidiary, which owns companies in Brazil, Argentina, Guatemala, and Ecuador. Over the next several years it will begin taking on the characteristics of a multinational company, rather than a Mexican company. The question arises whether Telmex will present itself to the market as a multinational company or continue to suffer from a discount in the price of its shares by remaining a Mexican company. There are ongoing restraints to this movement of Mexican companies. Perhaps one of the biggest impediments is the corporate governance\(^\text{19}\) issue, since shares can be listed and file disclosure reported. This is problematic only to the extent that rights to minority shareholders are still not provided. Therefore, there is still a discount.

There is also a question of control. Many of the biggest Mexican companies still remain under the control of a family or a single entity. For that reason, control is not something that is for sale in the Mexican markets as it is in the United States. However, discounted shares of Mexican companies remain.

When considering alternatives for Mexican markets that are not functioning, it is not suggested that Mexicans only consider going to the United States and acting like U.S. companies simply because they will get a better price for their shares. On the other hand, Mexican companies going to the U.S. markets will improve their disclosure, improve the Mexican markets, and may ultimately lead to a convergence of the markets. The markets will begin to interface better and the local markets will benefit as a result.

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18. Telmex is a telecommunications company based in Mexico City. Telmex is currently positioned as the regional market leader in Telecommunications, with a presence in Mexico, the United States, Guatemala, Puerto Rico, and Brazil.

19. Corporate Governance is the relationship between all the stakeholders in a company. This includes the shareholders, directors and management of a company, as defined by the corporate charter, bylaws, formal policy and rule of law.