THOMSON REUTERS

EXTEL
IDENTIFYING EXCELLENCE

Investor Perceptions on ADRs

Commissioned by Deutsche Bank's Depositary Receipts group

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EXECUTIVE SUMMARY

Thomson Reuters Extel was commissioned by Deutsche Bank to undertake a study of investor perceptions on the American Depositary Receipts (ADR) market, to gain feedback and metrics on sentiment, policies and advantages/disadvantages around investing in ADRs. Undertaken between November 2010 and January 2011, the study comprised interviews and discussions with portfolio managers at 35 asset management firms. A full list, excluding participants requesting confidentiality, is presented in the section Respondents at the end of this report. The total equity AUM represented by responding firms is approx $1.3 trillion.

The fundamental findings are

- Investors see a range of real benefits provided through investing in ADRs. These include ease of trading, lower costs, transparency and overall flexibility and choice. But flexibility and choice are not necessarily sufficient incentives by themselves. Especially in a world where investors are still risk-averse, the greater security of sponsored and listed DR programs exerts a powerful attraction. Sponsored ADRs are notably more appealing to investors than unsponsored issues, and listed ADRs favoured by two-thirds of respondents over Level 1 instruments.

- Asset management firms do not have a centralized or organized companywide approach to ADRs, and the rationale for investing in them. It's important here to stress the distinction between **firms** and **funds**. While certain firms do run ADR-only funds, in itself an executive level decision, outside of these exceptions the decision to invest in an ADR versus an underlying share is either dictated by client mandate or made at the Portfolio Manager (PM) level.

Expanding on these points

- **THE MANDATE MATTERS THE MOST** Nearly two thirds of participants said their decision to invest in ADRs was fundamentally driven by mandates from ultimate asset holders. **'It is down to the different mandates of portfolios, sometimes you cannot invest in international stocks, but the way the prospectus is written you can buy an ADR.'** Those mandates may apply either way, either allowing ADR investment, or restricting investment to exclude ADRs – either way; they are the core basis from which an ADR decision will then flow. In this context, it is interesting that investors running wrap accounts are often those who are directed towards ADR programs. **'Our wrap accounts are ADR-only directed by our clients.'**

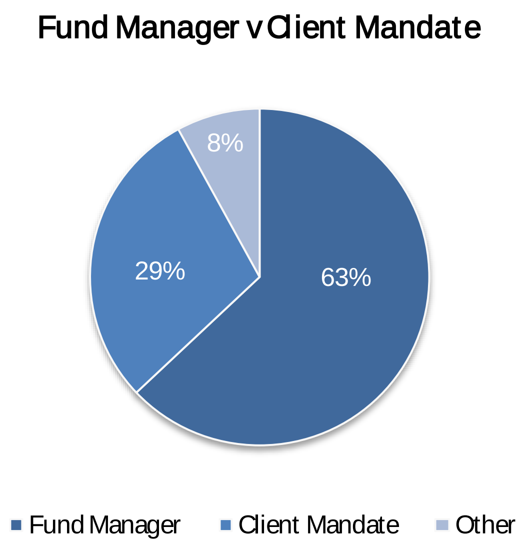
- **MANAGERS MATTER TOO** For a quarter of respondents, the ADR decision was theirs alone to take, and just then became a 'straightforward' decision on value, portfolio fit, risk profile etc. **'I don't think it's a function of the ADR versus the underlying. It's more about liquidity. It allows people to take positions that matter to their portfolios.'** As we explore immediately below, this then takes us into a range of factors that investors consider around ADRs. Yet the critical point is centered on the inherent complexity of the 'sales' story here. Not only is there no single reference point at buyside firms to focus on for an ADR program, nor is there one single value or benefit with universal resonance that encapsulates the attributes of ADRs to those investors able and willing to consider the instruments.

- **PORTFOLIO MANAGERS SEEM UNAWARE OF ANY DR INVESTMENT POLICY**
None of the respondents indicated that there was a corporate policy or edict that existed in terms of ADR/GDR investment. Quite definitely, from the portfolio manager perspective, he or she does not have a companywide policy that they are following. That is not to say such a policy may exist, even if in theory rather than practice. But, if it does, it has no material impact at the PM level. **'There is no one rule for the whole firm or any person making overall decisions on whether or not to invest in ADRs.'** Further, and as an obvious corollary of this, none of the respondents believed there was a designated executive at their firm responsible for ADR investments, or the decision process specifically relating to ADRs as an investment class. One of the major challenges for ADR/GDR issuers is to identify the right individuals on the buyside, and while the existence of dedicated 'gatekeepers' would simplify this challenge, it is our conclusion that trying to identify such 'gatekeepers' would be a fruitless task. Even those asset managers we spoke with that have a focus on ADRs as a 'preferred' investment vehicle - and among our respondents there were PMs running dedicated DR funds - made it clear that they were not operating under any internal mandate, nor was there an overseeing function at the firm that set any ADR 'policy'. Admittedly, and fairly obviously, PMs with a specific DR mandate were looking only at this asset class, but that is much

more an implicit parameter rather than any explicit directives or procedures. For these PMs, as with all others in the study, the actual investment decision was either in their own remit, or a function of the external mandate they were working with.

The pie chart below shows the breakout in terms of the key factor(s) in the ADR investment decision process.

What or who drives the ADR investment decision?



- **THE VALUES INVESTORS SEE IN DR INVESTING** To further develop the point above, although the central thrust of the study was to uncover the existence (or not) of a co-ordinated policy on ADR investments, the conversations we held with investors also gave insights into the values and benefits that encourage them to invest in ADRs. Asset managers see true value in ADRs and, especially in emerging markets, appreciate the lower trading and custodial costs, and the enhanced transparency and security that an ADR can offer. These factors are, of course, well recognized already in the market, but it does emphasize the fundamental point that ADR programs will always find a receptive audience. Investors want the facility to take advantage of investment opportunities, and see ADRs as a means to do so whilst minimizing risk exposure, and the ancillary complications, time and costs implicit in direct investment in a local issue.

- **IMPORTANCE OF EASE OF TRADING AND LIQUIDITY** While there is no single answer, investors find ADRs appealing essentially for reasons of convenience. That may be through the enhanced liquidity they offer, because trading and custody is lower cost and less complex, or because compared to the local market ordinary share, especially in emerging markets, the ADR may be a more reliable vehicle, or other reasons besides. **'Easier access to securities, generally at lower trading costs.'** The fundamental point is appreciating the need, when promoting and marketing ADRs, to focus on the specific attributes under the overall banner of convenience that the particular instrument offers.

- **COUNTING THE COST** Convenience is often equated in purchasers' minds with lower costs. Certainly, to an extent, our research here would bear this out. Investors see lower fees and charges as the most important benefit that an ADR can deliver. **'Transaction costs are definitely lower, we save having to buy and sell local currency and the custody and trading is cheaper.'** With a rating of 3.47 (on the 1-5 scalar system we use) investors scored lower costs as substantially more important than any other benefit mentioned, with disclosure/transparency rating next at 2.80.

- **SPONSORED DR PROGRAMS FAVORED** Investors clearly prefer sponsored ADRs, with nearly three quarters of respondents articulating the view that sponsored issuance was more secure, reliable and liquid. Again, concerns over convenience play an important part in the decision process in this instance too. Alongside this, when asked for their sentiment towards ADRs versus GDRs, most respondents were agnostic, and did not feel ADRs offered specific benefits over GDRs, or vice-versa. Of those who saw advantages in one or the other, ADRs were well-regarded by more respondents than GDRs, although GDRs certainly did have their adherents. **'We would rarely consider unsponsored ADRs, as although they have gained momentum, they are not as secure. It is the same with non-listed ADRs, which we would not consider at all. In the same way, we prefer ADRs over GDRs, as they require filing with the SEC, which is a tougher regulator, unquestionably. For us, and in line with our investment approach, Levels II and III are the real ADRs, and the ones that we follow.'** The message is that ADRs rule the roost, but the considerations are more about individual issue quality, liquidity and ease of trading.

- **LISTING COMES TOO** As the comment above illustrates, investors both value the added transparency and 'safety' of listed ADRs, and often consider the unsponsored/unlisted question as one side of the same coin, as it were. **'Strong preference for sponsored and listed ADRs, though we hold some OTC too.'** The point here is twofold. Firstly, with 68% of respondents expressing a preference for listed ADRs, and even more - 74% - for sponsored issues, investors are wary of the opacity and higher risk implicit in both unlisted and unsponsored issues. Secondly, investors put these considerations together, largely because the potential downside is very similar for both. Essentially, investors, when they care about it, focus on Level II and III ADRs, which are both listed and sponsored.

- **THE MERITS OF ADRs VERSUS GDRs** The pie chart on page 13 shows that for the majority (over 60%) of respondents, there is no real differentiation in their investment decision process between ADRs and GDRs. Nearly a quarter of investors focus only on ADRs, and rather less – 15% - exclusively on GDRs. In evaluating these numbers, it should be recalled that, in line with the remit of this study, we only interviewed US-based investors.

FINDINGS & COMMENTS

We present here both the metric ratings and output from the study, along with a selection of the most relevant and representative comments we collected during our conversations with investors. In presenting these findings, we have followed the core of the question set that we discussed with investors.

- ### What are your reasons for investing in ADR stocks versus the local issue?

'The ease of it, the mandate of the portfolio, liquidity and trading time zone – these are the critical factors for us. It differs by country, but there is no one rule for the whole firm or any person making overall decisions on whether or not to invest in ADRs.'

'Some clients are with firms that have investing restrictions and are unable to hold ordinary shares, so it is on a firm by firm basis on SMA accounts. This is not the case for the whole firm, it could differ by country dependent on the SMA firm, there is no overall policy about holding ADRs, it is client driven.'

'We invest in all Emerging Markets, so ADRs are very convenient. Whenever they are available and there is no large difference in price vs. the local shares, we prefer to hold ADRs. This is the case for the whole firm, differs with the availability of ADRs in different regions and is decided on a case by case basis, no overall company policy, but we think they are convenient.'

'What matters most is ease of access to securities, generally at lower trading costs. However, we will only buy level II & III. The decision to invest is down to the Portfolio Manager.'

'Liquidity, ease of trading and market access, this is the case for the whole firm. The decision differs between countries but is mainly client driven.'

'It is down to the different mandates of portfolios, sometimes you cannot invest in international stocks, but the way the prospectus is written you can buy an ADR. This is the case across the company - it is mainly driven by portfolio mandates. Sometimes we run institutional money and the mandate is domestic issues but they will allow us to hold ADRs as well.'

'We hold both ORD and ADR. It is client driven if they want to have the ability to hold them.'

'I like stocks that trade well and are not actually weak. I find that companies that have ADRs can be more transparent, their quality of accounting could be better. And lower commission cost and no direct final exchange cost, fewer problems with the trading. I make this decision but it is not a company policy.'

'ADRs are very convenient if there are capital controls and tax issues in the local market. Other than that it makes little difference to us.'

'They are easy to settle and custody. Could be easy to trade, unless if they are in the pinks. Really need to be listed in London. Isn't it all about GDR's now and not ADRs? Didn't know they still made ADRs. There is no overall company policy, down to the individual fund manager.'

'It doesn't really matter to me because I am able to buy both, so it really doesn't matter to me where a company is listed. I would tend to buy the local versus the ADR, though.'

'For us it is mostly liquidity, if a stock is trading with equal liquidity we are happy to invest in the ADR, some stocks even have higher liquidity in the ADR, but generally we are indifferent to if we invest in the ADR or the local issue.'

'The most common reason for investing in ADRs is that we are prohibited from investing in the local issue by separately managed account wrap programs. In some markets there are high costs associated with registering to trade in the local market, and, as a result, the ADR may be a better option. We may also invest in ADRs when there is better liquidity or a better price at the time the order is placed. This goes for the whole firm, we don't tend to change or define our decision by country, but there is no overall company policy or one person making the decisions on ADRs.'

'It's down to convenience. I just think we predominantly invest in ADRs over here. That is even allowing for instances where we focus on investment internationally, where we buy international locally or buy some local shares because you can't achieve everything in ADRs. Still even then we prefer and tend to use ADRs for some reason. But mainly for the rest of the firm ADRs are much more convenient.'

'I have no opinion on that. I don't think it's a function of the ADR versus the underlying. It's more so liquidity. It allows people to take positions that matter to their portfolios. I don't think that's a function of the ADR or the underlying stock. I think it's more of the size of the company and the free float. One issue is local tax, every time you make an investment you have to pay this tax. I don't have to do that in the ADR, so that's fine.'

'We are able to invest in both. I am not biased one way or the other. Having the ADR definitely facilitates companies in their exposure globally to investors.'

'I don't differentiate between one or the other, although if we can, we invest in the ADR. It's always better to have an ADR.'

'I'm indifferent between the merits of ADRs and GDRs, and don't feel the need to change my current approach. As long as there is enough liquidity in ADRs I'll stick with ADRs.'

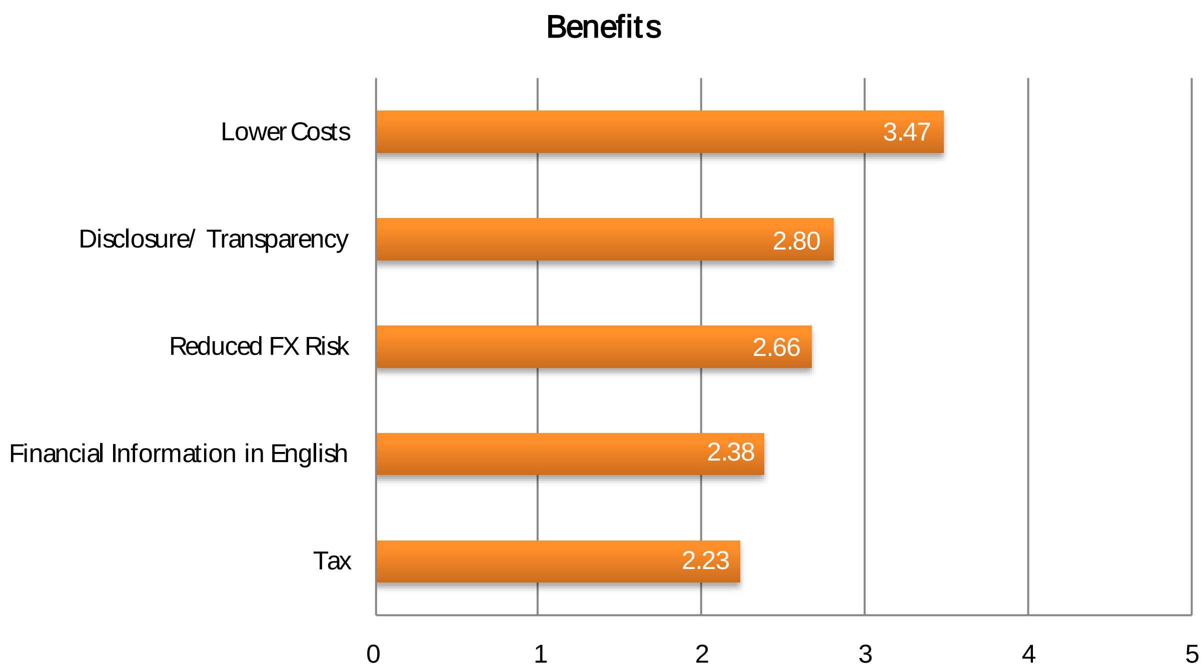
'For us liquidity is important in the decision to invest in the ADR or not.'

'Having an ADR opens up the stock to investors who can't particularly invest locally. However liquidity in the ADR is very important.'

'There is no major influence. US-based investors prefer to use the ADR as a vehicle. I just think it's great that the ADR exists.'

'ADRs must have high liquidity, this helps provide access to lots of investors, including state pension funds in the US that would not otherwise be able to buy local shares due to mandate.'

- **What do you see as the key benefits/advantages to investing in DRs?**



The graph shows the average rating of respondents' views on a scale of 1 to 5, where 1 equals strongly disagree and 5 equals strongly agree.

'I do not know if lower costs and tax issues have been proven to be a benefit of ADRs, though we are currently weighing these items to determine if they would benefit our clients.'

'Transaction costs are definitely lower, we save having to buy and sell local currency and the custody and trading is cheaper. That is the major benefit. Conversely, taxation is not a big issue for us.'

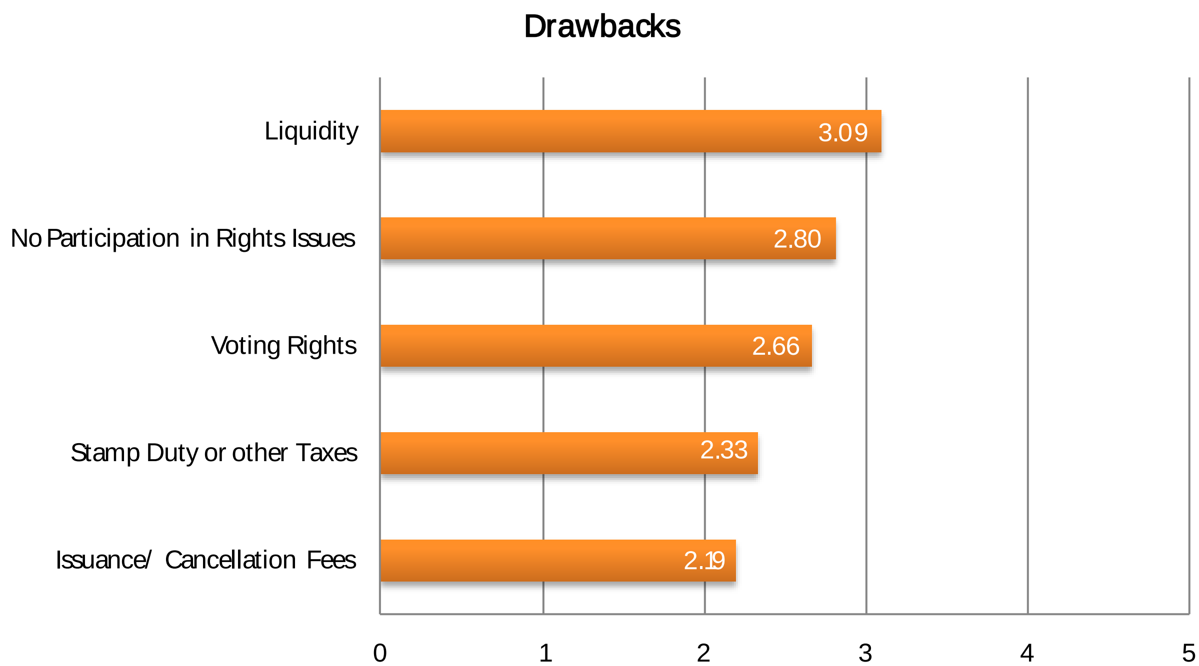
'Disclosure is appreciated so only fully registered ADRs are a realistic option for us. In general all companies give information in English nowadays so there are no language problems, and that is not a factor that has any discernable influence on our decision process.'

'I don't see any huge pros or cons with investing in the ADR, or at least none that are significant enough for us.'

'Custody costs are a little lower and if it is a listed ADR companies have to file with the SEC, and we like that. So the fact that they have an ADR is very good and we do prefer the ADR partly because it's cost issues. Other than that it is largely immaterial. The ADR is just sort of shares in an envelope.'

'It depends on which fund we are investing through because some funds are geographically allocated in different regions and in some cases there is a tax issue.'

- **What do you see as the major drawbacks/disadvantages to investing in DRs?**



The graph shows the average rating of respondents' views on a scale of 1 to 5, where 1 equals strongly disagree and 5 equals strongly agree.

'No participation in rights issues; some companies make arrangements to allow it, but in general they do not register such offerings with the SEC and investors have to sell their rights. That is a negative for sure.'

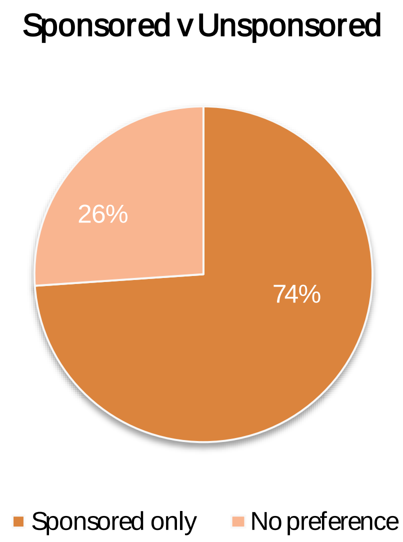
'When we are looking at a GDR program, from a US investor point of view, the information is more restricted than it is for non-US investors, as we cannot receive research on new IPOs.'

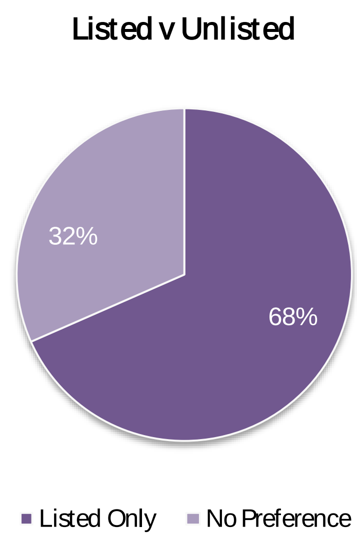
'Lack of liquidity is top of the list for me. That is critical in having control and confidence in my portfolio.'

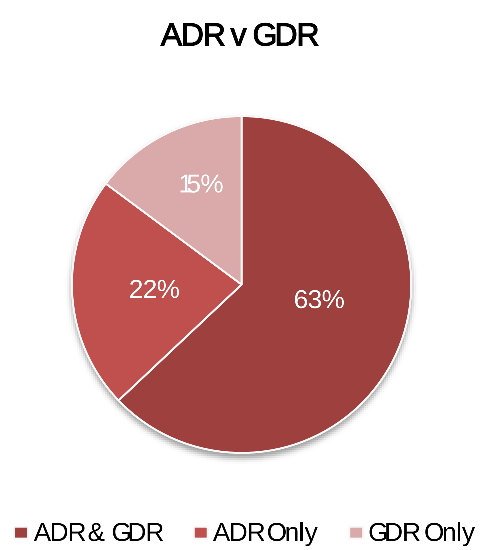
'Quite a lot – to be honest. That's why I said we focus on sponsored, level II or III ADRs. Anything else can be expensive, can offer liquidity concerns, and voting rights don't exist.'

'They can be too costly to get into, with potential for cancellation fees. Concerns around liquidity are top of the list for me.'

- **Do you differentiate in your investment decisions between different types of DRs?**







‘I prefer sponsored and listed ADRs, and prefer ADR over GDR.’

‘I have no particular preference for the different types of DRs.’

‘We would rarely consider unsponsored ADRs, as although they have gained momentum, they are not as secure. It is the same with non-listed ADRs, which we would not consider at all. In the same way, we prefer ADRs over GDRs, as they require filing with the SEC, which is a tougher regulator, unquestionably. For us, and in line with our investment approach, Levels II and III are the real ADRs, and the ones that we follow.’

‘We only invest in sponsored and listed DRs, we don’t differentiate between ADR and GDR.’

‘Strong preference for sponsored and listed ADRs. We hold some OTC. We only manage Emerging Markets so mostly hold the GDR but will hold ADR where available.’

‘I don’t differentiate between the different ADRs, but I don’t invest in GDRs.’

‘I trade where there is most liquidity so it doesn’t matter if they are sponsored or listed or not.’

‘We prefer sponsored, listed ADRs over unsponsored, non-listed or pink sheet ADRs. However, as long as liquidity and spreads are reasonable, we will invest in all types of ADRs. We rarely invest in GDRs because most of our clients are prohibited from investing in them.’

- **How does the DR versus ORD decision-making criteria apply to individual actively managed funds versus particular product types (e.g. Wrap accounts, SMAs, index funds) versus the policy of the institution as a whole?**

‘Our wrap accounts are ADR-only directed by our clients. Where clients have the ability for ORD, we have a strong preference for the ORD issue.’

‘There is no difference other than what the mandate dictates.’

‘Based on a firm by firm basis, where the said firm can or cannot hold ordinary shares.’

‘We definitely prefer sponsored and listed ADRs.’

‘It’s down to the mandate of the fund.’

‘When there is no limitation against investing in the DR vs. the ORD, the decision-making criteria are the same across funds and product types.’

STUDY SCOPE & PROCESS

Based on discussions with Deutsche Bank, a tightly focused question set was finalized. This included both metric-based questions (where respondents provided a rating on a 1 to 5 scale); and more open questions, designed to elicit commentary and feedback.

Thomson Reuters Extel utilized our extensive databases of buyside firms and individuals to identify PMs based in the United States holding ADRs within their portfolios, with an overall focus on larger, more influential buyside institutions. The question set was emailed to these investors, in the first instance, based on our widespread experience that this adds to recognition and concentration when then the respondents are contacted directly. All respondents were then followed up by telephone to ascertain their interest, and to encourage and collect commentary and responses.

The study was undertaken from 8th November 2010 through to 14th January 2011, with a total of 35 verified responses received from PMs at 35 separate fund management institutions. We provide in the following section – **Respondents** - a list of the participating institutions. A key intent in the study was to seek to gain as deep a response as possible from different buyside firms, as we wanted to uncover whether different institutions had a specific policy (and policy-holder) towards ADR investment. Additionally, when considering respondent bias, the provision of views from individuals at different organizations minimizes any chance of respondent collusion, or provision of a 'company answer' rather than a considered verdict from an investment professional.
All responses were collected directly through telephone conversations, with the exception of three responses received by email. In all cases the interviews were conducted by members of the Thomson Reuters Extel perception study team, with three team members in New York and one in London undertaking all calls and interviews between them. To eliminate any potential for interviewer bias, no one interviewer conducted more than ten interviews. Once the study was complete, all commentary and metric ratings were compiled and then calculated. For the metric data, no weighting was applied to responses from one firm as opposed to another, both as the statistically limited total of responses meant that any weighting system could introduce distortions in the findings, and as the strength and influence of the responding firms was both highly significant and of a broadly comparable level. Additionally, the nature of the study implied that equivalence should be given to all responses. While very many of the respondents both gave ratings and contributed to often lively discussions, not all respondents replied to all questions.

This report was then produced, based exclusively on the interviews and findings, and issued to Deutsche Bank on 21st January 2011. No part of this report may be republished or redistributed without the express permission of Deutsche Bank.

BACKGROUND

Depositary Receipts (DRs) have been in existence for over eighty years. With the demand from investors for DRs growing at up to 40 percent annually, fuelled by the aim of investors to diversify their portfolios, the core appeal DRs provide remains very much in force. For investors this is all about getting access to international issuers, and hence extending their portfolio opportunities without currency exposure. For companies the key attraction is to widen their potential stockholder base, and hence the liquidity pool for their stock.

Thomson Reuters data shows well over 2,000 DR programs, emanating from all parts of the world, and a current total investment level in excess of $1 trillion. There are two fundamental types of depositary receipt - American Depositary Receipt programs (ADRs), and Global Depositary Receipt programs (GDRs). ADRs offer companies listed outside of the United States exposure to US investors, while GDRs deliver the same benefit on a global scale – potentially access to any capital market - outside the issuer's domestic home.

The further key classifications for DRs are sponsored/unsponsored and listed/unlisted. Sponsored DR programs are those issued on behalf of, and in formal agreement with, the issuing company, with unsponsored DRs being issued by one or more depositary banks on their 'own book' as it were, without a formal relationship with the underlying company. Such unsponsored issuance has grown, both to match investor demand to be able to access particular stocks, and as a way for depositary banks to both respond to clients and create a market opportunity.

A sponsored Level I DR program is the easiest way for companies to access US capital markets. These are traded in the USA over-the-counter (OTC) market, and do not require listing or full SEC registration. Probably the largest single program type, Level 1 DRs can make up around 10% or so of total stockholder base for a major multinational company. Once established, many companies then migrate and upgrade and to a listed Level II or Level III DR program, which carries compliance requirements with SEC or exchanges, but gives greater transparency, and confidence, to potential investors.

RESPONDENTS

Clearly responses were only collected from USA based institutions, with in all cases specific conversations being held with PMs actively investing in ADRs as part of their portfolio. In total discussions were held with 35 buyside firms, with seven firms requesting confidentiality in terms of their participation. The list below details the names of the participating firms, obviously excluding those requesting confidentiality. No individual names of PMs are provided, in line with our data protection policy.

AllianceBernstein (Growth)
AllianceBernstein (Value)
Blackrock Investment Management
Brandes Investment Partners
Capital World Investors
Citadel Investment Group
Deephaven
Egerton Capital
Esemplia Emerging Markets
Federated Investors
GAP Asset Management
Goldman Sachs Asset Management
HSBC Global Asset Management
Institutional Capital

Janus Capital Management
JP Morgan Asset Management
Morgan Stanley Investment Management
Newgate Capital Management
Oaktree Capital Management
OAM Avatar
Olivewood Capital
Ontario Teachers Pension Plan Board
Scout Investment Advisors
Standard Pacific Capital
Talpion
Templeton Asset Management
Templeton Portfolio Advisors
Tocqueville Asset Management

CONTACTS

Thomson Reuters Extel undertakes investment industry studies worldwide, with major market studies of brokerage, buyside and investor relations performance in Europe, North America and Asia. Aligned with these market surveys, we conduct bespoke perception, sentiment and market research projects for over 70 corporations, governments, financial institutions and industry bodies around the globe. Each year we gather views, ratings and feedback from some 15,000 investment professionals.

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