

Un-sponsored ADRs

Market review, May 2015

Passion to Perform





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Market review

Broker demand has been the main driving force behind the significant expansion of the un-sponsored American Depositary Receipt (ADR) market since the October 2008 SEC rule change, with all depositary banks actively establishing programmes around the world. Issuers and investors have both acquired a greater level of understanding on how the mechanism operates resulting in the structure becoming a common feature in the equities market. In this paper, the Deutsche Bank Depositary Receipt team analyses the current state of the un-sponsored ADR market to see how the landscape has evolved over this period, together with an assessment of the level of investor interest.

What is an un-sponsored American Depositary Receipt?¹

An un-sponsored ADR (UADR) is one in which no deposit agreement and no legal relationship is entered into between a depositary bank and the issuer. An unlimited number of depositary banks may therefore issue the depositary receipts evidencing ownership of the underlying ordinary shares held in custody in the issuer's home market. It is not uncommon for all four of the depositary banks to administer an un-sponsored ADR programme for a particular issuer company. The ADRs trade in the United States on the over-the-counter (OTC) market.

The establishment of a UADR programme is initiated by the depositary bank, mainly in response to investor demand and requires no action on the company's part in the form of legal documentation or otherwise. There are no costs involved to the issuer, no incremental reporting obligations on the part of the issuer, no requirements to comply with Sarbanes-Oxley and no US GAAP reconciliation (local financial statements suffice). Though there are key differences between a UADR programme and a sponsored level I ADR programme ("Level I"), from an investor perspective – both instruments provide an opportunity for investors to access foreign securities more easily within the framework of the US securities infrastructure.

Background

On 10 October, 2008, certain amendments to the exemption from US registration under Rule 12g3-2(b) became effective, making the exemption available to many more issuers than under the previous rules.

The Rule 12g3-2(b) exemption is the key precondition to establishing a sponsored Level I or un-sponsored American Depositary Receipt programme.

A depositary bank can independently make the determination that a foreign issuer meets the exemption for purposes of establishing a UADR programme, so long as the depositary represents that it has a "reasonable, good faith belief after exercising reasonable diligence" that the issuer electronically publishes the information required by Rule 12g3-2(b) (regular financial statements, annual reports and press releases in English, for example.).

The US Securities and Exchange Commission (SEC) rule change to the claiming of the Rule 12g3-2(b) exemption has been designed to encourage the establishment of ADR facilities for more foreign private issuers. Prior to 10 October 2008, issuers had to apply for exemption under Rule 12g3-3(b). Under the new rules the exemption became automatic, conditional on the electronic publication of the information described in the previous paragraph and the issuer having a primary trading market outside the US. These changes have encouraged the formation of many new UADR programmes.

¹ 'Un-sponsored ADRs: Evolution and opportunities' (Deutsche Bank Depositary Receipts, November 2012) and 'Recent Amendments to Rule 12g3-2(b) and the practical implications for ADR issuers' (Deutsche Bank Depositary Receipts, September 2008)

UADR market

Growth and current size

The UADR market was relatively under-developed prior to the rule-change in 2008 with 169 UADR programmes in existence. Post rule-change, the number of new UADR programmes increased significantly to 1,323 by Q3 2012 and now stands at 1,579 programmes (Figure 1). The number of UADR programmes has grown more than nine times post the rule-change.

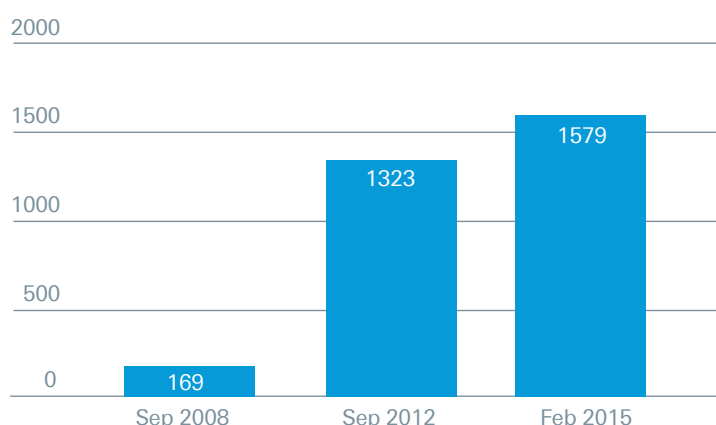
Figure 2 shows the geographical distribution of the UADR market, pre-rule change. UADR programmes were available for companies from 18 countries with Japan, UK, France, Hong Kong, Australia, Denmark, South Africa, Germany and China accounting for 90% of the UADR universe. Japan had by far the largest market share with 50%.

Widespread geographical distribution in the UADR market has now become much more prevalent. UADR programmes are available from over 40 countries, with Japan, UK, Hong Kong, Australia, Germany, Singapore, France, Italy and Indonesia appearing in the top 10 and making up 64% of the market. With an increasingly broader geographical footprint, Japan's market share has now come down to 14%.

Certain countries – such as Russia, Malaysia, India and Brazil – still do not permit the establishment of UADR programmes. India is in the process of reviewing regulations.

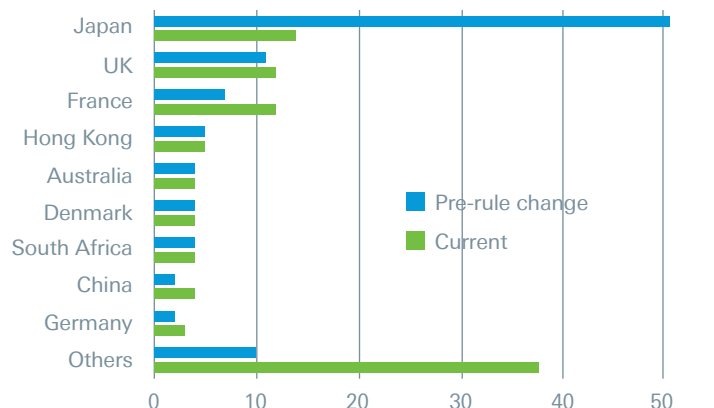
Figure 3 shows that small and mid cap companies constitute the majority of the UADR programmes. This trend has not changed since 2008 with nearly 78% of UADRs represented by small and mid cap companies at the end of February 2015.

Number of UADR programmes prior to rule change and now
Figure 1



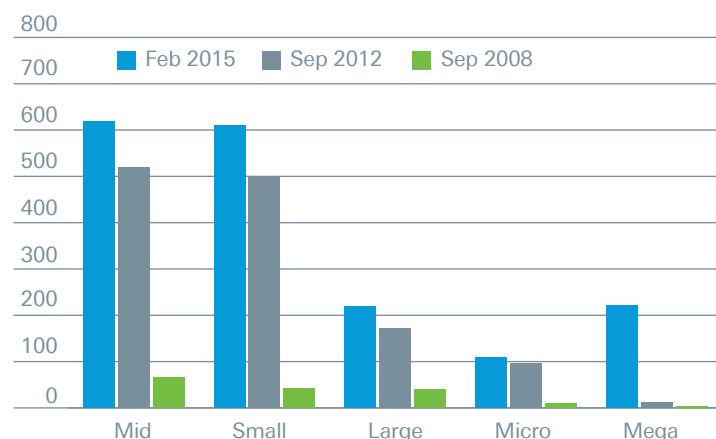
Source: Depositary bank websites, Bloomberg (March, 2015)

Country segmentation: Pre-rule change vs current
Figure 2



Source: Depositary bank websites, Bloomberg (September, 2008 & 2014)

Number of UADR programmes by market capitalisation
Figure 3



Source: Bloomberg (March, 2015)

UADR trading

Figure 4 illustrates quarterly UADR volumes, since September 2007. As expected, volumes were relatively thin prior to the rule-change, with volumes rising sharply in the preceding three quarters post-rule change. More recently UADR trading volumes have seen an upward swing in the last five quarters, hitting a peak of 823 million in the quarter-ended December 2014.

Figure 5 shows the total number of UADR programmes traded. The chart shows that there has been a ten-fold increase since the pre rule-change period. In the quarter ending December 2014, the number of UADR programmes traded totaled 815, representing 52% of the UADR universe. Interestingly, almost half the number of UADR programmes established do not trade.

However the rationale for depositary banks is that investors now have the choice to invest in UADRs and a facility is readily available should there be demand.

UADR institutional ownership

With the rise in the level of UADR trading, institutional ownership has in turn become more widespread. It is worth noting that publicly filed data for UADRs is not as readily available compared to listed ADR programmes. Public data shows that 162 institutional investors held UADRs worth USD3.6 billion in September 2008. The figure has since more than doubled to 350 institutional investors holding UADRs worth USD6.1 billion at the end of December 2014. See [Figure 6](#).

Un-sponsored ADR volumes since rule change (USD millions)

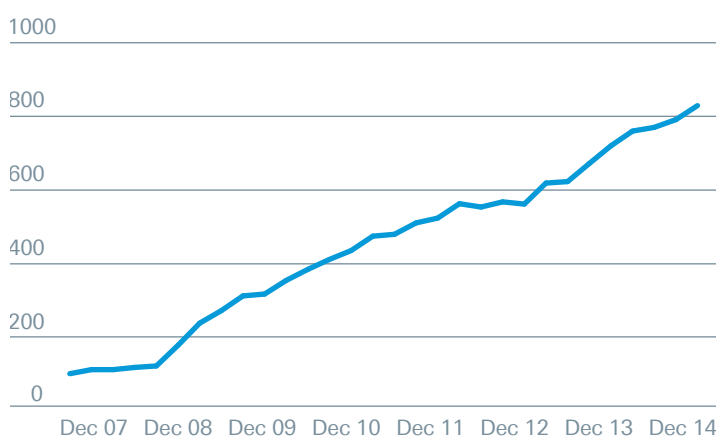
Figure 4



Source: Bloomberg (December, 2014)

Number of UADR programmes traded

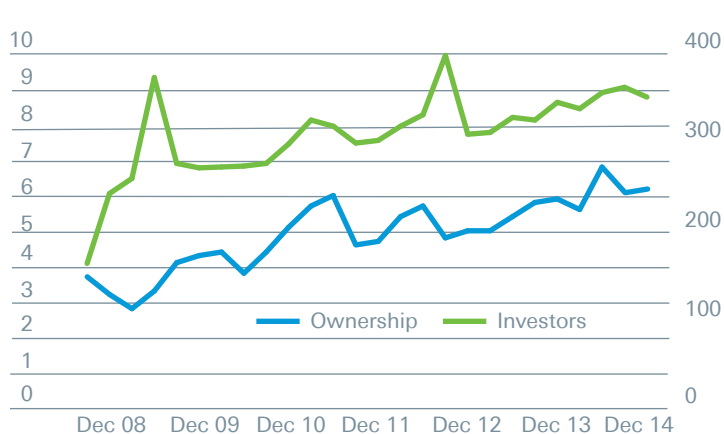
Figure 5



Source: Bloomberg (December, 2014)

Institutional investments in UADRs (USD billions)

Figure 6



Source: FactSet Research Systems Inc (2015) (December, 2014)

Table 1 lists the largest institutional investors in UADR programmes based upon the latest publicly filed data. The top three investors by value are Fisher Asset Management, Parametric Portfolio Associates and Thornburg Investment Management. Compared to our analysis in 2012¹, Thornburg used to be the largest investor but has now reduced the amount invested in UADRs from USD1.27 billion to USD0.5 billion. Fisher has remained relatively unchanged while Parametric has more than doubled its amount invested. Some of the more established investors – such as Fidelity, Brandes and

Lazard – now appear in the top 10. In terms of investment style, growth at reasonable price (GARP) investors feature prominently. **Table 2** shows the institutions with the greatest number of UADR programmes in their portfolios; Parametric Portfolio Associates has by far the largest ADR portfolio.

Many institutions – such as Lazard, Brandes and Thornburg – offer separately managed account (SMA) portfolios, incorporating dedicated ADR funds². Many of these funds will have investments in UADRs.

Top institutional investors in UADR programmes by value held

Table 1

Name	Value Held USD million	Equity Assets USD million	Holdings Style	Investor Type	Metro Region
Fisher Asset Management LLC	1,203	50,515	GARP	Investment Adviser	Seattle/WA Metro
Parametric Portfolio Associates LLC	713	59,924	Index	Investment Adviser	Seattle/WA Metro
Thornburg Investment Management, Inc.	565	49,612	Growth	Investment Adviser	Albuquerque/ NM Metro
DSM Capital Partners LLC	247	5,693	Growth	Investment Adviser	Upstate NY Metro
Fidelity Management & Research Co.	246	848,402	GARP	Investment Adviser	Boston/MA Metro
Brandes Investment Partners LP	238	14,824	Value	Investment Adviser	San Diego/ CA Metro
Lazard Asset Management LLC	212	83,782	GARP	Investment Adviser	New York City/ NY Metro
Thomas White International Ltd.	123	1,637	GARP	Investment Adviser	Chicago/IL Metro
Westchester Capital Management LLC	116	4,457	GARP	Hedge Fund Manager	New York City/ NY Metro
Water Island Capital LLC	115	2,672	GARP	Hedge Fund Manager	New York City/ NY Metro

Source: FactSet Research Systems Inc (2015) (March, 2015)

Top institutional investors in UADR programmes by number of UADRs held

Table 2

Name	Number of UADRs Held	Equity Assets USD million	Holdings Style	Investor Type	Metro Region
Parametric Portfolio Associates LLC	228	59,924	Index	Investment Adviser	Seattle/WA Metro
Glenmede Investment Management LP	100	12,535	GARP	Investment Adviser	Philadelphia/ PA Metro
Checchi Capital Advisers LLC	77	272	GARP	Investment Adviser	Los Angeles/ CA Metro
Columbia Management Investment Advisers LLC	72	161,038	GARP	Mutual Fund Manager	Boston/MA Metro
FTB Advisors, Inc.	71	669	GARP	Investment Adviser	Nashville/ TN Metro
Madrona Funds LLC	68	48	Index	Investment Adviser	Seattle/WA Metro
The Dreyfus Corp.	44	43,505	GARP	Investment Adviser	New York City/ NY Metro
PNC Investments LLC	41	1,495	GARP	Investment Adviser	Pittsburgh/ PA Metro
Aperio Group LLC	39	8,429	GARP	Private Banking/ Wealth Mgmt	San Francisco/ CA Metro
E*Trade Capital Management LLC	38	1,678	GARP	Investment Adviser	New York City/ NY Metro

Source: FactSet Research Systems Inc (2015) (March, 2015)

²'Separately managed accounts: the DR opportunity' (Deutsche Bank Depository Receipts, September 2014)

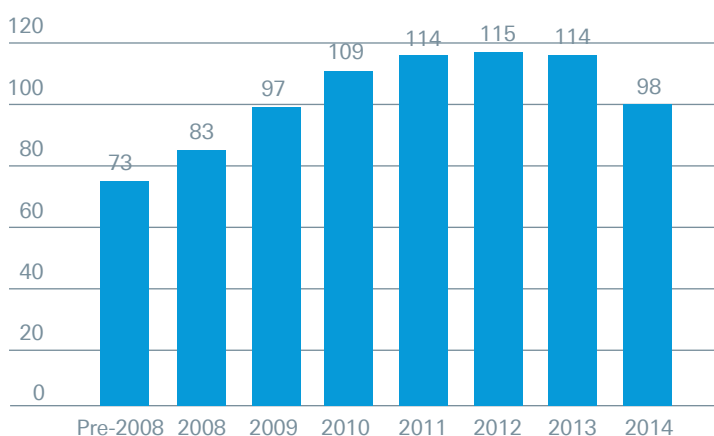
Brokers dealing in UADR programmes

There is an active dialogue between depositary banks and brokers who trade ADRs. In fact many of the requests to set-up UADR programmes originate from brokers. As the universe of UADRs has broadened, there has been a corresponding increase in the volume and the number of brokers trading UADRs. [Figure 7](#) illustrates that pre-rule change, 73 brokers publicly disclosed

their trading volume. Over the past six years, the number of brokers trading in UADRs has grown to 98, peaking at 115 in 2012. [Table 3](#) shows that the largest brokers are not only the bulge bracket firms such as Merrill Lynch, but also other players such as INTL FCStone, KCG, Cantor Fitzgerald and Canaccord Genuity.

Number of broker/dealers dealing in UADRs

Figure 7:



Source: Bloomberg (December, 2014)

Top broker/dealers dealing in UADRs in 2014

Table 3

Broker/Dealer	Value Traded USD million
Merrill Lynch	4,878
INTL FCStone Securities Inc	4,845
KCG Holdings Inc.	4,137
Cantor Fitzgerald	4,133
Canaccord Genuity	3,791
Citigroup Global	2,584
Goldman Sachs	1,726
Barclays Capital	1,647
CLSA Americas LLC	1,371
BTIG LLC	1,344

Source: Bloomberg (December, 2014)

UADR vs level I programmes

Prior to the SEC rule change, the number of sponsored Level I programmes greatly outnumbered UADR programmes. Following the rule change the trend was reversed. In addition to boosting the number of UADR programmes, the rule change did make it easier to establish and maintain Level I programmes, resulting in numerous new Level I programmes being set-up. As the

market has matured, the growth of new Level I programmes has tapered off since 2012 with 830 Level I programmes in existence, compared to 1,579 UADR programmes ([Table 4](#)). Level I ADR programmes are clearly fewer in number but are actively traded and much more widely held.

UADRs vs Level 1 ADRs comparison

Table 4

Criteria	UADR	Level 1 ADR
Number of programmes	1579	830
Number of institutional investors	350	1106
Value held USD million	6,100	37,952
Turnover USD million	44,051	98,514
Number of ADRs traded	815	635
Number of brokers	98	155

Source: Bloomberg, FactSet, depository bank websites (March, 2015)



Conclusion

Growth

Depository banks have collectively set up over 1,400 UADR programmes over the past six years with the total now standing at 1,579, representing a nine-fold increase since the rule-change. UADR programmes are now available from 40 countries.

Trading

There has been a ten-fold increase in the volume of UADRs traded since 2007, peaking in the last quarter of 2014 at 823 million. Trading is seen in 815 programmes or 52% of the UADR universe.

Ownership

Publicly filed data showed that 350 institutions held USD6.1 billion worth of UADRs at December 2014. Thornburg Investment Management and Fisher Asset Management are two of the largest investors in terms of value invested, while Parametric Portfolio Associates has the greatest number of holdings in UADR programmes.

Broker activity

Broker participation in the UADR market has risen with 98 brokers publishing their volumes at December 2014 as against 73 brokers in September 2008.

UADR programmes have become a common feature of the equities market with issuers, brokers and investors gaining a better understanding of the structure and the regulations surrounding their establishment. As international portfolio diversification strategies continue to persist with institutional investors, trading in UADRs is likely to rise further. Deutsche Bank's Depositary Receipts team has developed an expertise in UADRs and is well positioned to act as central resource for all market participants.



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