

Depository Receipts Review
2011

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Depository Receipts Review 2011

FOREWORD

I am delighted to present Oxford Metrica's inaugural issue of Depository Receipts Review. The Review aims to provide both issuers of DRs and investors therein an independent summary of developments and issues of relevance to Depository Receipts.

The last few years have seen a significant growth in DRs with some 2,700 companies around the world issuing these instruments. The BNY Mellon Composite DR Index which includes over 900 of these stocks represents a market capitalisation in excess of \$10 trillion.

We are pleased to publish our interview with Michael Cole-Fontayn, CEO Depository Receipts at BNY Mellon, a leading depository bank. The interview highlights the nature of these instruments and his view on future developments.

Reputation Review 2011 has several interesting pieces including an article from global insurers Chartis on the D&O risks faced by the management & officers of DR issuers; given the increase in unsponsored programmes we review the advantages of converting to a sponsored DR arrangement; for investors we focus on the the proven benefits of investing in DRs.

The Review concludes with an interview with Scott Cutler who heads up the listing division at NYSE Euronext which is a leading venue for the trading of listed DRs. This interview covers issues of relevance to both issuers and investors in DRs, including an update on the proposed merger of NYSE Euronext and Deutsche Börse.

We hope you will find the Depository Receipts Review a useful resource.



Dr Rory Knight
Chairman

Dr Rory Knight is Chairman of Oxford Metrica. He was previously Dean of Templeton College, Oxford University's business college.

INTERVIEW: MICHAEL COLE-FONTAYN, CEO DR, BNY MELLON

Michael Cole-Fontayn is the CEO of Depositary Receipts at BNY Mellon. Cole-Fontayn's group facilitates the establishment and trading of American, global and other depositary receipts. They help to bring a universe of international opportunities to investors.

What are Depositary Receipts?

Depositary receipts, or DRs, are equity securities that trade in an investors' market and represent an underlying security that trades in a foreign market. American depositary receipts, or ADRs, are the most popular type of depositary receipts. Simply, an ADR is a U.S. equity that directly represents the equity of a non U.S. company. BNY Mellon is the largest custodian of these assets by far; in this role we're called a depositary bank.

How is buying and holding DRs different buying and holding foreign ordinary shares?

DRs have a number of advantages including the fact that they are easier and less expensive for investors to purchase and hold. As an example, ADRs trade on the NYSE, Nasdaq, or on the over-the-counter (OTC) market; they are priced in U.S. dollars; they deliver proxy statements and information in English; and they pay dividends in U.S. dollars. ADRs typically maintain the full disclosure standards of the exchange on which they trade.

What types of companies create DR programs?

Essentially, any company that wants access to international investors, whether for valuation, liquidity or visibility would benefit. Many of our clients have employees outside their home market and want to offer employee stock plans denominated in the local employees' currency. DRs are also a good tool for international M&A since they give the company a local share for valuation. Finally branding is a primary concern – a company wants to be listed and traded where its most important customers are based.

How do DRs work? How do investors buy and sell DRs?

DRs are bought and sold just like U.S. stocks. Investors typically can buy or sell DRs through their usual brokerage account, and the cost is usually exactly the same as purchasing any other local stock.

Why do investors buy DRs? What are the benefits?

Investors are increasingly interested in expanding their portfolios globally. By being able to diversify into countries and industries around the world, investors can own best-in-industry-class companies and participate in the hottest global trends. DRs offer a simple, convenient way to overcome the obstacles to investing in foreign shares. These issues include unreliable settlements, costly currency conversions, poor information flow, unfamiliar market practices and confusing tax conventions. The depositary bank then works with the issuers to ensure all dividends are paid in U.S. dollars, and all material shareholder information is available in English.

Explain pricing and cross-trading.

Most DRs trade in their local market in addition to the DR market and currency fluctuations, as well as time zone differences create opportunities for some traders to arbitrage the differences. This added volatility ensures liquid markets in both securities.

Regardless, the price of a DR is simply a product of the home market share price, the foreign exchange value of the currency, and any ratio that may exist for the shares (one DR can represent a fraction or a multiple of the foreign share in order to ensure the DR trades at an appropriate price in the DR market.)

A cross-trade is a transaction where a broker executes an order in a foreign market for a local client. The trader will purchase the foreign shares overseas and then deposit them with BNY Mellon. We then create, or "issue" the DR.

Do mutual funds and ETFs invest in DRs?

DRs are an important part of many global and international mutual fund and ETF portfolios. BNY Mellon maintains a family of DR Indices broken out by country, sector and region, and we have partnered with ETF and mutual fund providers that create portfolios benchmarked to our indices.

Where else do DRs trade?

We've discussed ADRs, which are the "classic" depositary receipt. There are also GDRs that trade in London, Luxembourg and several other exchanges in U.S. dollars. They gained popularity in the late 90's, especially with emerging markets investors with strong ties to the UK.

But it doesn't end there. Recently capital has been shifting and new pools of investable capital are now growing in China, India, Brazil and other countries. DRs are the perfect mechanism for issuers to gain access to those investors and companies have been looking to list in those countries for many of the same reasons that companies historically create American DR programs. Companies that are interested in the BRIC (Brazil, Russia, India and China) nations may now issue or Brazilian DR (BDR), Russia (RDR), India (IDR) or Hong Kong DR (HDR) programs.

That sounds exciting, where else can companies now list DRs?

As I mentioned, the BRIC nations have all recently been launched. In addition we helped launch the first Dubai DR a few years ago and are advising on the first South African DR as well. There have been some local DRs in existence for several years, such as Taiwanese DRs, used largely by Chinese companies seeking exposure to Taiwanese investors. We are also in the process of finalizing several other types of DRs that we hope to announce sometime in 2011, so please watch this space.

This sounds like a dynamic space to be in, what is your outlook on the product as an asset class?

We obviously believe in this product and its versatility. I've been in this business for more than 20 years and the growth and changes we've seen over the last five years alone are simply amazing. We'll continue to grow and adapt to the needs of our investor clients, issuer clients and their intermediaries, and meet those needs with new innovative products. We're heavily invested in expanding our product offering and promise more solutions for our clients to come!

THE EMPIRICAL EVIDENCE ON THE BENEFITS OF DRs

Depository Receipts (DRs) provide benefits for both issuers and investors by removing the friction of international equity investment. For traders, there are practical benefits such as reduced transaction costs and the elimination of custodial charges, currency fluctuations and language barriers. For investors, DRs offer portfolio diversification and access to an expanded universe of securities. Issuers of DRs benefit from access to significant new sources of equity capital and a more diversified shareholder base.

Beyond these market benefits, there are substantial value and liquidity advantages to be gained by issuers and investors alike. These advantages stem from the reduction in the asymmetry of information between managers and shareholders. Specifically, the improved information flow, particularly in the case of listed programmes, serves to reduce the uncertainty which surrounds investors’ estimates of future cash flow and thereby reduces the firm’s cost of capital.

The improved information flow serves to reduce uncertainty and the firm’s cost of capital.

The value advantage

Illustrated in Figures 1 and 2 is measurement of this value advantage. The full universe of DR programmes is analysed; see Appendix. Value Reaction™ captures the average impact on shareholder value of establishing an over-the-counter (OTC) programme (Level I) or a listed programme (Levels II and III). All market-wide factors have been removed and the returns are risk-adjusted. The dates on which the various DR programmes started trading have been aligned such that Event Day 0 is the initial trading day for all programmes. 261 trading days reflect one calendar year. The graph encompasses a wide range of countries and market cycles which, together with the large sample sizes, ensure the rigour of the methodology.

Figure 1: The value advantage of DRs



The research results¹ demonstrate the significant value-added from the establishment of a DR programme; over 10% for listed programmes and slightly less for OTC programmes. The greater increase for listed programmes reflects the increased information disclosure integral to full registration with the Securities and Exchange Commission (SEC), reconciliation with US Generally Accepted Accounting Principles (GAAP) and annual reporting that are required for listed programmes.

¹ *Depository Receipts: Investing in a World Asset Class*, Oxford Metrica

Companies from less developed capital markets have more to gain from DRs. OM research demonstrates that, for issuers in emerging markets², the average value increase from establishing a listed programme is over 20% and, for an OTC programme, over 30%. The equivalent figures for the BRIC nations (Brazil, Russia, India, China) are 35% for a listed programme and 50% for an OTC programme.

It is possible to isolate the 'information effect' by examining the value impact on firms which upgrade their OTC programme to listed status or, conversely, choose to delist their listed programme to the OTC markets. In each case, the DR programme is retained. Figure 2 shows the stock market reaction to these decisions.

Figure 2: The value of disclosure



Firms which upgrade their DRs to listed status add an average 15% of shareholder value by doing so, in addition to the initial gain from establishing the original programme. Consistently, the average market reaction to firms which choose to delist their programmes from listed to OTC status is a fall in value of over 25%. Choosing to delist a programme sends a powerful signal to the US capital markets that corporate management has elected to withdraw from the disclosure requirements necessary for listed programmes. The firm's reputation with investors is damaged as regards the voluntary standards of governance to which management is willing to adhere.

Choosing to delist a programme sends a powerful signal to the US capital markets.

The liquidity advantage

Trading volume activity reflects the speed and intensity with which information about a firm is disseminated, digested and acted upon by investors. In the context of DRs, an increase of liquidity in ordinary share trading would indicate that the firm is now more visible, with greater access to (and from) investors, and receiving more profile and wider coverage from equity analysts.

The Trading Volume Multiplier is defined as the multiple of the previous year's average daily trading volume in ordinary (local) shares. Thus a Trading Volume Multiplier of one indicates normal trading volumes and no significant impact on liquidity. Figures 3 and 4 illustrate the positive (above one) impact on home-market liquidity from establishing a DR programme, for listed (Levels II/III) and OTC (Level I) DRs, respectively.

² *Depository Receipts: Creating Value across Emerging Markets*, Oxford Metrics

Figure 3: The liquidity advantage of listed (Levels II/III) DRs

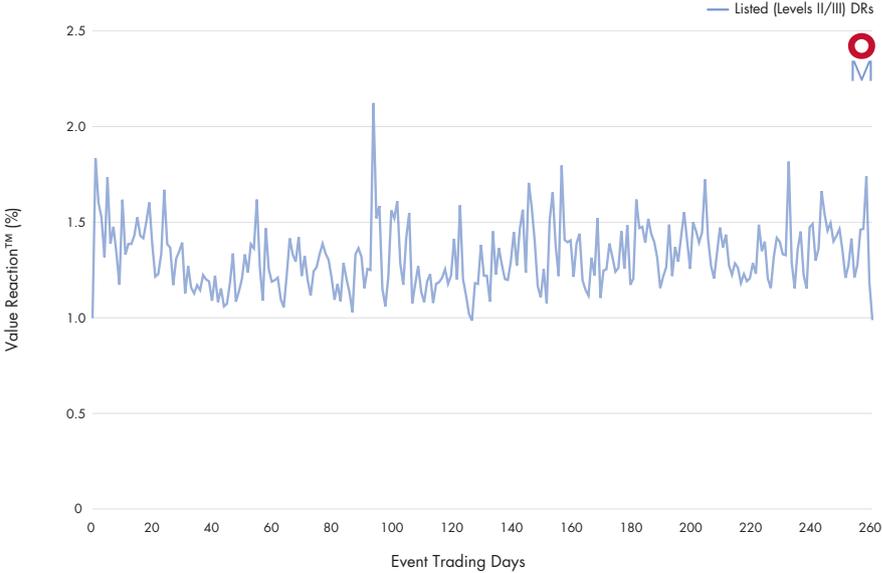
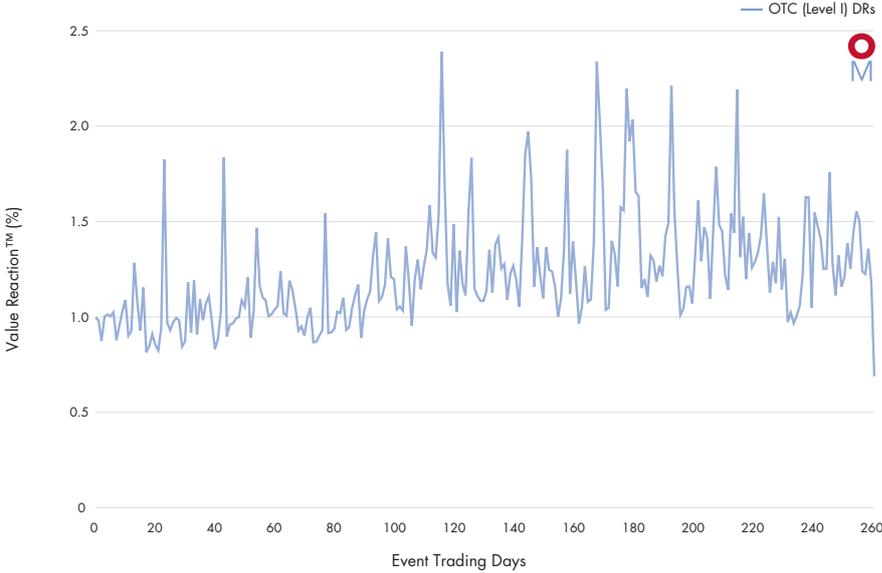


Figure 4: The liquidity advantage of OTC (Level I) DRs



The research results show that the establishment of a listed DR programme increases home market liquidity by an average of 32% over the first year of trading, while the establishment of an OTC programme improves liquidity in ordinary share trading by approximately 23%. The equivalent increases in liquidity for issuers from emerging markets are 40% for listed DRs and 48% for OTC programmes as the visibility and coverage of the issuer’s stock rises significantly.

The visibility and coverage of the issuer’s stock rises significantly.

SUMMARY

The Oxford Metrica research summarised in this section measures the value and liquidity advantages of Depositary Receipts for issuers and investors. The evidence suggests that, in addition to the direct shareholder benefits of DRs, the additional and voluntary disclosure by firms produces a powerful signal of superior governance, and encourages a virtuous cycle of reputation and value in the market.

WEIGHING THE OPPORTUNITIES AGAINST THE RISKS

by Geraud Verhille, D&O Manager Europe, Chartis

The benefits of an ADR programme are well-established: access to substantial new sources of equity capital, an opportunity to broaden the shareholder base and a new market for securities. In addition, the registered ADR securities of a foreign company can serve as a currency for acquiring a US business, whether listed or not, by means of an exchange in securities. However, setting up an ADR programme also means entering the world of US-listed companies as a "private foreign issuer". This requires being governed by the rules and exposed to potential liabilities generated by US legislation relating to securities – specifically, the US Securities Exchange Act of 1934 (the Exchange Act) which regulates the trading of securities and the Securities Act of 1933 which covers public offerings. Three key market participants utilise securities legislation: the enforcement division of the Securities Exchange Commission (SEC), the plaintiffs' bar (and its use of the class action system in US courts) and the Department of Justice (DOJ) for criminal matters. These entities are powerful and well-resourced, and this legislation provides them with substantial power. In addition, it must be remembered that the Foreign Corrupt Practices Act (FCPA) – a piece of US anti-bribery legislation – forms part of the US securities laws and applies to all companies traded on US exchanges.

What draws these three market players into action against US-listed companies is most often either allegedly incorrect or misleading "disclosure" (financial, operational or otherwise), or a lack thereof by the companies to market stakeholders. The disclosure requirements and possible exemptions vary with the level of ADR programme chosen and, in practice, there is a clear correlation between the level and the exposure to liabilities. In terms of litigation, Level I ADR issuers, which are traded over-the-counter (OTC) and have limited disclosure requirements, have been least affected historically with around 10 cases in the past 10 years. Cases against issuers with listed programmes (Level II and III ADRs) are more numerous with around 100 cases in past 10 years. As a percentage of each respective universe, it is much lower for Level I ADRs with a population of around 1,900 and significantly higher for Levels II and III of which there are around 800 programmes³.

It is vital therefore that foreign private issuers are aware of the general trends across US securities law, as well as the more specific items relevant only to them. The last ten years have seen a number of themes emerge, some of which have been exacerbated by the recent litigation and legislative change brought about by the global financial crisis. The US-listing scene, for example, has always been a dynamic environment with regular changes brought about by legislation (e.g. Private Securities Litigation Reform Act 1995, Sarbanes-Oxley 2002, Dodd-Frank Act 2010) and through additions to case law including recent decisions by the US Supreme Court.

SEC and DOJ investigative and enforcement activities may have varied over time - with a current surge driven by the political environment - but one aspect has been constant: the plaintiffs bar's appetite in seeking damages from companies, whatever their origin, that have generated losses to shareholders. Foreign issuers have not been spared, with cases such as DaimlerChrysler, Royal Ahold, Shell Petroleum, making headlines with settlements ranging between \$120 million and over a billion dollars. Beyond the headlines, however, there is substantial litigation activity involving issuers with ADRs which has led to settlements ranging from several million and several hundred million dollars, or to dismissals. Whatever the outcome, the legal expenses in defending directors, officers and the issuer are rarely below several million dollars. The same outcomes would apply to investigation or enforcement actions by the SEC or DOJ – in each case, substantial resources to cover counsel costs must be expended.

It is vital that foreign private issuers are aware of the general trends across US securities law.

³ Source: www.adrbnymellon.com at 30 April 2011

Recent history

The first ten years of the 21st century have seen steady growth in the number of class actions brought against foreign issuers. The levels of activity ebb and flow, but it is clear which way the trend is going. According to NERA, in the first half of 2010, 15.8% of all cases filed named a foreign-domiciled company as the primary defendant – just exceeding the previous peak of 15% in 2004. In fact, it is only the third time since 1996 that the proportion of filings against foreign companies exceeded the proportion of foreign companies listed on US stock exchanges.

The good news is that the most recent burst of activity, fuelled by a wave of shareholder lawsuits seeking to hold boards legally responsible for corporate losses suffered in the economic downturn, is starting to subside. In addition, some recent court decisions could have a positive effect in limiting the size of the class seeking compensation (i.e. which security holders can join the litigation).

The good news is that the most recent wave of shareholder lawsuits is starting to subside.

We would advise caution, however, before celebrating these developments since, on the negative side, companies that have issued ADRs are facing an unusual aggregation of legal and regulatory challenges, each one of which could result in investigations and/or class actions with serious financial and operational repercussions. And the plaintiffs' bar shows no sign of loosening its hold on this particular stream of class action activity. So what are the key trends companies need to keep in their sights as they navigate their way through this uncertain landscape?

"As one door closes"

US courts have been an attractive forum for all sorts of litigation, including so-called 'foreign cubed' litigation – foreign plaintiffs bringing claims in US courts against foreign issuers based on securities transactions that occurred on foreign exchanges. Access of foreign cubed plaintiffs to US courts depends on the extraterritorial applicability of US laws, in particular the antifraud provisions in Section 10(b) and Rule 10b-5 of the Exchange Act, the most used legal weapon to seek redress.

Over the last four decades, case law had built up a series of tests that looked typically at whether alleged wrongful conduct had had "substantial effects", or if "sufficient conduct" had occurred, in the United States to give US courts subject matter jurisdiction to act. Foreign cubed litigation can happen independently of whether a company has an ADR programme or not. Where extra-territorial applicability is of specific interest to foreign issuers with ADRs is whether the class seeking damages can be expanded to include foreign holders of securities; and thus making the damages requested far greater.

On June 24 2010, the US Supreme Court firmly closed the door on this particular avenue, and limited the extraterritorial reach of US federal securities law in its decision *Morrison v. National Australia Bank Ltd.* ("Morrison"). Essentially, it ruled that the Exchange Act did not create a private right of action for foreign plaintiffs to bring claims against foreign issuers based on securities transactions that occurred on foreign exchanges.

This one decision meant that the pure foreign cubed cases could be dismissed and also that judges could start reducing the size of various class actions by simply limiting the plaintiffs to the domestic holders of ADRs. Historically, the largest, so-called blockbuster settlements (i.e. greater than \$500 million) have included holders of foreign securities. Should the Morrison standard be constantly applied in practice, we should see more instances where damages sought are limited to domestic ADR holders.

“Another one opens”

Just three weeks after the Morrison decision, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act, which contains a provision that undercuts Morrison as it applies to enforcement actions brought by the SEC and DOJ. Essentially, it grants these bodies new authority to bring civil or criminal law enforcement proceedings involving transactional securities fraud. It also confirms the extra-territorial reach of these agencies in respect of the enforcement of the FCPA – a particularly hot topic recently.

While it did not go as far as extending the extraterritorial reach of Rule 10b-5's private right of action, it does require the SEC to solicit public comment and conduct a study on whether US federal anti-fraud laws should be extended to cover conduct outside the US (to be delivered by mid-2012). It also increased the power of the SEC to pursue market fraud worldwide on behalf of aggrieved US investors and lightened the burden of proof against “aiders and abettors” – both of which will mean potentially larger and more far-reaching SEC enforcement actions.

Understanding the opposition

While the pace of filings has slowed overall – mainly driven by the reduction in the number of cases arising from the sub-prime crisis – the trend for non-financial institutions cases continues on an upward trajectory. It is interesting however to look underneath the headline figures to see where the plaintiffs' bar is focusing its attention so that companies can learn from the experience of others. Once the plaintiffs' bar has invested resources in a case, it will then look to replicate its approach against other issuers. In the first instance, they are likely to target domestic businesses, then international and then particular issues.

For example, in terms of the allegations made, there has been something of a shift. While previously many cases centered on revenue recognition, more recent cases often have focused on operational issues such as sub-optimal outcomes from drug trials, product recall, unproven reserves in oil & gas companies or safety issues. There has been an increase also in the frequency of cases alleging breaches of fiduciary duty in connection with mergers and acquisitions for example alleging destruction of shareholder value.

Inevitably, these operational issues suggest that certain industries are being targeted. By sector the largest percentage increase in filings has been against health technology firms, firms in the electronics sectors and technology services sector, and in the energy and non-energy minerals sector. In the latter category several of these filings involved allegations related to the Deepwater Horizon oil spill in the Gulf of Mexico.

A longer-term trend has been an increase in cases against businesses based in South East Asia – a surprising 40% of cases have been against companies domiciled in China, Taiwan, South Korea and Japan. Some of this can be accounted for possibly in underestimating the considerable differences in regulatory requirements between local and US listings.

Boards of directors are advised to keep an eye on other companies in their sector that might face similar problems in order to assess whether their company also could be targeted. Even when the claim's arguments are weak and cases are dismissed, achieving “closure” will amount to substantial legal bills and considerable managerial time and energy.

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Looking for protection

The insurance markets are clearly one area to which businesses can look for help in managing and mitigating risks, while the legal and regulatory terrain is in a state of flux and the recent increase in litigation activity is cause for concern. The first is making sure that what you are buying in terms of insurance does the job you are buying it for – this is especially true in Directors and Officers (D&O) liability insurance, where policies' terms and conditions vary widely. Typically, a policy must provide protection for individual directors and officers facing actions brought by the SEC, the DOJ and the plaintiffs' bar. These actions will require substantial legal expense coverage as well as coverage for damages.

As recent events highlight very clearly, D&O risk is a constantly evolving area with regular new sources of liability and new legislation, driven by economic, financial and political circumstances. This means that it is important to turn to a carrier that actively takes into account such changes and captures them in the cover that it provides. The reputation, longevity and claims paying ability of each proposed carrier in a D&O programme also requires consideration. There is no point in having a policy if it does not respond when claims are brought or if there is no effective claims handling. The access to in-house and experienced claims resources - especially with specific US litigation experience - is essential to deal with claims and to support settlement opportunities as they arise.

As a private foreign issuer, there are great potential benefits from embracing US markets. Awareness of the new exposures that arise from it, following the actions of the SEC, DOJ and plaintiffs' bar, monitoring the evolving legal environment and ensuring the existence of adequate insurance protection will enable the foreign company to mitigate the potential downsides.

D&O risk is a constantly evolving area with regular new sources of liability and new legislation.

BUILDING REPUTATION WITH A SPONSORED DR

Effective 10 October 2008, there was a change in US securities law which prompted a rapid increase in the number of unsponsored Depositary Receipt (DR) programmes. Essentially, the amendment enabled an unsponsored DR programme to be established for a company, without its consent, for the convenience of US investors.

Prior to the amendment - to Rule 12g3-2 of the Securities and Exchange Act of 1934 -listed companies in markets outside the US were exempt from registration with the Securities and Exchange Commission (SEC), if such companies had fewer than 300 US investors. Relief from registration was available under section (b) of the Rule which required management to act to apply for exemption.

The amendment to section (b), however, has obviated the need for companies to apply for such relief from registration by providing an automatic exemption to all foreign companies; provided that more than 55% of share trading volume is in their primary market and that a minimum amount of English language information and financial data are available on their website.

The result is that many DR programmes have been created for foreign companies without the active participation of management.

In the year following the rule change, more than 800 companies across 34 countries emerged with unsponsored programmes. Since more than one depository bank can establish an unsponsored programme for a given company, there is the possibility for multiple versions of a DR programme to exist for the same security. Across these more than 800 public companies, 1,364 unsponsored DRs have been established.

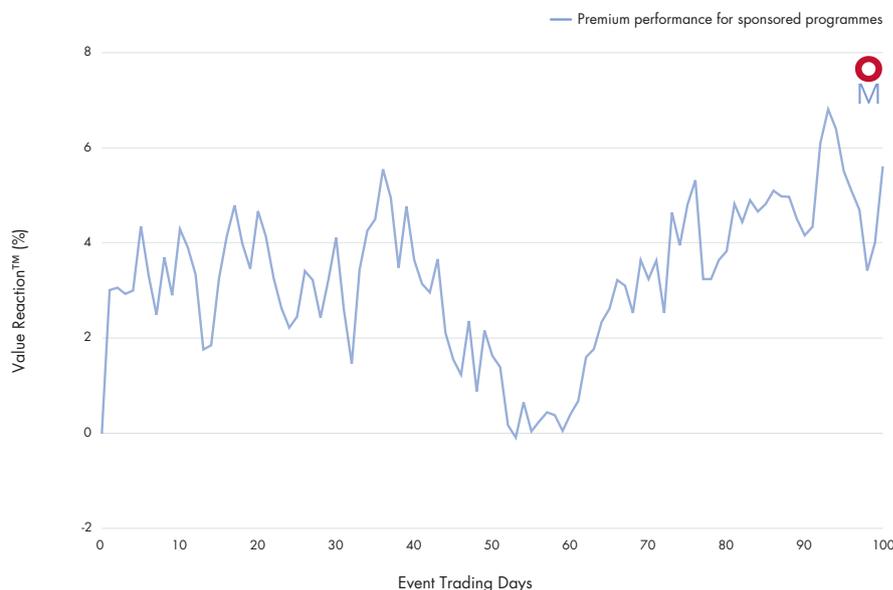
The arguments summarised in this section suggest that the existence of an unsponsored DR presents corporate Boards with a significant opportunity to build reputation and value by embracing the process and converting the DR to a sponsored arrangement.

The existence of an unsponsored DR presents corporate Boards with a significant opportunity to build reputation and value.

The value and liquidity impact

Figure 5 reveals the premium performance enjoyed by companies with sponsored programmes, over those with unsponsored programmes. The premium is the difference in local share price reaction to the establishment of sponsored and unsponsored OTC (Level 1) DRs; market-wide factors are removed and returns are risk-adjusted.

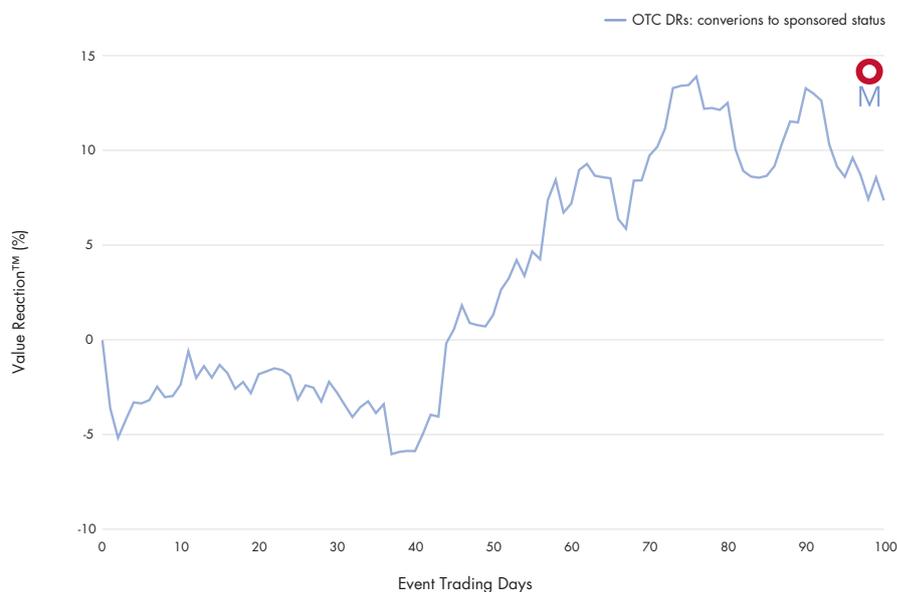
Figure 5: Sponsored programmes enjoy better performance



The graph shows that, when companies establish their OTC DR, companies with sponsored programmes experience an average value increase of 5% greater than do those companies which establish unsponsored programmes.

Figure 6 presents evidence on the impact on issuers' local share prices when converting an existing unsponsored programme to sponsored status. The results reveal that the average value added for companies which convert their DR is approximately 10%.

Figure 6: Value added from converting to a sponsored programme



The market rewards the conversion to sponsored status and welcomes the superior governance, positive investor relations and direct communication with shareholders. The companies which elected to convert their programmes have, in doing so, embraced a more direct relationship with investors and enhanced their corporate reputation.

Liquidity benefits also are generated from a sponsored arrangement. Increased visibility of the stock and wider access for US investors result in greater trading in the local shares. Oxford Metrica research⁴ shows that converting an unsponsored DR programme to sponsored status increases home market liquidity by approximately 30% as the issuer's visibility to the US investor is heightened and investor relations activities are energised.

Increased visibility of the stock and wider access for US investors result in greater trading in the local shares.

Ten reasons to convert to a sponsored programme

For firms seeking to generate and sustain their corporate reputation, conversion to a sponsored arrangement yields a number of key benefits:

- 1 **Reputation signalling.** The research results demonstrate that the reputation benefits associated with sponsored programmes are significant.
- 2 **Governance and control.** Under sponsorship, the issuer can determine informational and voting rights, the ability to participate in corporate actions, the ratio of shares represented by each DR, and any fees and charges payable by participating investors, if any.
- 3 **Proactive investor relations.** With a sponsored programme, the issuer works with the depositary to identify existing and prospective holders, and is thereby able to communicate fully and directly with investors, and engage in and control its investor relations activities.

⁴ *Building Corporate Reputation: Taking Ownership of Unsponsored Depositary Receipts*, Oxford Metrica

- 4 **Avoids market confusion.** Under a sponsored arrangement with a single depositary bank, the same fees and exchange rates apply to all holders. Investor confusion or discontent is minimised further by the depositary acting as a single source of information and provider of regular reporting.
- 5 **Support services.** Designed to enhance programme visibility, the issuer is entitled under a sponsored programme to receive support services from its depositary bank as it relates to investor relations and market knowledge.
- 6 **Strategic advantage.** Under a sponsored programme, the DRs can be used towards various strategic purposes, such as the inclusion of DR holders in rights offerings and other corporate actions, the potential to use DRs in merger and acquisition transactions, and the use of DRs to fund compensation plans for companies with US employees.
- 7 **No additional compliance costs.** A sponsored Level I DR programme entails no additional regulatory obligations to those currently disclosed in the home market.
- 8 **Access to US investors.** An issuer is better placed with a sponsored DR programme to expand its US investor base, and generate potentially a virtuous cycle between improving liquidity and reducing transaction costs.
- 9 **Potential value enhancement.** Better communication with investors reduces uncertainty around their estimates of future performance and helps to build reputation equity. Research summarised herein shows an average value increase of around 10% for companies which convert to sponsored programmes.
- 10 **Potential liquidity improvement.** With a sponsored programme, and concomitant financial incentives from the depositary, issuers can conduct targeted investor relations activities and generate greater visibility in the US market. Oxford Metrica research shows that conversion to sponsored status increases trading in the issuer's local shares by 30% on average.

Taking the initiative to build reputation equity

For Boards which discover that an unsponsored DR programme has been established for their company, there are two options. The firm may state publicly that its website disclosures are inadequate for compliance with the automatic exemption to SEC registration. However, the risk of reputation damage by doing so is significant if investors interpret the move as a reduction in disclosure for existing shareholders or as managerial reticence to communicate.

Alternatively, companies may convert their programme to a sponsored arrangement. Consequently, the issuer regains contractual control and the ability to communicate directly with its US shareholders while the US investor enjoys better information flow and reduced uncertainty. The evidence demonstrates the beneficial effects of this decision on value and liquidity performance.

While the general argument for converting to sponsorship is compelling, each company will have distinctive characteristics - relating to managerial commitment to investor relations, and trading liquidity and share ownership in the US - which render both legal advice and an individual assessment prudent.

For many companies, the discovery of an unsponsored programme is a powerful opportunity to energise investor relations and build reputation equity.

The issuer regains contractual control and the ability to communicate directly with its US shareholders.

INTERVIEW: SCOTT CUTLER, EVP, NYSE EURONEXT

Scott Cutler is Executive Vice President and Co-Head of U.S. Listings and Cash Execution at NYSE Euronext. Mr. Cutler is responsible, *inter alia*, for the NYSE listing business globally. He manages the Exchange's relationship with over 2100 companies worldwide.

What are the benefits for issuers of ADRs to be listed as opposed to being traded over the counter in an unlisted or Level 1 format?

Level 2 or Level 3 ADR programs give a company a U.S.-registered security that is traded on a public U.S. exchange. This enables the company to broaden its shareholder base and benefit from the additional liquidity and visibility provided by being on a public exchange. A Level 1, or unlisted, programme, on the other hand, does not trade on a public exchange and does not offer the same liquidity, visibility and overall opportunity. A lot of funds will not participate in the trading of Level 1 ADRs, and it is not as effective a way to tap into the US market.

Following the change in the US regulatory environment over the last few years with the perceived increase in compliance costs, is there still a net benefit to listing?

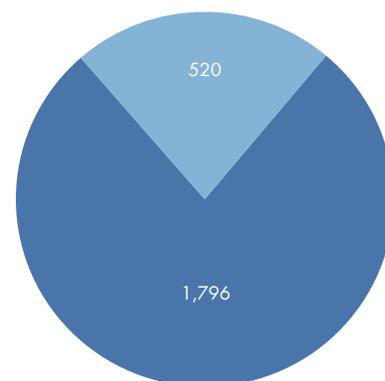
The U.S. financial system suffered setbacks over the last couple of years. Damage was done to investor confidence, and regulators are addressing some of the system's shortcomings. Throughout the crisis, the regulated, transparent markets worked very well, something that has benefited NYSE-listed companies, which were better able to weather the storm with their large and stable more diversified shareholder base.

There have been a number of de-listings of prominent ADRs in the last few years. What would your advice be to issuers considering such action?

In the last half of the past decade, we have seen some Western European companies in particular deregister and delist from the U.S. This trend has now reversed and we are seeing a strong inflow of new non-US companies, including from Western Europe. One issue a company should consider before deregistering and delisting is the impact it could have on their shareholder base. The moment they deregister, it sends a negative signal to the market. Companies should take a long-term view. The benefits of listing in the US capital markets far outweigh the costs and liabilities from sometimes stringent regulatory requirements. That is why we continue to attract so many non-US listings to the NYSE.

In your experience what key steps should a company take in preparation for an NYSE listing of their ADR program?

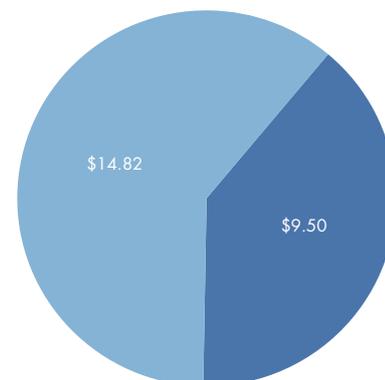
Companies should number one, be very focused and committed to being listed here. A listing in the US is not for every company, and companies have to make sure that being here we will add value to their business, and that they have a story that makes sense for US and global investors. They have to have a strong team to convey that message.



■ U.S. Domestic ■ International

International stocks make up less than 1/3 of NYSE listed stocks by number but....

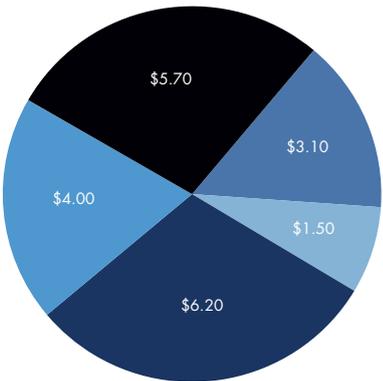
....nearly 2/3 by market capitalisation (\$t)



■ U.S. Domestic ■ International

Are there any trends in the provenance of recent ADR listings? Is there a dominant country or region, for example China, BRIC or emerging markets generally?

In the first quarter of 2011, IPOs on NYSE Euronext markets raised more capital than any other market in the world. The capital markets of Brazil and China in particular now play a prominent role on the global stage. NYSE Euronext markets currently list well over 100 companies from BRICs countries with a total global market capitalization of more than \$1 trillion, far more than any other exchange group in the world. The list continues to grow, as we see many more Chinese and Latin American companies tap into the US markets. AdecoAgro from Argentina and Arcos Dorados, also from Argentina, were two recent examples that both listed in the US earlier this year, following the record IPO by Banco Santander Brasil and the huge secondary offering by Petrobras in recent years.



Legend: Asia Pacific, Caribbean, EMEA, Latin America, Canada

Average trading on the NYSE in 2011 Q1, has been significant in all regions(\$b)

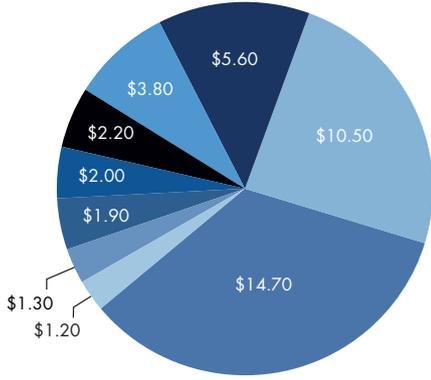
Is there a strong interest among US investors for international equities and do you expect this to grow in the coming years?

Since the crisis in 2008 we have seen a large amount of capital being reallocated to the emerging markets. We see that trend continue, especially in places like as Brazil, Colombia, Argentina, and China. These countries are growing much faster than the US and Europe. More and more investors are looking for growth opportunities and reallocating their portfolios to those markets.

There has been some consolidation in the market for Stock Exchanges reflected in various cross-border mergers of exchanges? Do you expect this trend to continue and what are the implications for DR issuers?

Financial markets are globalizing. If you look at the big banks and major financial institutions, they have already been global for more than a decade; exchanges are catching up on this trend. NYSE Euronext, the results of the merger between the former NYSE and Euronext, is the first truly global exchange group. Our proposed merger with Deutsche Boerse further accelerates our global strategy. It is important for issuers to recognize that trading has become global and they should expect trading in their securities to become more global. What we do as an exchange is provide connectivity with all these different liquidity pools around the world, using one technology to provide the most efficient trading. At the same time, companies should keep in mind that differences between the various jurisdictions of different countries remain, and that their securities cannot be traded seamlessly between one country and another. It's incumbent on the world's exchanges and the competitive environment in which we find ourselves to operate as efficiently as we can. Our goal is to be the world's leading global exchange group, providing world-class trading venues across multiple asset classes and time-zones.

NYSE Euronext leads the pack in global IPOs in 2011 Q1 (\$b)



Legend: NYSE Euronext, Shenzhen, Singapore, Shanghai, LSE, Hong Kong, Brazil, Oslo, Canada

What does the NYSE provide its listed companies?

The NYSE is very committed to our listed companies. In addition to the superior market quality, visibility and access to liquidity, we provide a strong suite of products and services that help companies navigate the US and the global capital markets. What is unique about the NYSE's offering is that our services provide sophisticated market intelligence tools across all markets, not just our markets. With the fragmentation we have seen recently in the equities markets, it can be quite difficult for IROs to understand what is driving the movement in their stock, and we see it as our job to help them.

APPENDIX: THE DR LANDSCAPE

The coverage of world equities by DRs is extensive. The diagrams below show the breakdown of depository receipts by country and region for both listed and OTC traded instruments.

Figure A1: The number of OTC DRs by region

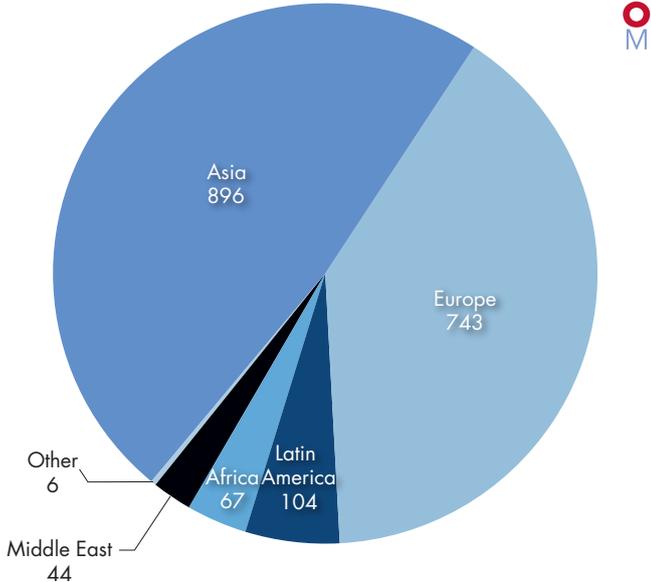


Figure A2: The number of Listed DRs by region

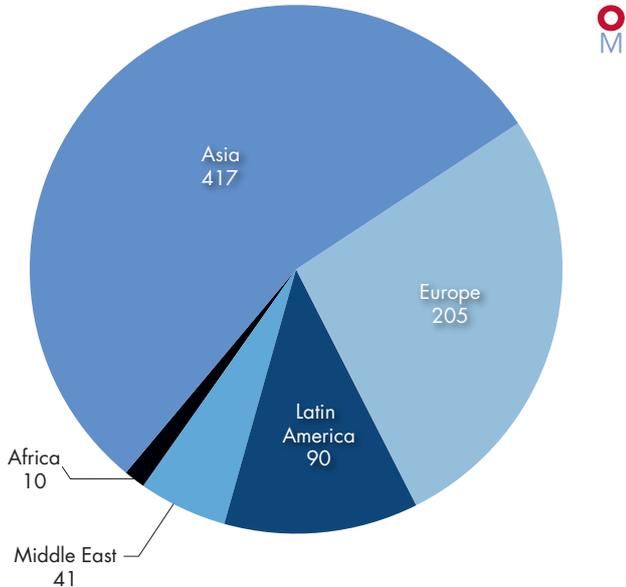


Figure A3: The number of Asian OTC DRs by country

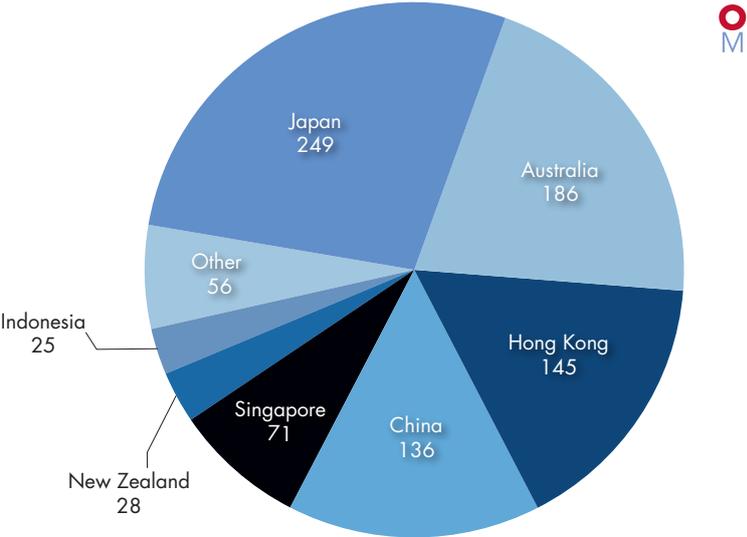


Figure A4: The number of European OTC DRs by country

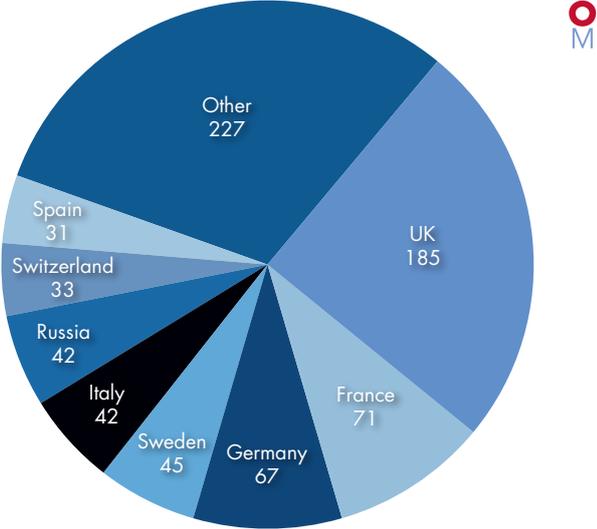


Figure A5: The number of Latin American OTC DRs by country

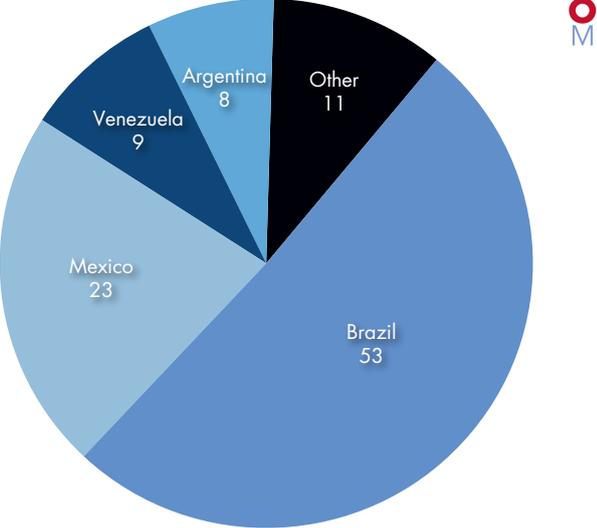


Figure A6: The number of Asian Listed DRs by country

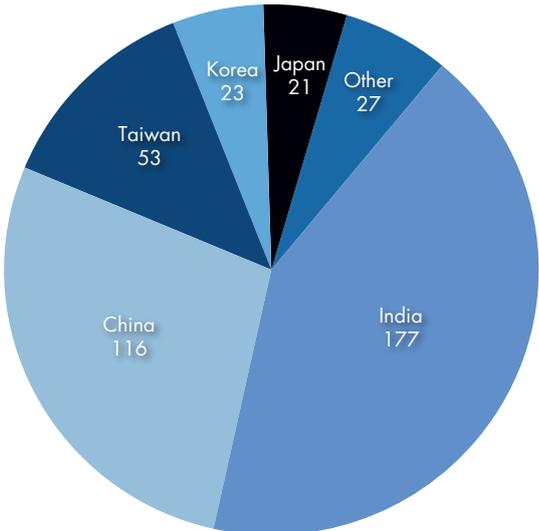


Figure A7: The number of European Listed DRs by country

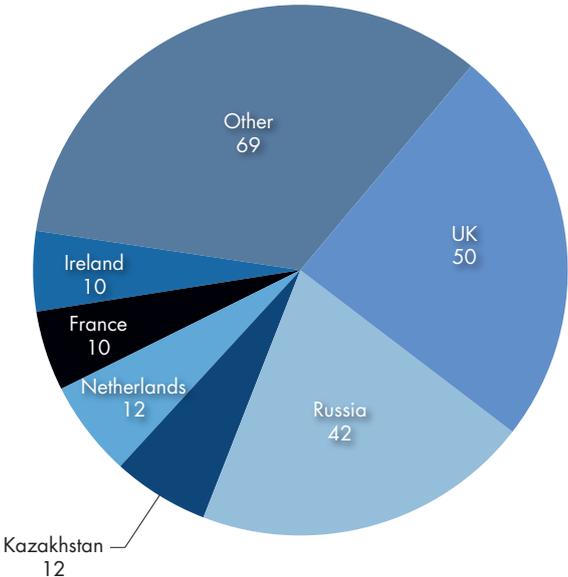
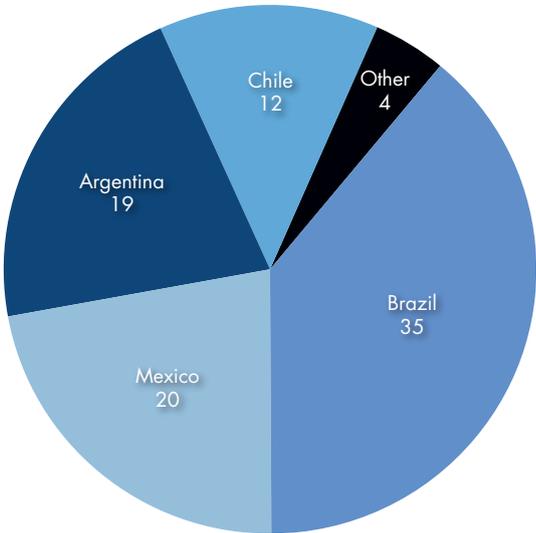


Figure A8: The number of Latin American Listed DRs by country



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