



Building Corporate Reputation:  
Taking Ownership of Un-sponsored Depository Receipts



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This Whitepaper is a summary presented for general informational purposes only. It is not a complete analysis of the matters discussed herein and should not be relied upon as legal advice.



## FOREWORD

I am delighted to present Oxford Metrica's latest Whitepaper on depositary receipts, or DRs. We have been studying and monitoring this market for more than a decade. This experience leads us to consider recent developments in the market for unsponsored depositary receipts to be significant enough to warrant the full focus of this study.

As a director or officer in a public company for which an unsponsored depositary receipt programme has been, or may be created, this briefing is of considerable direct relevance to you.

In the last year or so, DR programmes for more than 800 companies have been established by depositary banks to meet investor demand for these securities. Many of the DR programmes have been created without the active participation of company management.

This briefing sets out how the situation has arisen, and what you can do about it in the best interests of your shareholders.

We provide evidence of the reputational benefits of management taking an active role in the process. The implications are that, at the very least, you should consider the potential benefits of converting the unsponsored DR to a sponsored arrangement - you owe it to your shareholders.

A handwritten signature in blue ink, reading "Rory Knight" with a stylized flourish at the end.

Dr Rory Knight  
Chairman

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

## EXECUTIVE SUMMARY

- There has been a recent change in the US securities regulation which now allows DRs to be created for companies outside the US without their explicit participation.
- In the 12 months since the change, more than 800 companies have had such unsponsored DRs established and the number is growing.
- The establishment of an unsponsored DR programme reflects US investor demand for a USD equivalent security.
- The management response to such programmes has significant implications for corporate reputation.
- Empirical evidence (over 26 years) suggests that conversion of the unsponsored DR to a sponsored Level I DR increases share price on average by 10% and liquidity by 30%.
- There are many additional benefits which include improved investor relations and governance.

## 1 INTRODUCTION

This briefing is introduced with a description of the change in US securities regulation which has given rise to the rapid increase in unsponsored Depository Receipt programmes.

“A minor change in the SEC’s rules has significant implications for companies traded worldwide”.

### A CHANGE IN THE RULES OF ENGAGEMENT

A listed company in any market outside of the United States which has not raised public capital in the US has no filing or disclosure obligations under the US Securities legislation, provided that US investors in the company are less numerous than 300. Although many do not, all foreign companies, vis à vis the US, are required to register under section 12g of the Securities and Exchange Act of 1934 (the Act). Those with fewer than 300 US investors are exempt under section (a) of Rule 12g3-2 (the Rule). However, if US investors in the company number more than 300, it is obliged to register with the Securities and Exchange Commission (SEC). Relief from this registration obligation had hitherto been available under section (b) of the Rule which required management to act to apply for exemption. A change in the Rule, effective 10 October 2008, 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 financials are available on their website. This of course makes life easier for qualifying companies that do have more than 300 US investors. Previously exempt companies in this category that do not qualify under the new Rule have three years to comply.

This seemingly minor amendment to the Rule has significant consequences for foreign companies with fewer than 300 US shareholders. The implication is that, under the new arrangement, a trading facility in their shares in the form of a DR programme can be established for the convenience of US investors without the consent of the company. There are thousands of companies around the world that may not be aware that they are now automatically qualified under the Rule and consequently, they face the prospect of an unsponsored DR being created by a depository bank. This arises because, to establish a DR programme, a depository bank completes a Form F-6 which before the amendment required that companies had applied for exemption. The revision to Form F-6 allows depository banks to affirm that in good faith they believe the company in respect of which the DR programme is being established is so compliant with the amended Rule. The scope now has widened considerably.

### IMPLICATIONS OF THE CHANGE FOR THE BOARD

Not surprisingly, there has been a significant increase in the number of unsponsored DRs. 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.

“1,364 unsponsored DR programmes are now operating without the participation of management”.

The amendment is intended to increase investor access and, therefore, the liquidity in trading of shares of non-US companies. Early indications are that it is having the desired effect.

“The existence of an unsponsored programme is more opportunity than threat”.

The Boards of these companies are now in a situation whereby they are generating additional attention from US investors. This paper argues that the discovery of an unsponsored DR programme represents an opportunity to build reputation and value, and it should be embraced.

Firstly, the existence of the unsponsored programme neutralises the spectre of crossing the 300 US investor threshold inadvertently. The unsponsored programme is evidence of the company’s exemption from registration under those circumstances.

Secondly, it provides management with a significant opportunity to build reputation by embracing the process and converting it to a sponsored arrangement. It is this approach that we propose in the briefing.

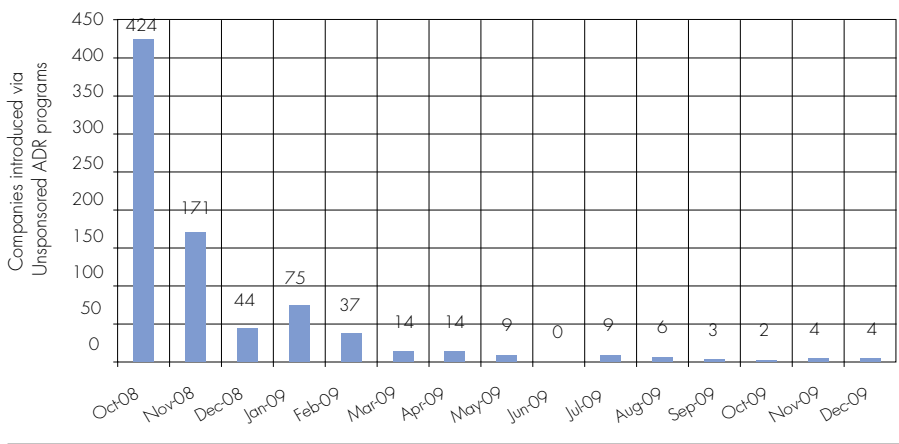
Section 2 illustrates how the market in unsponsored DRs has developed since the change in regulation. Section 3 demonstrates the potency of reputation signalling to the market when a sponsored DR programme is established. Section 4 presents the key benefits of converting an unsponsored DR programme to sponsored status. Section 5 outlines the options facing companies with unsponsored programmes, and Section 6 concludes the paper with a summary of the issues.

## 2 RECENT DEVELOPMENTS

In the year following the SEC’s amendment to the Rule, 1,364 unsponsored programmes have been created by the four major depository banks. After the initial cascade of 424 in October 2008, the market settled down to a slower rate of introduction; Figure 1.



Figure 1: New companies introduced via unsponsored DR programmes



Figures 2 and 3 illustrate the European and Asian distributions by country. The companies are fairly evenly distributed across Europe (388) and Asia (382). The remaining 36 companies come from South Africa (27), Israel (7), and one each from Mexico and Peru. In all, 34 countries are represented.

Figure 2: European distribution by country

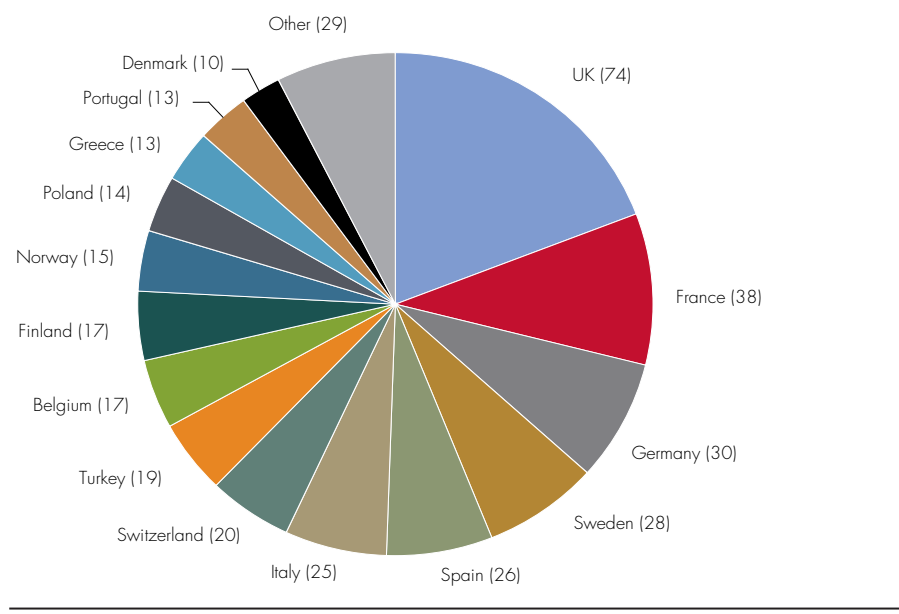
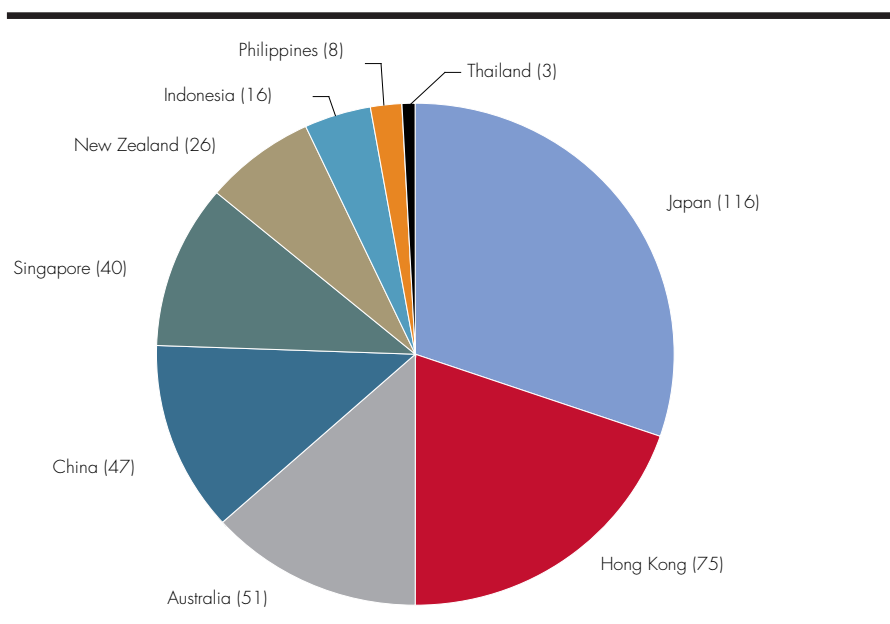


Figure 3: Asian distribution by country



### 3 BUILDING REPUTATION AND VALUE

The establishment of an unsponsored DR programme should prompt Boards, whose company shares are represented by these DRs, to re-evaluate their relationship with investors. The way in which Boards choose to respond to this situation can determine the future value performance of their business.

“Reputation is the key issue”.

Our research suggests that the existence of an unsponsored DR programme offers Boards a potent opportunity to enhance corporate reputation significantly.

Figure 4 depicts the share price reaction for a portfolio of firms establishing new over-the-counter (OTC) depositary receipts. The research<sup>1</sup> analyses the OTC DRs<sup>2</sup> over almost a quarter of a century. Using share prices in the local market, the graph shows the reaction to establishing a new DR, where all market-wide influences have been removed and the returns have been risk-adjusted. The dates on which the new programmes have been established are aligned such that the first trading day for each programme is Event Day 0.

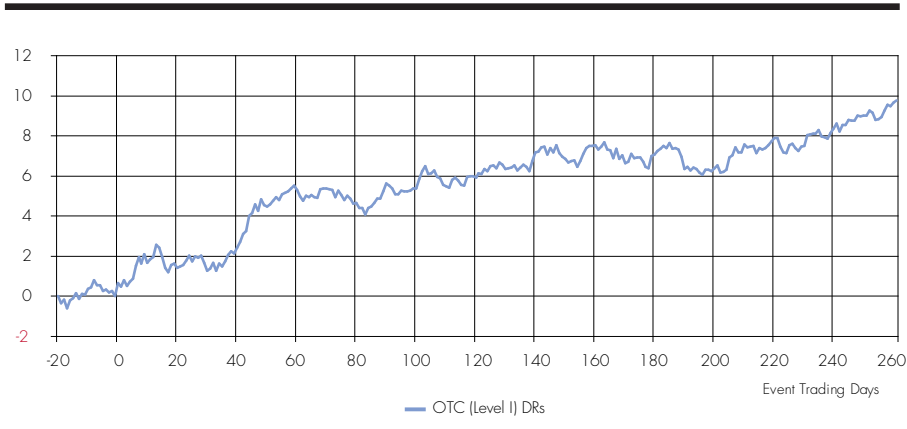
The market responds positively as investors welcome the improved access, coverage and trading opportunities DRs provide. Almost 1,000 basis points are added to the value of the portfolio. The analysis covers a period of over two decades.

For companies, DRs raise their visibility and availability in the US, and thereby increase and diversify their investor base, with the associated liquidity and value benefits. Simply, many US investors cannot purchase non-US equities easily and prefer dollar denominated, US settled and cleared securities. Additionally, DRs enable employees in US subsidiaries of non-US companies to participate in employee ownership plans, for example.

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

2 The majority of these are American Depositary Receipts (ADRs) though Global Depositary Receipts (GDRs) are included.

Figure 4: Value added from new OTC DRs



For US investors, DRs offer familiar settlement and clearing facilities, payment of dividends in US dollars, and the elimination of global custodial charges and uncompetitive exchange rate conversions. For investors prohibited or limited from owning non-US shares, DRs offer access.

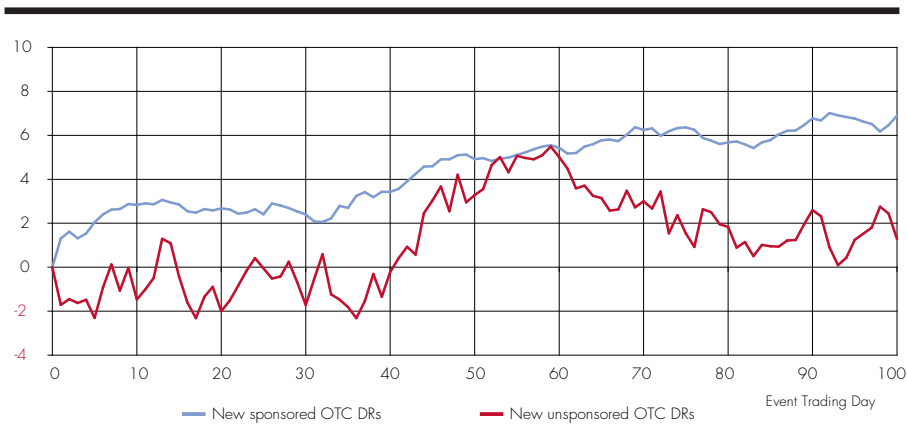
Figure 5 presents further evidence which demonstrates the comparative performance of sponsored and unsponsored OTC DR programmes for the first 100 days following their establishment.

Whilst the initial reaction in the local market to the establishment of unsponsored DRs is understandably insignificant, at plus or minus 200 basis points, the establishment of sponsored programmes is clearly positive. In the first 100 days following establishment, the companies with sponsored programmes enjoy an average value increase of over 600 basis points (over and above the wider movements of the market). This differential in performance for firms with sponsored programmes is illustrated in Figure 6.

The value premium for companies with sponsored DR programmes, over those with unsponsored programmes, is about 5%.

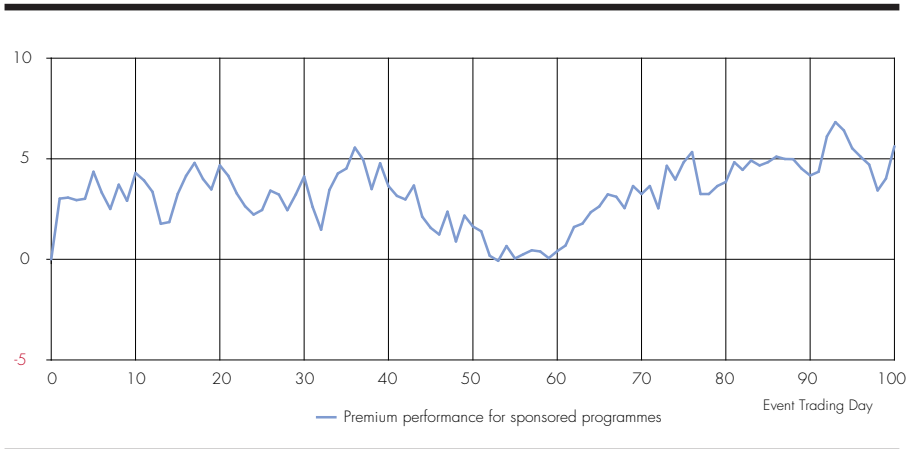
For companies already with an unsponsored DR programme and considering conversion to a sponsored programme, the results are striking. Figure 7 shows that the average value increase for firms which convert their DR to sponsored status is around 10%.

Figure 5: Value added from sponsored and unsponsored OTC DRs



The message from investors is clear: superior governance, positive investor relations and direct communication with shareholders is welcomed by the markets, and rewarded. In essence, these companies have chosen to embrace a more direct relationship with investors and, in doing so, have enhanced their reputation.

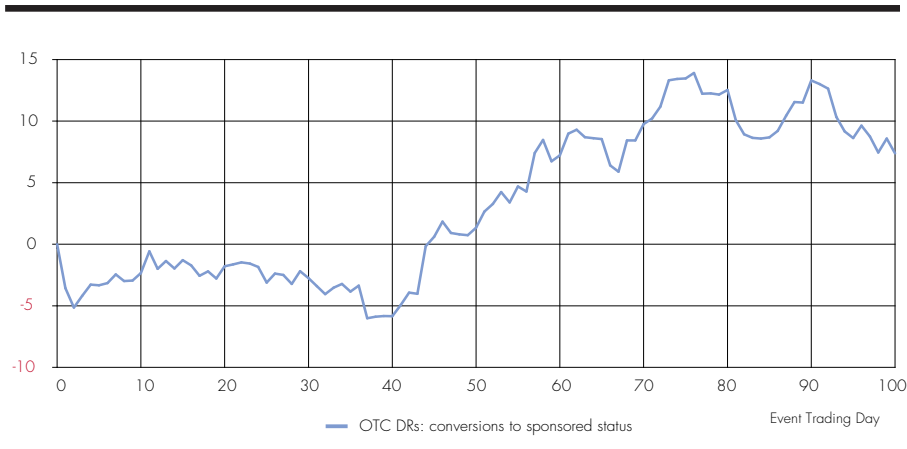
**Figure 6: Premium performance for sponsored programmes**



A sponsored arrangement brings with it also liquidity benefits. Trading of the company’s shares in the local market benefits from the greater visibility brought by the sponsoring depository and the wider access achieved for US investors. Illustrated in Figure 8, the Trading Volume Multiplier is defined as the multiple of the previous year’s average daily trading volume in local shares. Thus, a value of greater than one indicates a positive impact on trading volume in the local market.

“Conversion from an unsponsored to a sponsored DR generally increases value & liquidity”.

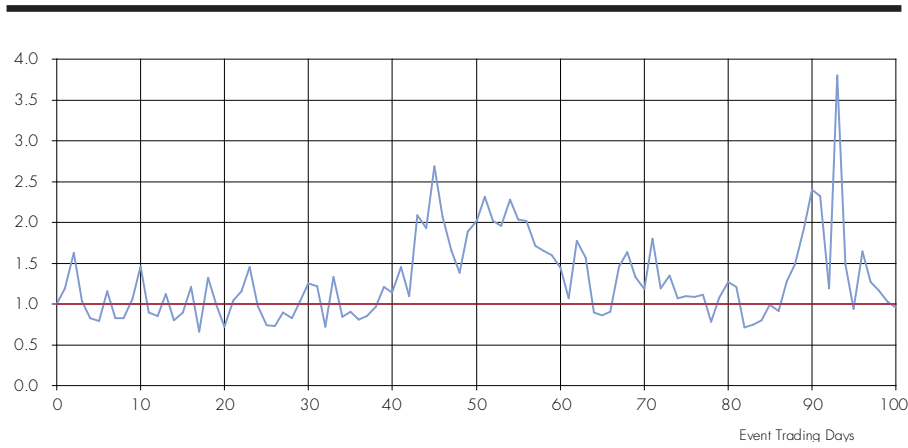
**Figure 7: Value added from converting to a sponsored programme**



Converting an unsponsored DR programme to sponsored status increases liquidity in local shares by an average 30% in the first 100 days. Sponsorship heightens the visibility of the issuer to US investors and energises its investor relations activities.

The evidence presented herein suggests that the reputation signal sent to markets by converting one's unsponsored DR to a sponsored arrangement is both positive and significant. Conversion translates into improved trading liquidity and enhanced shareholder value. The next section outlines some key additional benefits from converting to a sponsored programme for companies with unsponsored DRs.

**Figure 8: Liquidity increase from converting to a sponsored programme**



#### 4 TEN REASONS TO CONVERT TO A SPONSORED PROGRAMME

Within the context of building and protecting corporate reputation, there are a number of specific reasons for companies with unsponsored DRs to consider converting their programmes to sponsored status. The key benefits of converting are presented below.

“Sponsored DRs have a premium on unsponsored”.

##### REPUTATION SIGNALLING

As demonstrated in the previous section, the reputation benefits of positive investor relations are significant. Equally, the markets are unforgiving if they perceive a company to be restricting deliberately its disclosure. Finally, companies choosing to terminate their DR programmes can experience on average a 20% drop in value (over and above market movements) as investors react to the sudden withdrawal of disclosure<sup>3</sup>.

##### GOVERNANCE AND CONTROL

Under a sponsored DR programme, the issuer can determine through its deposit agreement the terms of the programme, such as 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.

<sup>3</sup> Ibid

With conversion to a sponsored programme, comes the ability to terminate all extant unsponsored programmes. The SEC requires that the deposited securities and related DR holders under any unsponsored programme be transferred by the depository to the new sponsored programme. Thereafter depositories are prohibited from creating unsponsored programmes in parallel with the sponsored DR programme.

### PROACTIVE INVESTOR RELATIONS

A company has limited ability to identify or communicate with DR holders in an unsponsored programme and the depository has no obligation to provide shareholder communications. Nor is the depository under any obligation to provide notification of shareholder meetings or to exercise voting rights on behalf of DR holders.

In a sponsored programme, the depository works with the issuer to identify existing and prospective holders. The issuer is able to communicate fully and directly with investors, and engage in and control its investor relations activities.

### AVOIDS MARKET CONFUSION

Unsponsored DR programmes often have multiple depositories that can charge DR holders according to different fee schedules and exchange rates, creating investor confusion or discontent. For example, for the same dividend payout, US dollar disbursements might differ depending on the exchange rate applied by each depository.

Under a sponsored Level I DR programme, the same fees and rates apply to all holders. In addition, the depository can offer a more seamless shareholder service by acting as a single source of information and through regular reporting.

### SUPPORT SERVICES

Under a sponsored DR programme, the issuer is entitled to receive support services from its depository bank as it relates to investor relations and market knowledge. These services are designed to enhance programme visibility.

### STRATEGIC ADVANTAGE

Under a sponsored programme, the DRs can be used for certain 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.

### NO ADDITIONAL COMPLIANCE COSTS

A sponsored Level I DR programme entails no additional regulatory obligations from what is currently disclosed in the home market.

### ACCESS TO US INVESTORS

With a sponsored DR programme, the issuer is better positioned to expand its US investor base. Access to new investors can increase trading in the issuer's shares which may reduce transaction costs and generate additional demand for the shares.

## POTENTIAL VALUE ENHANCEMENT

More effective investor relations and shareholder communications serve to improve investors' understanding of issuer performance and reduce uncertainty surrounding financial estimates. The greater information flow reduces the risk associated with the business and thereby its cost of capital, and enhances shareholder value.

Research presented in the previous section shows an average value increase of around 10% for companies which convert to sponsored programmes.

## POTENTIAL LIQUIDITY IMPROVEMENT

A sponsored programme can provide greater visibility in the US market. Issuers have the ability to conduct targeted investor relations activities, and financial incentives from the depositary can help fund those efforts. In addition, issuers can consider listing on Pink OTC Market's OTCQX market tier or NYSE's ArcaEdge, designed to enhance visibility for leading foreign companies with Level 1 DR programmes.

Research hitherto presented indicates that conversion to sponsored status increases trading in the issuer's local shares by an average of 30%.

The general arguments for converting an unsponsored DR programme to sponsored status are persuasive though each company should seek legal guidance. The next section outlines the steps an individual company might wish to take when considering how to respond to the discovery of an unsponsored DR programme representing its shares.

## 5 TAKING THE INITIATIVE

For Boards which discover that an unsponsored DR programme has been established for their company, either they may ensure and state publicly non-compliance with the Rule or they may establish a Sponsored DR programme.

### NON-COMPLIANCE WITH THE RULE

If a company states publicly that its website disclosures are not adequate for compliance with the automatic exemption from the Rule, a depositary bank cannot assume reasonably that they are adequate. The depositary bank(s) may agree to withdraw the unsponsored DR(s), although termination is not legally required provided that the depositary can demonstrate a reasonable belief that the company is compliant.

However, the impact on corporate reputation is not trivial if investors perceive any reduction in disclosure for existing shareholders. Our research indicates that any perceived reticence in communication often is associated with significant investor fallout.

Where a company has not met the conditions for exemption from the Rule, management must monitor the number of its US shareholders, particularly since the existence of an active unsponsored DR is likely to foster greater US investor interest. Without the exemption, to exceed 300 US shareholders would trigger the requirement to register the shares with the SEC and adhere to stricter reporting standards. In addition, once the number of US shareholders exceeds 300, the possibility of an unsponsored programme would arise again.

#### ESTABLISHMENT OF A SPONSORED DR PROGRAMME

By establishing a sponsored DR, a company can ensure that any unsponsored DR programmes relating to its shares are withdrawn. It is market practice that they do so in exchange for a cancellation fee typically paid by the sponsoring depositary bank.

The general benefits of a sponsored DR programme are several and have been outlined in the previous sections. A sponsored programme enables the issuer to negotiate the terms of its depositary agreement, regain control over investor relations and voting entitlements, and improve both the liquidity and performance of its shares. Investor uncertainty is reduced and corporate reputation enhanced. A Level 1 programme does not require the full SEC registration or reporting standards that are required of U.S. listed DRs.

#### AN INDIVIDUAL APPROACH

In order to assess the relative merits of conversion to a sponsored arrangement for any particular company, it is advisable to conduct a thorough evaluation of its own particular circumstances. While the general argument for converting to sponsorship is compelling, there are other factors - such as managerial commitment to investor relations, and trading liquidity and share ownership in the US - which could affect the decision. Each company with an unsponsored DR programme will have a different profile as to the potential benefits of a sponsored facility.

## 6 SUMMARY AND CONCLUSIONS

The SEC amendment to the Rule, effective 10th October 2008, was introduced to improve trading and accessibility of non-US companies shares to US investors. A major consequence of the amendment is the response by depositary banks to establish unsponsored DR programmes to represent the shares of non-US firms. These firms now attract greater interest from US investors yet have no ability to communicate directly with their new DR holders. It is imperative for the protection of their corporate reputation that Boards of companies with unsponsored DRs take action.



The options facing Boards are limited. Prompting withdrawal of the unsponsored DR by failing to comply with the conditions required for exemption to the Rule risks reputation damage. The alternative is to establish a sponsored DR programme thus ensuring that all existing unsponsored programmes are withdrawn.

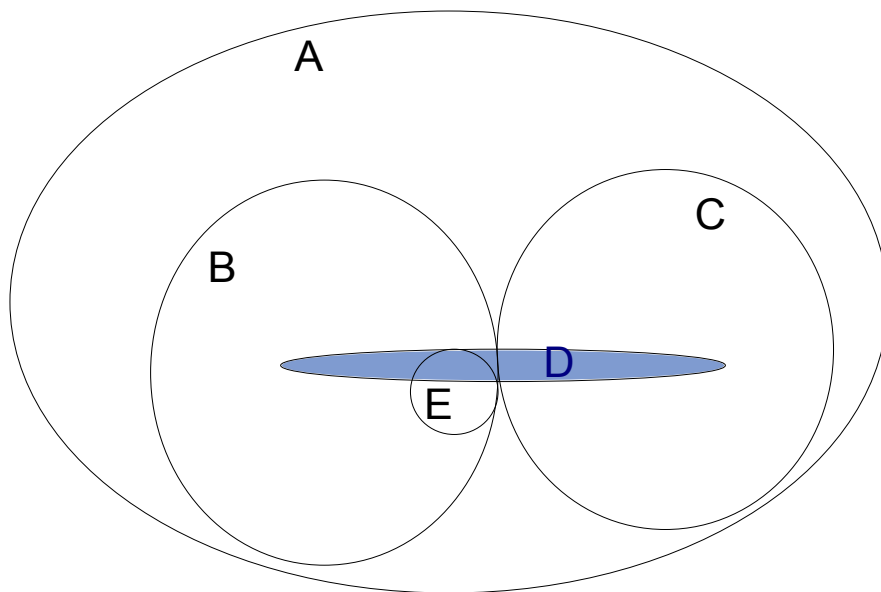
Establishment of a sponsored DR programme generates considerable benefits to the issuer and its investors. The issuer regains contractual control and the ability to communicate directly with its US shareholders, while the US investor enjoys better information flow and reduced uncertainty. The associated value and liquidity advantages are measurable and demonstrable.

Each company will have distinctive characteristics which render both legal advice and an individual assessment prudent. The Boards of companies finding themselves with unsponsored DR programmes can choose to use the discovery as a prime opportunity to energise their investor relations and build reputation.

## APPENDIX

This appendix provides a digrammatical overview of the various categories of companies created by the SEC regulations and the relevant reference material.

### The universe of non-US listed companies without sponsored DRs



#### USING USUAL SET NOTATION:

$A =$	{non-US listed companies (henceforth 'Companies') without sponsored DRs}
$\rightarrow A' =$	{Companies with sponsored DRs}
$B =$	{Companies with >300 US investors}
$\rightarrow A-B =$	{Companies with <300 US investors}
$C =$	{Companies with <300 US investors which auto-qualify for exemption}
$\rightarrow A-(B \cup C) =$	{Companies with <300 US investors which do not auto-qualify for exemption}
$D =$	{Companies with unsponsored DRs}
$\rightarrow B \cap D =$	{Companies with >300 US investors with an unsponsored DR} and
$\rightarrow C \cap D =$	{Companies with <300 US investors with an unsponsored DR} = 808
$E =$	{Companies with >300 US investors which do not qualify for exemption under new rules}
$\rightarrow D \cap E =$	{Companies with >300 US investors with an unsponsored DR which do not qualify under new rules}. These companies are not "grandfathered"
$\rightarrow E \cap D' =$	{Companies with >300 US investors without an unsponsored DR which do not qualify under new rules }

## RESOURCES

1. The Securities Exchange Act 1934, (The Act) establishes Securities & Exchange Commission (SEC). (Useful source for Act & promulgated Rules)  
[www.law.uc.edu/CCL/34Act/index.html](http://www.law.uc.edu/CCL/34Act/index.html)
2. Section 12g of The Act requires issuers to register with the SEC.  
[www.law.uc.edu/CCL/34Act/sec12.html](http://www.law.uc.edu/CCL/34Act/sec12.html)
3. Section 12g3 of The Act empowers the SEC to promulgate rules to exempt Foreign Private Issuers (FPI)  
[www.law.uc.edu/CCL/34Act/sec12.html](http://www.law.uc.edu/CCL/34Act/sec12.html)
4. Rule 12g3-2b was promulgated by SEC Release No. 34-8066, 28 April 1967  
[www.law.uc.edu/CCL/34ActRls/rule12g3-2.html](http://www.law.uc.edu/CCL/34ActRls/rule12g3-2.html) (as amended)
5. Rule 12g3-2b was amended by SEC Release No. 34-58465, 5 September 2008 (effective 10 October 2008)  
[www.sec.gov/rules/final/2008/34-58465.pdf](http://www.sec.gov/rules/final/2008/34-58465.pdf)
6. Rule 12g3-2a exempts foreign companies from Section 12g registration i.e. if less than 300 US shareholders do not need rely on 12g3-2b.  
[www.law.uc.edu/CCL/34ActRls/rule12g3-2.html](http://www.law.uc.edu/CCL/34ActRls/rule12g3-2.html)
7. Form F6 was amended by SEC Release No. 34-58465, 5 September 2008 (effective 10 October 2008) enables Unsponsored ADR without consent  
[www.sec.gov/rules/final/2008/34-58465.pdf](http://www.sec.gov/rules/final/2008/34-58465.pdf)
8. Each of the depository banks has a website which offers helpful resources:

BNY Mellon	<a href="http://www.adrbnymellon.com">www.adrbnymellon.com</a>
Citibank	<a href="http://www.citi.com/dr">www.citi.com/dr</a>
Deutsche Bank	<a href="http://www.adr.db.com">www.adr.db.com</a>
JPMorgan Chase	<a href="http://www.adr.com">www.adr.com</a>

## GLOSSARY OF TERMS

Delisting/Deregistration	The downgrading of a DR programme from U.S. listed (Levels II/III) status to OTC (Level I) status.
Depository Receipts	Depository Receipts (DRs) are negotiable US securities, denominated in US dollars, that represent shares of companies listed outside the United States. DRs are issued by a depository bank to evidence that the underlying shares have been deposited with a custodian in the local market.
Form F-6	The form used by depository banks to register new DRs with the SEC.
Listed (Levels II/III) DRs	Depository receipts that are listed on a US exchange (NYSE, NYSE Amex or NASDAQ) and require, therefore, full SEC registration, reconciliation with US GAAP or IFRS and annual reporting with a Form 20F filing. Level III DRs additionally raise capital.
OTC (Level I) DRs	Depository receipts that trade in the “over-the-counter” OTC market and are exempt from US reporting requirements and from complying with US GAAP.
Regulation S DRs	Depository receipts that provide for raising capital through the placement of DRs offshore to non-U.S. investors in reliance on Regulation S, are exempt from US reporting requirements and from complying with US GAAP.
Rule 12g3-2(b) (the Rule)	Exemption to the requirement that foreign private issuers register their securities with the SEC under Section 12(g) of the Exchange Act (1934).
Rule 144A DRs	Depository receipts that are privately placed and trade among Qualified Institutional Buyers (QIBs) in the PORTAL electronic trading system, are exempt from US reporting requirements and from complying with US GAAP.
Section 12(g)	The section of the Exchange Act (1934) requiring registration of a class of securities with the SEC if there are more than 300 holders of that securities class in the United States.

Securities Act of 1933	This Act requires among other things, the distribution of prospectuses and the filing of registration statements prior to the public sale of certain securities.
Securities Exchange Act (1934)	This Act was passed in the wake of the Great Depression which followed the Stock Market Crash of 1929. The Act is a law governing securities trading on the secondary market and to regulate exchanges in the United States for the protection of investors.
Securities and Exchange Commission (SEC)	The US Securities and Exchange Commission (SEC) is an independent regulatory agency in the United States created by Section 4 of the Securities and Exchange Act (1934) to regulate the securities industry in the United States and enforce federal securities laws.
Termination	The cessation of a DR programme such that only the local shares in the issuer's home market are traded.
Upgrade	The development of a DR programme from one status to another – for example, from OTC (Level I) status to listed (Levels II/III) status - for which additional requirements must be met.





## About Oxford Metrica

Oxford Metrica provides strategic counsel on reputation and international listings to corporate boards around the world. The firm is a recognised leader in measuring the benefits, for issuers and investors, of establishing an international shareholder base. Oxford Metrica is uniquely placed to supply senior corporate management with evidence-based intelligence on the merits of converting an unsponsored depositary receipt programme to sponsored status.

We deal with all aspects of a conversion, from identifying the particular benefits for your company to handling all the practical steps required to capture these benefits. This includes managing the process of selecting a suitable depositary bank.

We would be delighted to help your company navigate these issues and look forward to hearing from you.

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