



Effective October 2008, the SEC modified its rules to modernize disclosure requirements relating to ADRs, which ultimately resulted in a significant expansion of the ADR investing landscape.¹ In this article we provide information about what ADRs are and how they work, as well as an overview of the rule changes and their impact.

For over 80 years, American Depositary Receipts, or ADRs, have provided a convenient way for US investors to buy stock in non-US companies without the complexities and costs of purchasing shares directly from foreign markets. Harding Loevner first began offering ADR-only portfolios for our clients in 2000, basing them upon the model portfolios created for our core Global Equity and International Equity Strategies.

ADRs provide US investors key diversification benefits. They are listed, traded, and settled in US dollars, which makes electronic trading and portfolio accounting more straightforward from the perspective of a US investor. The price of ADRs is determined continuously according to the price of the underlying foreign equity and the foreign exchange rate.

The Creation and Types of ADRs

ADR programs are created by purchasing a block of shares from a non-US company in the local market and depositing them with a US bank, which in turn issues receipts (or ADRs) for the shares. The ADRs then trade in the over-the-counter (OTC) market or on US stock exchanges, depending on the type of ADR. There are two basic categories of ADRs: “sponsored” or “listed” ADRs and “unsponsored” or “OTC” ADRs.

¹ SEC Release No. 34-58465, September 5, 2008. <http://www.sec.gov>.

ADR Fast Facts

- American Depositary Receipts, or ADRs, were created in the 1920s in order to make it easier for Americans to purchase, hold, and sell shares of non-US companies. ADR depository banks issue receipts for underlying foreign shares, and those receipts trade efficiently on US exchanges and/or in the over the counter market.
- ADRs are priced in US dollars, and associated dividends are paid in US dollars.
- American Depositary Receipts are a subset of the larger category of Depository Receipts. Global Depository Receipts, or GDRs, are another subset of this category. The GDR format allows for the simultaneous trading of the issuance in multiple markets outside that of the country of origin and is not specific to the American marketplace. GDRs are priced in the currency of the trading market.
- ADRs contain both currency and equity risk – they are priced continuously according to both the exchange rate and the price of the underlying foreign equity.
- ADRs are traded on major US exchanges such as the NYSE, AMEX, and NASDAQ. They are also traded as “pink sheets” in secondary, over the counter markets. Unlike foreign ordinary shares, ADRs are processed via the DTC system, which allows for fast and efficient trading and settlement for US investors.
- ADRs do not contain voting rights.
- Owning ADR shares in lieu of foreign ordinary shares can save American investors money on transaction, settlement, and custody costs.
- Recent SEC rule changes have made available more information about companies issuing ADRs. In addition, these rule changes have encouraged the ADR market to expand, increasing the opportunity set made available to American investors.

market. The shares of many well-known international companies are available as Un-sponsored ADRs.

SEC Rule Changes

Effective October 2008, the Securities and Exchange Commission updated the disclosure requirements for non-US companies offering securities for sale in US markets. The SEC cited improvements in global technology, and a desire to make useful information available in a timely manner, as the major reasons for making these changes. The changes are having an impact on ADR buyers and issuers in two important ways.

First, the new disclosure requirements should benefit investors in Sponsored ADRs by providing them expanded, timelier information about non-US companies. The speed, accuracy, and efficiency of the filing processes that non-US issuers must complete have been improved. Corporate updates and disclosures must be provided to the public more quickly and in English. Annual reports must now be filed within four months rather than six, and they may be submitted electronically rather than via cumbersome paper forms.

Second, and this is perhaps the most significant impact of the new rules, they grant foreign companies that meet certain criteria an *automatic* Rule 12g3-2(b) exemption. Previously, non-US companies had to actively apply for a Rule 12g exemption; now if they meet the qualifications they are granted the exemption whether they request it or not. The result is that the number of companies available for Un-sponsored ADR programs has increased dramatically.

Harding Loevner completed a study of the ADR marketplace in early 2008, before these rule changes were enacted. At the time, we estimated there were roughly 1,100 ADRs that we deemed as having a sufficient market. We arrived at this figure after accounting for the widespread duplication in ADR listings and eliminated names that did not trade frequently enough to provide adequate liquidity. Since the new rule changes went into effect—according to the Bank of New York, one of the world's largest issuers of ADR shares—more than 630 new ADR programs

have been created (between October 2008 and April 2009).² The majority of these issuances are Un-sponsored.

Many of these new Un-sponsored issuances are duplications, as it is possible to have multiple ADR programs based on the same underlying stock. In addition, many of the new ADRs trade very infrequently and thus would not be liquid enough for Harding Loevner's portfolios. While each individual new issuance must be examined separately, we estimate roughly one-third of new ADR programs are unique and liquid enough to warrant our further attention.

Implications of the Expanded ADR Universe

Harding Loevner works to ensure that our International Equity ADR and Global Equity ADR portfolios are closely correlated to the model of our ordinary-share International Equity and Global Equity portfolios. We consider the expansion of the ADR universe to be a positive development because it may allow us to match the ADR portfolios even more closely to our core strategies. In general, the type of high-quality, growing companies that we invest in are attractive ADR program prospects, and the expanding universe has allowed us to add new companies to our ADR portfolios that were previously unavailable.

The proliferation of names in the ADR universe makes in-depth research of the related companies all the more important, however. As fundamental investors, we examine carefully the financial statements and meet with the management of all companies we are considering for investment. This research-intensive approach is particularly important when investing in Un-sponsored ADRs, as these companies have the lowest threshold of US disclosure requirements. The recent changes in ADR regulation should not be seen as an unqualified gift from the SEC to investors, but rather as an expanded opportunity set for further research.

²Bank of New York, "Over 630 New Depositary Receipt Programs from Around the World!" (Oct 1, '08 – Apr 16 '09). Available at www.adrbnymellon.com/files/PB25029.pdf.

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