Renaissance®
Investment Management
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FAQ: Investing Internationally With ADRs

What is an ADR?

First created in 1927, American Depositary Receipts (ADRs) represent an ownership share in a foreign security that has been placed with a U.S. depositary bank. An ADR is created when a broker purchases shares of a foreign company in the local market and then delivers the shares to a depositary bank. The depositary bank then issues ADRs that are traded on either the U.S. exchanges or the Over-the-Counter (OTC) Market.

What are the primary advantages of an ADR?

- Avoids the expense and complexities of setting up sub-custodian trading accounts in local markets
- Retains the flexibility of an individually managed account (e.g., tax loss selling)
- Assets are considered U.S. securities and are U.S.-dollar denominated
- Dividends are paid in U.S. dollars
- U.S. settlement cycle

What are the types of ADRs?

As of December 2015, there were approximately 2,700 ADRs that trade in the U.S. on the New York Stock Exchange (NYSE), NASDAQ or OTC markets according to a BNY Mellon listing of ADRs. These ADRs can come in either the Sponsored or Unsponsored form. Companies with Sponsored ADRs have an agreement with a single depositary bank, which handles the custody functions for the sponsored company including the payment of dividends. Unsponsored ADRs constitute almost 60% of the ADR universe and can be issued by multiple depositary banks.

There are also three types of ADRs – Level 1, 2 and 3. Level 1 ADRs trade in the OTC market, while Level 2 and 3 ADRs trade on the New York Stock Exchange or NASDAQ. There are financial reporting differences between the levels. Level 1 companies are required to publish electronically in English certain home country documents such as annual reports, whereas Level 2 and 3 ADRs are required to report or reconcile their financials in U.S. GAAP. However, with the widespread global adoption of IFRS (International Financial Reporting Standards), the attraction of Level 2 or 3 ADRs has been greatly diminished.

What types of ADRs does Renaissance invest in?

Renaissance has extensive experience utilizing ADRs to actively invest in international equity markets for more than 20 years. We are indifferent as to the type of ADR we use, preferring to remain focused on underlying company fundamentals. As a result, Renaissance invests in both Unsponsored (Level 1) and Sponsored ADRs (Levels 2 and 3).

Does investing in ADRs limit a manager's opportunity set versus investing in ordinaries?

Renaissance has access to an extensive universe of ADRs allowing us to create diversified international portfolios for our clients. While certain countries have investment limitations such as a maximum percentage of foreign ownership or restrictions on the creation of unsponsored ADRs (e.g., Brazil, India, South Korea), the investable ADR universe of companies continues to increase. Of note, Renaissance does not purchase private placement ADRs (Rule 144A or Reg S), which does limit our ability to own certain well-known firms such as Samsung Electronics; however, we believe this does not hamper our ability to create well-diversified portfolios.

After the Securities and Exchange Commission implemented a registration rule change in October 2008, non-U.S. companies that meet certain qualifications are now automatically exempt under Rule 12g3-2(b). This effectively allows depositary banks to create ADRs without the consent of the foreign company and led to the creation of many new Unsponsored ADRs, resulting in the available ADR universe of companies that trade on the OTC markets more than doubling in size since 2008. The Renaissance universe consists of approximately 3,200 ADRs and foreign direct-listed shares, which covers ***approximately 85%*** of the MSCI ACWI ex US Index market cap.

How liquid are ADRs?

ADR liquidity varies significantly by company; however, market volume on the U.S. exchanges tells only part of the story. If the U.S. markets do not offer sufficient liquidity, we can opt to trade the ordinary shares in the local foreign market and convert the shares into an ADR. In the case of a sale, the process described above simply reverses. The ADR we wish to sell is cancelled, and the ordinaries are sold in the local foreign market. With the ability to effectively access foreign trading volume, we are able to look at both U.S. and local markets in establishing liquidity requirements for inclusion in our International universe.

What costs are involved with using ADRs compared to local ordinaries?

In comparing costs, we need to look at both commission costs and custody costs. Normal trading commissions are charged whether one trades local shares or the ADRs in the U.S. In general, U.S. trading costs are lower than foreign trading costs; however, trading costs will vary by country. When trading ADRs, the depositary banks typically charge an additional fee of up to 5 cents/share to create or cancel an ADR. Custody fees on average are much less for U.S. stocks when compared to foreign stocks, with research from BNY Mellon showing foreign custody fees ranging from 10 basis points to over 100 basis points, with a median of 44 basis points. In addition to normal U.S. custodian charges, ADR investors may also be assessed an annual Depositary Service Fee (DSF), which U.S. Depositary banks charge to manage the ADR program. In total, U.S. combined custody fees and DSF fees are generally *less* than foreign custody fees.

How do the returns of ADRs and ordinary shares compare?

ADR prices track very closely to the underlying ordinary share prices when adjusted for currencies. Depending on factors such as supply and demand, timing differences, currency controls and foreign ownership limitations, the ADR may at any given time trade at a slight premium or discount to the ordinary share. To highlight the similarities of returns of the ADR prices and ordinary share prices, we show a comparison between the MSCI ACWI ex US Index (local shares in U.S. dollars) and the BNY Mellon Classic ADR Index (ADRs), which demonstrates very similar risk/return patterns and high correlation between the two indices.

Are there any countries or regions in which Renaissance cannot invest due to its ADR focus?

Our current universe includes ADRs from over 40 countries. We do not invest in Frontier markets where ADR availability and trading volume are more limited.

INTERNATIONAL INDEX COMPARISON

BNY Mellon Classic ADR Index[1] and MSCI ACWI ex US Index[2]

Annualized Total Returns	BNY Mellon Classic ADR	MSCI ACWI ex US
3 Years	0.4%	0.2%
5 Years	7.0%	6.0%
7 Years	3.7%	3.7%
10 Years	1.9%	2.2%

Annualized Standard Deviation	BNY Mellon Classic ADR	MSCI ACWI ex US
3 Years	10.5%	10.2%
5 Years	12.0%	11.5%
7 Years	16.0%	15.0%
10 Years	20.4%	20.3%

R Squared	MSCI ACWI ex US vs. BNY Mellon Classic ADR
3 Years	0.98
5 Years	0.98
7 Years	0.99
10 Years	0.99

Data as of 9/30/16

[1] The BNY Mellon Classic ADR Index is a free float-adjusted capitalization weighted U.S. dollar total return index that includes all U.S. Exchange-listed or OTC traded Depositary Receipts with the exception of Grey Market Securities, New York Shares and Global Registered Shares.
[2] The MSCI ACWI ex US Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets, excluding the United States. The MSCI ACWI ex US consists of 45 country indexes comprising 22 developed and 23 emerging market country indexes.

Source: Renaissance Research, FactSet, MSCI, BNY Mellon

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REFERENCED INDICES

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