



FTSE Fixed Income Country Classification Announcement September 2020

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Evolution of the FTSE Fixed Income Country Classification Review Process

The FTSE Fixed Income Country Classification process¹ assigns accessibility levels to local currency government bond markets based on a transparent and objective set of technical criteria. An accessibility level of 2 is required for a market to be considered eligible for inclusion in the FTSE World Government Bond Index (WGBI), while an accessibility level of 1 is required for a market to be considered for inclusion in the FTSE Emerging Markets Government Bond Index (EMGBI). Markets on the cusp of reclassification to a higher level following enhancements to market accessibility, or to a lower level in the event of a deterioration of investment conditions, are placed on a Watch List.

Currently, the FTSE Fixed Income Country Classification process allows for an interim update each March to the Watch List composition, and communication to index users on the status of specific reforms or improvements in Watch List markets. However, changes to Market Accessibility Level are only announced at the annual September review.

FTSE Russell announces that effective from March 2021, changes to Market Accessibility Levels and changes to index inclusion, as a result of objective criteria assessment (market size and credit rating), can be announced, along with their implementation details, after both the September and March reviews. This change is intended to facilitate a more responsive approach to managing entry and exit of local markets to our benchmarks. The framework will continue to require that a market remain on the Watch List for a minimum of six months before a change to its Market Accessibility Level can be made.

¹ https://research.ftserussell.com/products/downloads/FTSE_Fixed_Income_Country_Classification_Process.pdf

Status of Watch List Markets

China

FTSE Russell is pleased to announce that Chinese Government Bonds will be included in the FTSE World Government Bond Index (WGBI) with inclusion scheduled to start with the October 2021 profiles. The commencement date is subject to final affirmation in March 2021 from members of the FTSE Russell advisory committees and other index users that these recently announced reforms have made the anticipated practical improvements to the market structure.

China was added to the WGBI Watch List in 2018 as a potential reclassification from Market Accessibility Level 1 to 2. Following the recent publication of enhancements to the infrastructure of the Chinese government bond market, Chinese Government Bonds (CGBs) are now considered to meet the technical standards of Accessibility Level 2 in the FTSE Russell Fixed Income Country Classification framework. An Accessibility Level of 2 is a prerequisite for a market to become eligible for inclusion in WGBI.

Since being placed on the Watch List, the Chinese authorities have implemented significant improvements to the fixed income market infrastructure, facilitating easier participation by international investors. These market enhancements include, but are not limited to:

- **Improving secondary market bond liquidity** through significantly more re-openings of existing bonds and ensuring new issues are larger, encouraging more market making services to foreign investors, taking steps to increase participation in the development of a treasury futures market, and providing greater access to European based participants by extending bond trading hours to 20:00 Beijing time from 21 September 2020;
- **Enhancing the foreign exchange market structure** by introducing regulation that allows investors to trade spot and forward FX with third parties for currency conversion and FX hedging purposes under both CIBM direct² and Bond Connect³; and
- **Developing global settlement and custody processes** by implementing a facility for foreign investors to have the option to choose a settlement cycle beyond T+3, as agreed between counterparties, without the need for submitting an application⁴ and, in the case of failed settlements, permitting three additional days to resettle the trades with the original trade terms.

It is recognised that further reforms are imminent including the extension of the facility to permit the legal entity to be registered when opening accounts for international investors⁵.

As a result of these reforms, FTSE Russell now considers that CGBs meet the technical requirements for Accessibility Level 2. However, because of the size of the international investor flows that follow a change to a country's classification status and the newness of the latest changes in regulation, the FTSE country classification process for WGBI requires that the practical operation of changes to market structures be tested before a change in a country's Accessibility Level can be fully confirmed.

Accordingly, FTSE Russell will continue to work closely with the People's Bank of China, the FTSE Russell Advisory Committees and index users over the coming months to ensure the efficacy of the new reforms in the following areas: the account opening process (including the ability to register at legal entity level); the ability to transact FX with third parties; and the changes to the settlement process to allow settlement beyond T+3. FTSE Russell will provide an additional confirmatory announcement with respect to these assessments in March 2021.

² <http://www.pbc.gov.cn/tiaofasi/144941/144979/3941920/4100044/index.html>

³ https://mp.weixin.qq.com/s/AU_HqZURAsBEBXZ6nyKqsg

⁴ <http://www.chinamoney.com.cn/chinese/scqgbbbscgqsggtz/20200916/1778795.html#cp=scqgbbbscgq>

⁵ <http://www.pbc.gov.cn/tiaofasi/144941/144979/3941920/4080994/index.html>; for an English translation of the consultation paper please see <http://www.iunhe.com/legal-updates/1302>

Subject to the final affirmation in March 2021, the inclusion of CGBs within WGBI will commence with the October 2021 profiles. Their addition will be phased into the index over a period of 12 months. Implementation details of the inclusion process will be provided in March 2021.

FTSE Russell warmly congratulates the People's Bank of China and other Chinese market authorities on the pace and extent of the recent market reforms, which are very much welcomed and widely acknowledged by the international investment community.

Malaysia

Malaysia will be retained on the Watch List, as of the September 2020 review, for possible reclassification from Market Accessibility Level 2 to 1.

FTSE Russell acknowledges the additional initiatives instigated by Bank Negara Malaysia (BNM), over the last twelve months to improve the accessibility of the Malaysian government bond market for foreign investors. Market enhancements include, but are not limited to:

- **Improving secondary market bond liquidity** through further progress on the establish of a Debt Management Office, an improved Auction Calendar that offers more re-opening of prior issues, a greater number of Malaysian Government Securities (MGS) available via repo, consolidation of bond issuances to increase the outstanding size per issuance and reducing the number of issuances and, introducing MGS futures with physical delivery; and
- **Enhancing the foreign exchange market structure** through making permanent the Appointed Overseas Office (AOO) programme, allowing Japanese local custodian banks to undertake third party FX and dynamic hedging and streamlining the FX documentation and due diligence processes.

FTSE Russell will continue to engage with its advisory committees and other stakeholders, over the next six months, to determine the practical improvements that emanate from these important and welcomed initiatives, which should enhance the experience of international participants in the Malaysian fixed income market.

Annual Review of Market Size, Credit Rating and Fixed Income Emerging Markets Designations

As part of the September annual review, objective index inclusion criteria (market size and credit rating) and fixed income emerging and developed markets designations are also assessed to ensure a consistent approach to market inclusion.

FTSE Russell confirm the following with respect to these assessments:

- There are no index inclusion changes due to changes in market size⁶ and credit rating.
- There are no changes to emerging markets designations based on updated IMF and World Bank data, which are the basis for fixed income emerging and developed market classifications.

⁶ On September 1, 2020, FTSE Russell clarified that due to recent Large Scale Asset Purchases (LSAP) of government bonds by the Reserve Bank of New Zealand as part of the programme announced on March 23, 2020, New Zealand is not considered to have met the market size minimum for inclusion in WGBI. For further details please see: <http://www.yieldbook.com/m/indexes/FTSE-indexes/message.shtml?id=297>.

Change to the Amount Outstanding Minimum for Swiss Government Bonds in FTSE Indexes

After a thorough review of contemporary issuance patterns of the Swiss Treasury with the advisory committees, FTSE Russell announces that the minimum amount outstanding for Switzerland government bonds will be lowered from CHF 4 billion to CHF 2 billion effective with the January 2021 profiles in FTSE fixed income indexes.

As a result of the change, 14 bonds with CHF 43.0 billion (USD 47.4 billion) in par amount outstanding are projected to enter the FTSE Swiss Government Bond Index, based on the September 2020 profiles, representing 80.9% of the index on a market value weighted basis.

FTSE Russell continually reviews index amount outstanding thresholds for local markets tracked by its indexes to ensure they accurately capture the most representative investment choice set for a given local market.

Review of Accessibility for New Government Markets

In August 2020, FTSE Russell announced the launch of three new government bond indexes tracking the market for fixed-rate local currency government debt issued by Nigeria, Saudi Arabia and Vietnam.⁷ As part of the September 2020 review, FTSE Russell announces that these markets are formally assigned a Market Accessibility Level of 0, indicating they are now being considered through the FTSE Fixed Income Country Classification process for potential inclusion into flagship global government benchmarks, such as the FTSE Emerging Markets Government Bond Index (EMGBI). Over the coming months, FTSE Russell intends to consult with advisory committees and index users on the accessibility conditions for foreign investors in these markets and any inclusion to the Watch List for possible reclassification will be considered at the next review in March 2021.

Review of Local Market Snap Times

FTSE Russell has gathered feedback from its advisory committees on a potential change to the snap time used for certain USD-denominated bonds in the FTSE fixed income indexes. As a result, FTSE Russell confirms that no change will be made at this time. The 3pm New York snap time will continue to be used for US Treasuries and US Agency Mortgages.

⁷ For further details, please see: <http://www.yieldbook.com/m/indexes/FTSE-indexes/message.shtml?id=297>.

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