

FTSE Global Equity Index Series

Minimum Foreign Headroom Requirement - Ground Rule Change

23 May 2016

At the May 2016 meeting the FTSE Russell Governance Board approved the following amendment together with clarification and the addition of examples within the minimum foreign headroom requirement Rule. This update is effective immediately.

6.0 Investability Weightings

E Minimum foreign headroom requirement

FTSE Russell defines “foreign headroom” as the percentage of shares available to foreign investors as a proportion of the **company’s Foreign Ownership Limit (FOL), i.e. (FOL - foreign holdings)/FOL**.

For example, if a company has a foreign ownership limit, of 49%, of which 39% is held by foreign investors, the foreign headroom will be calculated as 20.41% i.e. $(49\% - 39\%) / 49\%$.

- i. For a non-constituent that is subject to foreign ownership limit, a minimum headroom of 20% must be available in order to be included in the index.
- ii. Where the headroom of an existing constituent falls below 10%, its investability weight will be reduced an absolute value of 5% at the next quarterly review.

For example, if Company A’s current investability weight is 49% (i.e. equal to the FOL), a 5% absolute reduction will result in an adjusted investability weight of 44.0% (49%-5%).

If Company B’s current investability weight is 30% (i.e. Free Float more restrictive than FOL), a 5% absolute reduction will result in an adjusted investability weight of 25% (30%-5%).

Please note, prior to March 2016, existing index constituents which had a headroom less than 10%, had their investability weight reduced by 10% of their current investability weight i.e. if their investability weight was 49%, a 10% relative adjustment will result in an adjusted investability weight of 44.1% ($49\% * 0.9$).

- iii. The investability weight will continue to be reduced at subsequent quarterly reviews in increments of 5% until the headroom level increases to 10% or above. As a result of these quarterly 5% downward adjustments, should the investability weight of the security fall to 5% under this process, the security will no longer be eligible to remain in the index.
- iv. The investability weight of an existing constituent which has been subject to headroom adjustments will have its most recent 5% adjustment reversed at a quarterly review subject to a **minimum 20% headroom remaining post reversal (as illustrated in step 2 below)**.

For example, Company A has an FOL of 49%, foreign holdings of 32% and a current investability weight of 29%.

Step 1: The foreign headroom test is calculated as 35% (i.e. $(49\% - 32\%) / 49\%$),

highlighting a potential reversal.

Step 2: The post reversal foreign headroom test is calculated as 24% (i.e. $(49\% - 37\%) / 49\%$). For the purpose of the test the 5% adjustment is deemed to have the effect of increasing the foreign holding to 37%.

In the above example, Company A qualifies for a headroom reversal. The investability weighting will be increased from 29% to 34% (i.e. $29\% + 5\%$).

- v. In the event a security with a headroom adjustment increases its foreign ownership limit (FOL), the increase in the FOL will be implemented in two, 50% tranches, subject to the headroom remaining at 20% or above.

For example, Company A had two headroom adjustments down from a FOL of 24% to a current investability weight of 14.00%

Company A – Initial FOL of 24%	
(Q1) First Headroom Adjustment	19.00% (5% reduction from 24%)
(Q2) Second Headroom Adjustment	14.00% (5% reduction from 19%)

The Company announces an increase to its FOL from 24% to 35%. The increase in the FOL will be implemented in the following steps:

Company A announces an FOL increase to 35% (11% increase)	
(Q1) Subject to 20% headroom availability, FOR is increased by 50% of the 11% increase	$14.00\% + 5.50\% = 19.50\%$
(Q2) Subject to 20% headroom availability, FOR is increased by remaining 50% of the 11% increase	$19.50\% + 5.50\% = 25.00\%$
(Q3) Subject to 20% headroom availability, reverse second headroom adjustment of 5.0%	$25.00\% + 5.00\% = 30.00\%$
(Q4) Subject to 20% headroom availability, reverse first head room adjustment of 5.0%	$30.00\% + 5.00\% = 35.00\%$

- First quarterly review following the announcement of an increase in FOL to 35%; 50% of the FOL increase (in this case 5.50%) will be implemented (subject to headroom remaining at 20% or above).
 - Second quarterly review; the remaining 50% of the FOL increase will be implemented (subject to headroom remaining at 20% or above).
 - Subsequent quarterly reviews; if the headroom availability remains at 20% or above, the previous two headroom adjustments of 5% each will be reversed on a quarterly basis.
- vi. In the event a security with a headroom adjustment decreases its foreign ownership limit (FOL), the decrease in the FOL will be implemented in full at the next quarterly review.
- For example, Company A had a headroom adjustment down from a FOL of 24% to a current investability weight of 19.0%. The Company announces a decrease in the FOL to 21% (a decrease of 3% from the previous FOL of 24%).
- FTSE will decrease the existing adjusted investability weight by the 3% reduction in FOL at the next quarterly review, resulting in Company A having a new investability weighting of 16.0% ($19\% - 3\%$).
- vii. An existing constituent with a headroom adjustment, that passes the index eligibility screens (for example - liquidity, minimum size, investability weight) will not be eligible for index promotion from Small Cap to All-World (Large/Mid) until all headroom adjustments have

been reversed. An index demotion from All-World (Large/Mid) to Small Cap will proceed for an existing constituent with a headroom adjustment.

- viii. Where foreign ownership restrictions are not universally applied to all foreign investors, but only impact a particular set of foreign investors, a 5% headroom adjustment will be applied where there is evidence of these restrictions being enforced. This headroom restriction will be reassessed on a quarterly basis and will not be lifted until either foreign ownership restrictions are removed or all foreign investors are treated equally.
- ix. For an existing index constituent, where foreign investors are prohibited from purchasing additional shares (for example, where Indian companies are placed on the Reserve Bank of India (RBI) Ban List), a 5% headroom adjustment will be applied at the next quarterly review and reassessed on a quarterly basis. Upon removal of restrictions prohibiting the purchase of shares, a headroom test will be conducted at the next quarterly review and headroom adjustments removed if the index constituent passes the headroom test.
- x. Where a non constituent passes the relevant headroom test, but foreign investors are only permitted to hold a maximum of 1% of the free float adjusted shares in issue, the security will not be eligible for index membership.
- xi. Headroom tests will be conducted in conjunction with the March, June, September and December quarterly reviews.
- xii. Unless there is an increase in the foreign ownership limit, a headroom adjustment will not be reversed for a period of 6 months **(i.e. if a headroom adjustment has been implemented at the June review then the earliest it can be reversed is at the following March review)**.
- xiii. If a constituent has been removed from the index as a result of its investability weight falling below 5% following a headroom adjustment, it will only be reconsidered for inclusion after a period of 12 months from its deletion. For the purposes of index eligibility it will be considered as a new issue.
- xiv. Securities are assigned their official foreign ownership limit, however if permission is required from a local regulator to purchase additional shares beyond a certain permission threshold, then the more restrictive permission level is assigned as the foreign ownership limit for example, a security may have a foreign ownership limit of 24%, however any purchase beyond 22% requires prior permission from the local regulatory authority. In this example the security would be assigned a foreign ownership limit of 22%.

An updated version of the FTSE Global Equity Index Series Ground Rules is now available on the FTSE Russell website.

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