

Minimum Foreign Headroom Requirement - Ground Rule Update

04 April 2019

FTSE Russell would like to inform clients of the following updates to the Minimum Foreign Headroom Requirement which are effective immediately:

Summary

- A decrease in the foreign ownership limit (FOL) will result in a reduction in the FOL being implemented with the provision of a T+2 advanced notification from the date of discovery
- The first headroom adjustment level will be increased from an absolute value of 5% to an absolute value of 10%. All subsequent headroom adjustments will remain at an absolute value of 5%
- Where the FOL for an existing constituent has been reached and zero headroom is available, its investability weight will be reduced by an absolute value of 10% (it is the first headroom adjustment) or 5% (if it is a subsequent headroom adjustment) with a provision of a T+2 notice from the date of discovery.

A. Initial Weighting

Free float is calculated using available published information rounded to 12 decimal places.

Securities with a free float of 5% or below are excluded from the index

Details on free float restrictions can be accessed using the following link:

[Free_Float_Restrictions.pdf](#)

B. Foreign Ownership Restrictions

FTSE Russell's index methodology takes account of the restrictions placed on the equity holdings of foreign investors in a company where these have been imposed by a government, regulatory authority or the company's constitution.

Where the presence of a foreign ownership restriction creates a limit on foreign ownership (the Foreign Ownership Limit or FOL) that is more restrictive than the calculated free float for a company, the precise Foreign Ownership Limit is used in place of the free float for the purposes of calculating the company's investability weight.

If the foreign ownership restriction is less restrictive or equal to the free float restriction, the free float restriction is applied, subject to Rule A above.

If a company changes its foreign ownership restriction, a reduction in the FOL will be implemented with the provision of a T+2 advanced notification from the date of discovery. Increases in the FOL will be monitored up-to the index review lock down date and will be implemented in FTSE Russell indexes at the subsequent quarterly review, subject to Rule C Minimum Foreign Headroom Requirement detailed below.

In some jurisdictions, a company's foreign ownership restriction applies to the company's share classes in aggregate, and not to share classes individually. However, not all of the share classes of a restricted company might be eligible for index inclusion. In such cases, the aggregate (company level) foreign ownership restriction will be allocated pro-rata across those share classes that are eligible for index inclusion.

In certain jurisdictions, despite foreign ownership restrictions, the acquisition of shares above stated foreign ownership

limits is permitted. However, holdings of shares above the foreign ownership limit may be denied voting rights, for example in Japan.

Indian Securities - Foreign Ownership Limit (FOL) data is sourced from the Reserve Bank of India (RBI), the National Securities Depository Limited (NSDL) and the Central Depository Services Limited (CDSL).

In the event that FOL data is not publicly available from any official source the following FOL will be assigned for the purposes of calculating the company's investability weight and conducting the foreign headroom test:

- Private Bank Sector: 49% FOL
- Public Bank Sector: 20% FOL
- Others: 24% FOL

FTSE Russell may exercise discretion in determining whether a stock should be subject to the minimum foreign headroom test. Where discretion is being applied FTSE Russell will provide appropriate advance notice.

C. 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. $(FOL - \text{foreign holdings})/FOL$.

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. $(49\% - 39\%) / 49\%$.

- 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.
- For an existing constituent that is subject to foreign ownership limit, a minimum headroom of 10% must be available.**

Headroom tests are conducted in conjunction with the March, June, September and December quarterly reviews.

- Where the headroom of an existing constituent falls below 10%, its investability weight will be reduced at the next quarterly review. The first headroom adjustment will be an absolute value of 10%, any subsequent headroom adjustments will be an absolute value of 5%.**

For example, if Company A's current investability weight is 49% (i.e. equal to the FOL), a 10% absolute reduction will result in an adjusted investability weight of 39.0% $(49\% - 10\%)$. **Any subsequent headroom adjustment will be at 5% and result in the investability weight decreasing to 34% $(39\% - 5\%)$**

If Company B's current investability weight is 30% (i.e. Free Float more restrictive than FOL), a 10% absolute reduction will result in an adjusted investability weight of 20% $(30\% - 10\%)$.

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% $(49\% * 0.9)$. **Between March 2016 and March 2018, existing constituents that had a headroom of less than 10%, had their investability weight reduced by an absolute value of 5%.**

- Where the FOL for an existing constituent has been reached and zero headroom is available, its investability weight will be reduced by an absolute value of 10% (if it is the first headroom adjustment) or 5% (if it is a subsequent headroom adjustment) with the provision of a T+2 advanced notification from the date of discovery.**
- Where discovery occurs on the Thursday or Friday prior to a quarterly review effective date, then the FOL decrease will be applied after the index review effective date with a provision of a T+2 advanced notification**
- Where the FOL of an existing constituent is reported as approaching its FOL, a headroom test will be conducted at the subsequent quarterly review and if headroom falls below 10%, its investability weight will be reduced by 10% (if it's the first headroom adjustment) or 5% if it's a subsequent**

headroom adjustment.

vii. **Following the first headroom adjustment of 10%**, 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% **or below** under this process, the security will no longer be eligible to remain in the index.

viii. 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. $29\% + 5\%$).

ix. 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 9.00%

| Company A – Initial FOL of 24% | |
|---------------------------------|---------------------------------|
| (Q1) First Headroom Adjustment | 14.00% (10% reduction from 24%) |
| (Q2) Second Headroom Adjustment | 9.00% (5% reduction from 14%) |

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 | $9.00\% + 5.50\% = 14.50\%$ |
| (Q2) Subject to 20% headroom availability, FOR is increased by remaining 50% of the 11% increase | $14.50\% + 5.50\% = 20.00\%$ |
| (Q3) Subject to 20% headroom availability, reverse second headroom adjustment of 5.0% | $20.00\% + 5.00\% = 25.00\%$ |
| (Q4) Subject to 20% headroom availability, reverse first head room adjustment in increments of 5.0% | $25.00\% + 5.00\% = 30.00\%$ |
| (Q5) Subject to 20% headroom availability, reverse the first head room adjustment in increments 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 headroom adjustments will be reversed on a quarterly basis **in increments of 5%**.

In the event a security decreases its foreign ownership limit (FOL), the decrease in the FOL will be implemented in full **with the provision of a T+2 advanced notification from the date of discovery**.

Where the effective date of an FOL decrease is during the review week, then the FOL decrease will be implemented in conjunction with the index review effective date, subject to any prior scheduled FOL changes related to the Minimum Foreign Headroom Requirement (see Rules A and B above).

For example, Company A had a headroom adjustment down from a FOL of 24% to a current investability weight of 14.0%. The Company announces a decrease in the FOL to 21% (a decrease of 3% from the previous FOL of 24%).

The existing adjusted investability weight **will be decreased** by the 3% reduction in FOL at the next quarterly review, resulting in Company A having a new investability weighting of 11.0% (14% - 3%).

- x. 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 Micro Cap to Small Cap or from Micro Cap or 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 or Micro Cap will proceed for an existing constituent with a headroom adjustment.
- xi. Where foreign ownership restrictions are not universally applied to all foreign investors, but only impact a particular set of foreign investors, a **downward** 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.
- xii. 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 **downward** 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.
- xiii. 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%.
- xiv. Where a non constituent passes the relevant headroom test, but individual foreign investors or institutions 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.
- xv. 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).
- xvi. If a constituent has been removed from the index as a result of its investability weight falling **to 5% or below** 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.
- xvii. Securities which are deleted for failing headroom, but which after a period of 12 months meet the minimum 20% headroom test, will initially be added to the index at a minimum free float of 5%, subject to them having a foreign ownership limit. If a foreign ownership limit no longer applies, then the security will be added at its free float.
- xviii. Subsequent headroom reversals will be implemented in increments of 5% until the security reaches its foreign ownership limit, subject to the security continuing to meet the minimum 20% headroom test.

B. **Thailand Non-Voting Depositary Receipts**

A Non-Voting Depositary Receipt (NVDR) is a trading instrument issued by the Thai NVDR Company Ltd to overcome foreign investment barriers such as foreign investment limits. NVDRs entitle holders to the same financial benefits as those who invest directly in a company's ordinary shares, except that they have no voting rights. The NVDR price is equal to the price of the underlying securities on the Local Board.

If NVDRs are available FTSE Russell may, under certain circumstances, represent them in the index in order to fully represent the investable shares available to foreign investors.

- i. Where a security is **not** subject to a foreign ownership restriction, it is included in the index at its calculated free float.
- ii. Where a security is subject to a foreign ownership restriction, there is no NVDR or the NVDR does not satisfy the minimum foreign headroom requirement as outlined in Section C, and its Foreign Board share passes liquidity, it is included at its Foreign Board price with an investability weight equivalent to its FOL or calculated free float, whichever is more restrictive.
- iii. **For example**, Company A has an FOL of 25% and a free float of 90%. It has a maximum NVDR issuance limit of 35%, of which 30% has already been issued. As the NVDR fails the minimum foreign headroom requirement of 20%, the Foreign Board share is included with an investability weight of 25%.
- iv. Where a security is subject to a foreign ownership restriction and an NVDR is available which satisfies the minimum foreign headroom requirement as outlined in Section C, both the Foreign Board share and the NVDR are included in the index.
- The Foreign Board share is included in the index with an investability weight equivalent to the FOL and the separate NVDR with an investability weight equivalent to its NVDR limit or the difference between its Free Float and FOL, whichever is more restrictive.
- v. **For example**, Company A has an FOL of 49% and a free float of 80%. It has a maximum NVDR issuance limit of 35%, of which 20% has already been issued. It passes the minimum foreign headroom requirement.
- Company A will be included in the index with 2 separate lines:
- Foreign Board share is included in the index with an investability weight of 49% (FOL)
 - NVDR is included in the index at an investability weight of 31% (i.e. 80%-49%), as it is more restrictive than its NVDR limit of 35%
- vi. Where a security is subject to a foreign ownership restriction and its Foreign Board share fails liquidity, subject to the Local share passing all eligibility screenings and the NVDR satisfying the minimum foreign headroom requirement as outlined in Section C, the Local share is included with an investability weighting equivalent to its FOL + NVDR or its calculated free float, whichever is more restrictive.
- vii. **For example**, Company A has an FOL of 49% and a free float of 60%. There is no limit on its NVDR issuance, so effectively its can be 100% invested. Therefore the Local share is included in the index at an investability weight of 60%.

Updated copies of the Ground Rules are now available from the FTSE Russell website:
www.ftserussell.com

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