
FTSE Russell Client Consultation for Updating Shares Outstanding and Free Float

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Introduction

We have been working hard to bring together the combined insights, knowledge and client focus of the FTSE and Russell Index businesses. We are committed to protecting and enhancing the strengths of both businesses, and recognize that high client engagement, market consultation and consensus building play an important role in this process. As part of our commitment to strive to develop the best possible index solutions for our clients, we have been reviewing the methodologies of our global indexes with a view to their converging on best practice. A number of methodology and index policy changes have already been enacted as part of this process, most notably in the area of corporate action treatment.

As part of the methodology review, we would now like to review the process for updating shares outstanding and free float.

Responding to the Consultation

Please submit your response to the questions included in this consultation online at

<https://www.surveymonkey.co.uk/r/9RYYY3V>

The consultation will close on July 29, 2016. All responses will be treated as confidential. FTSE Russell may publish a summary of the consultation results, but no individual responses will be published and no respondents will be named. If you have any questions about this survey, or if you encounter any technical issues, please contact rpawson@FTSERussell.com.

Current Process

FTSE

FTSE's current process is to update shares quarterly subject to a 1% buffer, and intra quarter if the cumulative change exceeds 10% or USD 2bn. This latter provision was introduced in part to ensure that index reviews, particularly for the UK series (e.g. FTSE 100), can be conducted on up to date capitalisations. However, it has the disadvantage that it can engender demands for liquidity in the absence of a corporate

event that would supply that liquidity. Further, there can be several such updates per week, all of which must be processed individually by clients.

FTSE's current process for free float is to update quarterly subject to a 3% buffer. The buffer is necessary to prevent regular immaterial increases and decreases to the free float numbers, which consequently minimises unnecessary turnover.

Russell

Russell's current process is to update shares outstanding on a monthly basis subject to a 5% buffer. There are no-intra month updates apart from those occasioned by corporate events. The methodology has the advantage that several share changes can be processed simultaneously. However, there is a view that monthly updates are perhaps unnecessary.

Apart from updates in relation to corporate events, there is no process for free float updates in the Russell indexes other than the review of floats that takes place ahead of the annual reconstitution. Free floats are then updated with no buffers applied. The delay arguably causes the indices to lose representativeness over the course of the year, and means that corporate actions and events can be applied to outdated numbers.

We would like to solicit preliminary feedback on the desirability of the following proposed methodology to be used for both FTSE and Russell indexes:

Proposed FTSE Russell Converged Process

Quarterly Updates

On a quarterly basis, both the shares outstanding and the free float of each constituent are updated if either the pending updates to shares outstanding equal or exceed 1% or the pending updates to free float would cause the index free float to change by 3% or more. Both shares outstanding and free float are updated even if, when implemented in combination, the changes act to offset each other.

Intra-Quarter Updates

If between the index quarterly updates, FTSE Russell becomes aware of a follow-on public offering of new shares, or a secondary offering of existing shares, such that either:

- the investable market capitalisation change is equal to or greater than USD 1bn; or
- the resultant change in **index shares*** is 5% or more **and** the associated investable market capitalisation change is USD 250m or more.

(*) Index shares is defined as the number of shares x free float

In order to take advantage of timing to the liquidity event FTSE Russell will implement the change with two days' notice from the date at which they become aware of the event. If however FTSE Russell only becomes aware of the event more than two days after the subscription period has closed, implementation of the resultant changes will be deferred to the next quarterly update.

For the avoidance of doubt, events such as conversions of debt into stock, exercise of warrants, expiry of lock-ups, private placements and buy backs will not be implemented intra-quarter.

Please note: Any additional outstanding pending cumulative changes will not be implemented in conjunction with updates resulting from public primary offerings or secondary placings. These pending changes will be implemented at the next quarterly review (subject to breaching the quarterly parameters).

Example illustrations of proposed intra-quarter methodology:

Example 1

Primary Offering of 25m shares (no associated float change)

Company A

Shares in Index = 500m

Shares outstanding = 502m

Last closing price = GBP 10

Float = 100%

Test 1

$500\text{m} \times \text{GBP } 10 \times 100\% = \text{GBP } 5\text{bn}$ investable market capitalisation (before)

$525\text{m} \times \text{GBP } 10 \times 100\% = \text{GBP } 5.25\text{bn}$ investable market capitalisation (after)

$\text{GBP } 5.25\text{bn} - \text{GBP } 5\text{bn} = \text{GBP } 250\text{m}$ (net change) (= USD 359m)

Fails investable market capitalisation of => USD1bn, therefore move to test 2

Test 2

Index shares before = $500\text{m} \times 100\% = 500\text{m}$

Index shares after = $525\text{m} \times 100\% = 525\text{m}$

Difference = $25\text{m}/500\text{m} = 5\%$

$25\text{m} \times \text{GBP } 10 = \text{GBP } 250\text{m}$ (USD 359m)

Change in index shares passes both the =>5% threshold and => USD250m investable market capitalisation threshold

Result: Apply intra-quarter share update with T+2 notice

Example 2

Secondary Offering of 48m shares (float change)

Company B

Shares in Index = 800m

Shares outstanding = 790m

Last closing price = GBP 15

Existing Float = 50%

New Float = 53%

Test 1

$800\text{m} \times \text{GBP } 15 \times 50\% = \text{GBP } 6\text{bn}$ investable market capitalisation (before)

$800\text{m} \times \text{GBP } 15 \times 53\% = \text{GBP } 6.360\text{bn}$ investable market capitalisation (after)

$\text{GBP } 6\text{bn} - \text{GBP } 6.360\text{bn} = \text{GBP } 360\text{m}$ (net change) (= USD 518m)

FAILS investable market capitalisation of => USD1bn, therefore move to test 2

Test 2

Index shares before = $800\text{m} \times 50\% = 400\text{m}$

Index shares after = $800\text{m} \times 53\% = 424\text{m}$

Difference = $24\text{m}/400\text{m} = 6\%$

$24\text{m} \times \text{GBP } 15 = \text{GBP } 360\text{m}$ (USD 518m)

Change in index shares passes both the =>5% threshold and => USD250m investable market capitalisation threshold

Result: Apply intra-quarter float update with T+2 notice

Example 3

Secondary Offering of 400m shares (float change)

Company C

Shares in Index = 800m

Shares outstanding = 790m

Last closing price = GBP 3

Existing Float = 50%

New Float = 100%

Test 1

$800\text{m} \times \text{GBP } 3 \times 50\% = \text{GBP } 1.2\text{bn}$ investable market capitalisation (before)

$800\text{m} \times \text{GBP } 3 \times 100\% = \text{GBP } 2.4\text{bn}$ investable market capitalisation (after)

$\text{GBP } 2.4\text{bn} - \text{GBP } 1.2\text{bn} = \text{GBP } 1.2\text{bn}$ (net change) (= USD 1.73bn)

PASSES investable market capitalisation of => USD1bn and so no need to conduct test 2

Result: Apply intra-quarter float update with T+2 notice

Quarterly Updates **(See supporting analysis on page 10)**

1. We believe that 1% is the optimum buffer for quarterly share updates in order to ensure that the market capitalisation of constituents are regularly brought up to date. FTSE currently adopts this methodology and proposes to introduce this as new methodology for Russell in the absence of any strong objection. Do you object to a 1% buffer for quarterly share updates?

- No
- Yes (state preferred buffer)

2. We believe that 3% is the optimum buffer for quarterly free float updates in order to ensure that float is regularly brought up to date whilst avoiding regular immaterial increases and decreases to the free float numbers. FTSE currently adopts this methodology and proposes to introduce this as new methodology for Russell in the absence of any strong objection. Do you object to a 3% buffer for quarterly float updates?

- No
- Yes (state preferred buffer)

3. Is quarterly the correct frequency for shares and float updates?

- Yes
- No

If no, what is your preferred frequency?

- Monthly
- Semi-Annually
- Other (state frequency)

Intra-Quarter Updates **(See supporting analysis on pages 8-9)**

4. We propose to limit intra-quarter share/float updates to two specific events which we believe results in the natural supply of additional liquidity. Do you agree that intra-quarter updates should be limited to follow on public offerings of new shares and secondary placings of existing shares?

Yes

No

If no, what other liquidity events should be captured intra-quarter?

5. The intra-quarter buffers, (i.e. investable market capitalisation change =>USD 1bn; OR resultant change in index shares => 5% and associated investable market capitalisation => USD 250m), have been chosen as index impact is deemed to be sufficiently significant.

Do you agree with the buffers?

Yes

No (state preferred buffer)

6. Where discovery of the public offering/secondary placing is after close of the subscription period, do you agree that implementation should still be effective with T+2 notice as long as discovery is no more than 2 business days after subscription close? (e.g. Subscription close is Monday 4 April and discovery of the event is Wednesday 6 April. Therefore implementation with T+2 notice would be Monday 11 April).

Yes

No

7. If No, should we defer any late discoveries until the next quarterly updates?

Yes

Other (please specify)

Supporting Analysis – Intra Quarter Updates

Existing Methodology

FTSE – cumulative change exceeds 10% or USD 2bn; free float change greater than 3%

The data below reflects the total number of intra-quarter shares in issue and free float changes implemented **between January 2016 and March 2016**.

FTSE GEIS All Cap	January	February	March
Large	5	9	12
Mid	9	17	6
Small	38	35	54
Total	52	61	72

Russell – shares outstanding updated on a monthly basis subject to a 5% buffer; free float only updated at annual reconstitution

The data below reflects the total number of month-end share changes implemented **between January 2016 and March 2016**.

	January	February	March
RGI ex US	92	65	77
R2000	30	31	94
R1000	8	38	50
Total	130	134	221

Proposed Methodology

Intra-quarter updates limited to follow on public offerings of new shares and secondary placings of existing shares where investable market capitalisation change =>USD 1bn; OR resultant change in index shares => 5% and associated investable market capitalisation => USD 250m

The data below illustrates the number of intra-review changes which would have been implemented had the proposed methodology been in place **between January 2016 and March 2016**.

FTSE GEIS All Cap	=>5% Index Shares & USD 250m	Of which are =>1bn
Large	11	6
Mid	12	6
Small	18	1
Total	41	13

FTSE GEIS USA	=>5% Index Shares & USD 250m	Of which are =>1bn
Large	4	3
Mid	6	3
Small	16	0
Total	26	6

FTSE GEIS ex US	=>5% Index Shares & USD 250m	Of which are =>1bn
Large	7	3
Mid	6	3
Small	2	1
Total	15	7

Russell 3000	=>5% Index Shares & USD 250m	Of which are =>1bn
R1000	10	3
R2000	9	4
Total	19	7

The data below illustrates the number of intra-review changes which would have been implemented to the Russell 3000 Index had the proposed methodology been in place **between January 2015 and December 2015**.

Index	Jan 2015	Feb 2015	Mar 2015	Apr 2015	May 2015	Jul* 2015	Aug 2015	Sep 2015	Oct 2015	Dec* 2015
R1000	4	2	8	6	1	10	1	2	3	4
R2000	6	2	2	4	2	6	3	0	2	4
Total	10	4	10	10	3	16	4	2	5	8

*July figures incorporate June and July updates

** December figures incorporate November and December updates

Supporting Analysis – Quarterly Updates

Turnover impact of Russell US moving to quarterly shares and float updates

R3000	Share Changes	Float Changes	Share Turnover	Float Turnover	Total Turnover	MV of Index	Share Turnover %	Float Turnover %	Total Float and Share Turnover
June 2015	672	177	\$181,332,830,860	\$164,052,731,403	\$345,385,562,263	\$22,776,019,856,000	0.80%	0.72%	1.52%
September 2015	731	204	\$194,511,846,594	\$172,762,701,497	\$367,274,548,091	\$21,013,137,803,000	0.93%	0.82%	1.75%
December 2015	806	152	\$220,510,061,528	\$83,908,671,706	\$304,418,733,234	\$21,743,185,305,000	1.01%	0.39%	1.40%
March 2016	876	163	\$233,211,897,890	\$76,375,785,975	\$309,587,683,865	\$21,519,514,704,000	1.08%	0.35%	1.44%

R1000	Share Changes	Float Changes	Share Turnover	Float Turnover	Total Turnover	MV of Index	Share Turnover %	Float Turnover %	Total Float and Share Turnover
June 2015	212	35	\$149,784,386,100	\$78,365,708,897	\$228,150,094,997	\$20,900,118,094,000	0.72%	0.37%	1.09%
September 2015	261	38	\$167,727,294,150	\$92,521,636,808	\$260,248,930,958	\$19,366,779,562,000	0.87%	0.48%	1.34%
December 2015	311	32	\$188,180,751,025	\$61,400,420,387	\$249,581,171,412	\$20,082,552,607,000	0.94%	0.31%	1.24%
March 2016	321	32	\$204,570,735,970	\$62,566,814,595	\$267,137,550,565	\$19,952,357,867,000	1.03%	0.31%	1.34%

R2000	Share Changes	Float Changes	Share Turnover	Float Turnover	Total Turnover	MV of Index	Share Turnover %	Float Turnover %	Total Float and Share Turnover
June 2015	460	142	\$31,548,444,760	\$85,687,022,506	\$117,235,467,266	\$1,875,901,762,000	1.68%	4.57%	6.25%
September 2015	470	166	\$26,784,552,444	\$80,241,064,689	\$107,025,617,133	\$1,646,358,241,000	1.63%	4.87%	6.50%
December 2015	495	120	\$32,329,310,503	\$22,508,251,319	\$54,837,561,822	\$1,660,632,698,000	1.95%	1.36%	3.30%
March 2016	555	131	\$28,641,161,919	\$13,808,971,380	\$42,450,133,299	\$1,567,156,837,000	1.83%	0.88%	2.71%

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FTSE Russell is focused on applying the highest industry standards in index design and governance, employing transparent rules-based methodology informed by independent committees of leading market participants. FTSE Russell fully embraces the IOSCO Principles and its Statement of Compliance has received independent assurance. Index innovation is driven by client needs and customer partnerships, allowing FTSE Russell to continually enhance the breadth, depth and reach of its offering.

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