

Summary

The FTSE Russell logo is a light blue circle containing the text "FTSE" and "Russell" stacked vertically in white, bold, sans-serif font.

FTSE
Russell

External Advisory Committee Discussions

September 2020



External Advisory Committee Discussions

Introduction

FTSE Russell index standards are underpinned by strong governance and an emphasis on transparency. To ensure that our indexes continue to meet investors' requirements, independent committees advise on their design to make sure that they each evolve to continue to meet the highest standards in the industry.

To promote transparency, this note provides a summary of the topics presented to the advisory committees in Q3 2020.

1. Equity Country Classification

The results of the Annual Country Classification Review were approved by the FTSE Russell Product Governance Board and announced on 24 September 2020, following extensive consultation with the Policy Advisory Board, the Country Classification Advisory Committee, and the Regional Equity Advisory Committees.

The headline changes announced were:

- **Argentina** – reclassified from Frontier to Unclassified market status.
- **Russia**: new addition to the Watch List for possible reclassification from Secondary Emerging to Advanced Emerging market status.
- **Vietnam** – retained on the Watch List for possible reclassification from Frontier to Secondary Emerging market status.

A market included on the Watch List signals that engagement will take place with the local market authorities to address the outstanding Quality of Markets (QoM) criteria and other areas deemed by the external advisory committees to be in need of enhancement to meet the expectations of international investors.

The following Country Classification changes were reflected in FTSE Russell indexes in conjunction with the September 2020 index review, effective from the open on Monday 21 September 2020:

- Romania: reclassified from Frontier to Secondary Emerging market status.

- Peru: reclassified from Secondary Emerging to Frontier market status.
- Tanzania: reclassified from Unclassified to Frontier market status.

The full announcement can be found here: [Annual Announcement – FTSE Equity Country Classification - September 2020](#)

At the September meeting, the Country Classification Advisory Committee commented on the proposed changes to the QoM criteria ratings for individual countries; the updated QoM matrices can be found here: [FTSE Russell website](#)

Proposed changes to the FTSE Country Classification framework were also discussed. The proposals include potentially creating a new criterion for Tax and discontinuing the ‘Settlement & Rare Incidence of Failed Trades’ criterion. Following feedback from the members of the Country Classification Advisory Committee and the Policy Advisory Board, the proposals are being refined for further discussion in Q1 2021.

2. Equity Methodology

Treatment of Suspended Companies

As a result of a suspended UK company remaining in the index for 132 days prior to its removal, FTSE Russell was asked to consider an update to the methodology.

The current rules state that if the suspension period reaches 60 business days, the constituent should be removed at zero value at the next index review. This is subject to the 60th business day occurring on or before the Friday which falls four weeks prior to the index implementation date. Should the 60th business day occur after this date, the suspended constituent would be removed at the index review. A company could therefore remain in the indexes for up to 144 days before being removed.

There was unanimous support from the advisory committees for FTSE Russell to provide 20-days’ notice prior to removing a suspended company at zero value, following 20 days of suspension. Furthermore, the committee members commented that removal of the company did not have to align with an index review. This feedback will be given further consideration by the internal governance process and FTSE Russell will provide notice before any amendment to the existing rule becomes effective.

Thai Infrastructure Funds with a defined life cycle

Following on from discussion at the June meetings, the Regional Equity Advisory Committees considered whether Thai infrastructure funds holding assets with a limited lifespan should continue to be eligible for inclusion in the FTSE Global Equity Index Series (GEIS). Committee members shared their comments on whether the companies should be ineligible for index inclusion. There was general agreement that Thai infrastructure funds should continue to remain eligible for index inclusion. The committee members commented that as the underlying assets move closer to maturity,

the decrease in the market capitalisation (cap) of the funds is likely to lead to them becoming ineligible for index inclusion.

Treatment of Companies with Different Class Shares within FTSE indexes

The advisory committees were invited to consider whether two share classes of a major US company should continue to be represented as separate index constituents within the FTSE Global Equity Index Series. Within the Russell US indexes, the two share classes are combined into one index constituent using the conversion ratio between the two classes. FTSE Russell will consider the feedback and discuss further within the internal governance process.

Postponement of Index Reviews

During the March 2020 index rebalance, some index clients advocated for postponing the index reviews due to the fears of market disruption caused by the COVID-19 pandemic; this was exacerbated by the widespread move to working-from-home. The advisory committees were informed that since then, FTSE Russell has embarked on a technology project for an operational functionality to allow the deferral of an entire index review or for a single market, should the requirement arise in the future. Committee members commented on how much notice would be required before actioning a deferral once the review process has commenced. A policy is being formulated on how this process would operate in practice and will be published once formally approved.

Market Consultation – Eligibility of Shanghai STAR Market

Discussion took place on whether the Shanghai STAR Market should be considered as an eligible market segment for the local China indexes and GEIS. Committee members were invited to respond to the wider-market consultation which closed on Friday 25 September 2020 as well as comment at the meetings. Following due consideration of the feedback received, the results of the consultation were announced on 2 October 2020; see [hyperlink for further details: Inclusion of Shanghai STAR Market to the FTSE China A Index Series Market Consultation – Next Steps](#)

EMEA - FTSE UK Series Reserve List

To follow-up from debate at the June 2020 EMEA Regional Equity Advisory Committee, members were presented with a proposal to discontinue the reserve list for the FTSE UK Index Series and instead select the highest non-constituent company from the FTSE All-Share Index as a replacement. At the June meeting, committee members expressed the concern that the reserve list might not be sufficiently representative in times of high market volatility. The advisory committee was unanimous in supporting the proposal which will become effective from December 2020. Subsequent to approval by the FTSE Russell Product Governance Board, a technical notice was published; see [hyperlink: FTSE UK Index Series Ground Rule Change: Removal of Reserve Lists](#)

Americas

Russell US Indexes – Annual Reconstitution

In view of the ever-increasing size of the trades required for the single day event and to follow-up from previous committee discussions, FTSE Russell shared a progress update on the areas being researched.

System updates currently in development could potentially allow a move to implementing the annual recon as multiple events to mitigate against the risk of the current single event trades. Once the research on the possible alternatives has been completed, simulations from the new operating system will be shared with the advisory committee using live data. FTSE Russell assured the advisory committee that no changes will be introduced for the June 2021 recon.

Constituent Distribution of Digital Assets

The topic was raised at the September 2019 meeting when a company had recently paid a distribution in cryptocurrency; resulting in no action being taken within the index. FTSE Russell said that guidance will be provided in the methodology to clarify that if a passive index fund holding such a security is able to trade the distribution on an eligible exchange, with no significant barriers, the exchange-traded value would be used to reflect the distribution. If this is not the case, the distribution would be treated as having zero value. There was no objection to this approach and the topic will be given further consideration within the internal governance process before any guidance is published.

Business Development Companies (BDCs)

US Securities and Exchange Commission (SEC) rules require that any expenses incurred by a BDC be included in the funds expense ratio as Acquired Fund Fees and Expenses (AFFE). Recently, the SEC published a proposal whereby relief to funds will be provided should the fund's exposure generate less than 10% of AFFE. The advisory committee shared their comments on the SEC proposals and were of the view that BDCs should continue to not be included in the index.

3. FTSE EPRA Nareit Global Real Estate Index Series

Eligibility of Automotive Fuel Service Station / Retail Unit REITs

The Regional Real Estate Advisory committees discussed whether the index rules should clarify that restrictions to exclude fuel storage facilities do not apply to automotive fuel service stations with a retail unit. Fuel storage facilities are considered ineligible under rule 4.7.E in which ownership of "Storage caverns/units for commodities such as oil & gas" is not considered an eligible real estate activity. There was general support for a clarification of the rule to provide more transparency.

Eligibility of Interconnection Revenue for Data Centers

Data Centers have been included in the FTSE EPRA Nareit Global Real Estate Index Series for over 15 years, and in response to the size of the sector and client requests, a distinct Data Centers property sector was established in 2019. Rule 4.7.J states that data center revenue labelled colocation should be considered as eligible real estate revenue if the information provided in the annual report is sufficient in detail to ensure that revenues from ineligible activities are not included. Interconnection revenue is an essential part of the operation of data centers, but the rules are currently silent as to the eligibility of this revenue.

Opinions were divided on this area: the APAC Regional Advisory Committee welcomed the proposal to include interconnection revenue as an eligible real estate activity; however, members of the Americas Regional Advisory Committee said the proposed expansion of the representation of data centers was not compelling, and the EMEA Regional Advisory Committee suggested more consideration was needed. The index partners will give further consideration to this topic and will bring it back to the committees for discussion at a later meeting.

4. Policy Advisory Board

Policy Advisory Board comprises market practitioners of the most senior level based throughout the globe who provide feedback from a strategic viewpoint.

The members considered a report on the FTSE Term SONIA Reference Rates (TSSR) initiative; daily indicative rates based on overnight indexed swaps are publicly available on the FTSE Russell [website](#). FTSE Russell's decision to calculate TSRR follows the Bank of England's decision to not support LIBOR beyond 2021.

Members were updated on the FTSE Russell Green Revenues Classification System. The classification system is designed to provide a modular approach for investors to comply with the requirements of the EU Taxonomy.

An update on the UK Financial Conduct Authority Senior Managers and Certification Regime (SMCR) was provided, describing how it will apply to Benchmark Administrators such as FTSE Russell. The SMCR has replaced the current FCA Approved Persons Regime and will take effect from 7 December 2020, with a 12-month transitional period. The extension of the SMCR will bring all firms undertaking FCA regulated activity in-scope and will align FTSE International Ltd with other London Stock Exchange Group entities under SMCR.

Other topics discussed at the Policy Advisory Board include the following: recommendations for the September 2020 Equity Country Classification Announcement, the Fixed Income Country Classification Announcement and proposed enhancements to the FTSE Equity Country Classification framework.

5. Green Industries

A progress report on the implementation of Green Revenues 2.0 (GR 2.0) was shared at an extraordinary meeting in September. GR 2.0 data will be used to assess companies against the new Green Revenues Classification System (GRCS) which will replace the current Environmental Markets Classification System. A report on the need for green taxonomies, developments and approaches taken by the EU Taxonomy, and on GRCS was published by FTSE Russell on 14 September 2020; see hyperlink: [Sizing the green economy: Green Revenues and the EU taxonomy](#)

The advisory committee considered the potential options for incorporating GR 2.0 data in the indexes. Green revenues data is currently used in several tilt and selection indexes such as the Green Revenues, Smart Sustainability, Global Climate, TPI, SDG and Divest-Invest indexes.

Committee members commented on the options for incorporating the GR 2.0 data and voiced support for FTSE Russell's proposal to not introduce substantive changes in advance of the December 2020 index review. To allow sufficient time for impact analysis, client engagement, and market notice ahead of implementation, the transition is likely to commence with the June 2021 review. There will be further consideration by FTSE Russell prior to the announcement of the way forward in a market notice.

6. Asia Pacific Index Partner Advisory Committees

Singapore: at the September semi-annual meeting, the members of the STI & FTSE ST Index Advisory Committee considered and supported the proposed semi-annual index review. The committee members shared their comments on the treatment of suspended companies within FTSE indexes.

7. Fixed Income Country Classification

Country Classification - Joint Meeting of the Regional Advisory Committees

A joint meeting of the three Regional Fixed Income Advisory Committees and index clients was convened in September to discuss the progress being made by the Watch List markets, in preparation for the Annual Announcement.

The proposed options for a potential China inclusion in the FTSE World Government Bond Index (WGBI) were debated and additionally, the proposed changes to the FTSE Fixed Income Country Classification Watch List process were discussed. The proposals considered include: the minimum market size threshold requirements for inclusion in the global index; the assignment of Market Accessibility Levels; and when new standalone indexes should be announced. Further review will take place within the FTSE Russell internal governance process.

Country Classification – Annual Review

The results of the Annual Country Classification Review were approved by the FTSE Russell Product Governance Board and announced on 24 September 2020, following extensive consultation with the Policy Advisory Board, the Regional Fixed Income Advisory Committees, and index clients.

The headline changes announced were:

- **China** – to be reclassified from Market Accessibility Level 1 to 2, subject to final affirmation in March 2021 from members of the advisory committees and other index users that the anticipated improvements to ease market access for international investors have been integrated into working practice. Those three areas are: i) the account opening process (including the ability to register at legal entity level); ii) the ability to transact FX with third parties; and iii) the changes to the settlement process to allow settlement beyond T+3. The inclusion of China is scheduled to commence with the October 2021 profiles; inclusion of Chinese Government bonds will be phased into the index over a 12-month period.
- **Malaysia** – retained on the Watch List for possible reclassification from Market Accessibility Level 2 to 1.

A market included on the Watch List signals that engagement will take place with the local market authorities to address the outstanding Market Accessibility Level criteria. The full announcement can be found here:

[Annual Announcement – FTSE Fixed Income Country Classification - September 2020](#)

The following topics were also considered at the Regional Fixed Income Advisory Committees.

8. Fixed Income Methodology

Index Credit Rating Methodology – Future Evolution

Moody's and S&P ratings are currently used within FTSE fixed income indexes. A proposal to incorporate Fitch ratings by moving to a middle-of-three credit rating methodology was widely supported by committee members and will proceed to be considered at the FTSE Russell internal governance process.

International Organization of Securities Commission (IOSCO) – Annual Review of Ground Rules

IOSCO is recognised as the global standard setter for the securities sector. It develops, implements and promotes adherence to internationally recognised standards for securities regulation.

As part of the annual process of assessing compliance with the IOSCO principles for Financial Benchmarks Final Report (the IOSCO Principles), the Regional Fixed Income Advisory Committees conducted the annual review of the Statement of Principles and endorsed that the policy continues to meet the purpose for which it was designed. The principles are invoked by FTSE Russell in the event that strict adherence to the Ground Rules might

potentially lead to significant market distortion. A link to the policy can be found [here](#).

EMEA - FTSE Actuaries UK Gilts Index Series

At the September meeting, committee members considered the date to be used to determine the term to maturity for sliding gilts to the lower maturity bucket sub-index. Advisory committee members commented that the process outlined at the meeting could prove to be more efficient and might avoid unnecessary turnover. FTSE Russell will consider the feedback and undertake further analysis for discussion at the next meeting.

US

FTSE Mortgage Index

Freddie Mac and Fannie Mae Uniformed Mortgage-Backed Securities (UMBS) are tracked separately at the cohort level in the FTSE US Agency Mortgage Index. The advisory committee considered whether to continue to track UMBS separately or combine into a single cohort. Committee members shared their comments on the efficacy of the current pricing methodology and cohort construction given prevailing valuations and the contemporary market structure, as well as the utility of reporting specified-pool composition data for index cohorts.

FTSE US Broad-Investment Grade Index

US-denominated Asset-Backed Securities (ABS) are currently eligible for inclusion in the index; however, the index methodology does not specify the eligible collateral type. The advisory committee members commented on the various collateral types under consideration, the introduction of a deal size minimum, and the potential recalibration of tranche size minima to capture additional issuance.

Canada

The Canada Fixed Income Advisory Committee and separately, the Canada Dealer Advisory Forum convened for their September meetings.

FTSE Canada Sector Scheme

The members were informed that FTSE Russell was consulting on whether to create two new sub-indexes in the Government Provincial Sector: 'Pure Provincial Bond Index' and 'Quasi-Provincial Bond Index'; the exact index naming conventions are to be confirmed. Within the 'Quasi-Provincial Bond Index', the sub index would be broken down into two further sub-indexes: 'Agency' (to include bonds not directly issued by the province but guaranteed by the province), and 'Non-Agency' (to include bonds not directly issued by the province and *not* guaranteed by the province). There are no changes proposed to the Sector classification scheme. The committee members shared their comments.

FTSE Canada Par Call handling

The members favoured a proposal for FTSE Russell to include an additional field: 'Weighted Average Yield to Worst (YTW)', to reflect bonds with a par call option. The current index files include the Weighted Average Yield to Maturity (YTM).

Review of collateral type eligibility for asset backed securities (ABS)

Debate took place on whether clarification should be provided in the methodology on the eligible ABS collateral types for index inclusion. The committee members were of the view that there is currently no need for further clarity to be included within the methodology.

Consultation on the 0+ and 0-1 Real Return Bond Index

The FTSE Canada Real Return Bond (RRB) Index has a concentration of securities which have a staggered maturity across the curve; every five years, approximately 10-15% of the market cap matures and exits the index. Committee members shared their comments on whether a 0+ version of the RRB index should be created or whether there should be a potential future change to the existing index methodology. FTSE Russell is giving this topic further consideration.

Separately, a client notice was released to inform market participants that the two securities which will fall below the minimum one year to maturity criterion for index inclusion will exit the FTSE Canada Real Return Bond index on 1 December 2020 in line with published index methodology.

Review of Limited Recourse Capital Note (LRCN)

Discussion took place on the inaugural issuance of an LRCN in July 2020 and FTSE Russell's decision to deem the LRCN ineligible for index inclusion. Committee members shared their views on how LRCNs are being priced and treated in the market, and whether there would be interest for the creation of a standalone LRCN index.

The advisory committee members commented that there was general support from the buy-side community to deem LRCNs ineligible for index inclusion.

FTSE Canada Treasury Bill Index Series

Following requests from clients and advisory committee members, additional analytics within the T-Bill constituent files are to be provided. Effective from October 2020, files will contain constituents for all T-Bill indexes. The files will be published daily on FTP at approximately 5:30pm (EST) and made available on third party platforms upon request.

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