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# FTSE Russell Nationality Assignment

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*Important Information*

*The proposals set out in this consultation document are included in order to gather feedback and may or may not result in changes to FTSE Russell Nationality Assignment.*

# FTSE Russell Nationality Assignment Consultation

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## Responding to the Consultation

Please submit your response to the questions included in this consultation online at <https://www.surveymonkey.co.uk/r/FVRCJXS>. If you have any questions about this survey, or if you encounter any technical issues, please contact [rpauson@FTSERussell.com](mailto:rpauson@FTSERussell.com).

## Introduction

As part of the ongoing effort to align the methodologies of the FTSE and Russell index series, the processes by which the respective indexes evaluate and assign nationality to constituent companies are currently under review. This consultation sets out a proposal for a unified nationality assignment rule that could be applied consistently across both FTSE and Russell global index series. Your observations, comments, and objections to the proposals in this consultation are encouraged.

The aim of the proposed nationality assignment rules is to ensure that nationalities are assigned to the vast majority of companies in an objective and transparent manner while allowing for limited discretion to be exercised in a small minority of cases where the rules result in a nationality assignment that seems illogical or unintuitive in the eyes of investors or other stakeholders.

If the proposed rule were to be implemented, there would be only a limited impact on current index memberships. For example, had the new rule been applied at the last Russell index reconstitution, 101 constituents of the Russell Global Index series would have been assigned a different nationality and of the 101, 27 would have become potential additions to the Russell 3000 index (and of these, 12 would have been eligible for the R1000). In addition, there would have been 49 nationality changes to constituents of the FTSE Global Equity Index Series (GEIS). A summary of the resultant changes is provided in the appendix to this consultation and a full list of indicative nationality assignments is provided in the accompanying spreadsheets.

Another corollary of the proposed rule is that certain companies would be assigned to countries where they are not listed or traded; this would represent a change to the GEIS (but not the RGI) indexes. For example, under the proposed rule, Prada would be assigned to Italy rather than, as currently in GEIS, to Hong Kong.

Although we believe this to be an appropriate nationality assignment from the perspective of a global index, we recognize that local FTSE indexes, particularly those which form the foundation of derivatives and ETFs, would continue to require their constituents to be traded in the region.

For this reason, the proposed nationality assignment rule is intended, at least in the first instance, to apply only to global indexes and to indexes derived from these. In order to avoid disruption to local index series, including the FTSE UK Series, we are proposing to recast the eligibility requirements of those indexes in terms that do not explicitly refer to a constituent's nationality assignment.

That proposal might in turn have implications for investors with mandates that follow composite indexes, for example 60% FTSE All World ex-UK plus 40% FTSE All Share: in such mandates certain constituents might be duplicated and others might be omitted. In the light of this, the consultation includes a question as to whether that consequence would be sustainable in the long term and, if not, whether certain of the local index series should, after a further consultation period, also adopt the new nationality assignment rule as part of their eligibility requirements.

## Current Processes

The current **Russell indexes nationality assignment rule** first establishes whether the company's headquarters (HQ), country of incorporation and a listing match. If so, the company is placed in that country. If not, three "Country of Risk" indicators are assigned to the company: HQ, Incorporation, and Primary Listing and the location of the company's assets is evaluated. If the location of the company's assets matches one of the Country of Risk indicators, the company is placed in that country. If not, the same test is conducted on the company's revenues. If that test too proves inconclusive, the nationality of the company defaults to location of its headquarters (HQ); however if the HQ lies in a Benefit Driven Incorporation (BDI), or if there is no domestic exchange (NDE), then the company is placed in the country of the primary listing. Full details of the Russell indexes nationality assignment process can be found within the Russell index methodologies:

<http://www.ftse.com/products/downloads/Russell-US-indexes.pdf>

<http://www.ftse.com/products/downloads/Russell-global-indexes.pdf>

The current **FTSE indexes nationality assignment rule** establishes whether the company is incorporated and has its sole listing in the same country and whether that listing meets the minimum liquidity requirement; if so, the company is assigned to that country. In all other circumstances, FTSE nationality is generally assigned to the country with the highest liquidity although the rules provide that other factors such as HQ, tax domicile, and perception of investors may be considered prior to final nationality determination. Full details of the FTSE indexes nationality assignment process can be found within the FTSE nationality guidelines:

[http://www.ftse.com/products/downloads/Determining\\_Nationality.pdf](http://www.ftse.com/products/downloads/Determining_Nationality.pdf)

## Proposal

The steps below set out a proposed nationality assignment process that combines attributes of the methods used in both the Russell and FTSE global indexes. Steps 1-3 closely align with the existing rules-based approach within the Russell indexes; please refer to the Russell methodology documents for full details. Steps 4 and 5 are more closely aligned with the current FTSE guidelines. The accompanying spreadsheet provides examples of the assignment process.

### Step 1 (assess country of risk indicators)

IF headquarters (HQ), country of incorporation and (any) listing match, then nationality is assigned to that country.

ELSE proceed to Step 2.

## **Step 2 (assess assets)**

IF the location of the company's assets matches one of the Country of Risk indicators (i.e. HQ, Incorporation, or Primary Listing), then nationality is assigned to that country.

ELSE proceed to Step 3.

Please note:

i) The assets test is deemed conclusive if the difference in the location of assets between the top and second ranked countries is at least (an absolute) 20% when calculated using the two year average. If it is less, the asset test is deemed inconclusive and the process moves to the next step. Statements such as "substantially all" or "majority of" will be accepted as confirmation that the stated threshold (i.e. 20%) has been achieved.

ii) Primary Listing is defined as the most liquid exchange by the two-year average daily dollar trading volume (ADDTV) from all exchanges within a country.

## **Step 3 (assess revenues)**

IF the location of the company's revenues matches one of the Country of Risk indicators (i.e. HQ, Incorporation, or Primary Listing), then nationality is assigned to that country.

ELSE proceed to Step 4.

Please note:

i) The revenues test is deemed conclusive if the difference in the source of revenues between the top and second ranked countries is at least (an absolute) 20% when calculated using the two year average. If it is less, the revenue test is deemed inconclusive and the process moves to the next step. Statements such as "substantially all" or "majority of" will be accepted as confirmation that the stated threshold (i.e. 20%) has been achieved.

## **Step 4 (primary listing)**

IF nationality has not been determined by Steps 1 -3 above then the nationality is assigned to the country of primary listing.

## **Step 5 (Chinese companies only)**

Following Steps 1-4, an additional step is undertaken to determine whether a company should be allocated a nationality of China:

IF (A-share/B-share/H-share/N-share/Red-chip/P-chip/S-chip) THEN nationality is assigned as China.

IF NOT: Continue to classify as country of Primary Listing.

## **Step 6 (other factors)**

In exceptional circumstances, FTSE Russell may consider factors other than incorporation, headquarters, assets, revenues, and primary listing when Steps 1-5 remain ambiguous or have yielded a nationality assignment that is illogical or unintuitive. These other factors may include but are not limited to:

- i. Tax domicile
- ii. Additional listings and their relative liquidity
- iii. Location of company meetings
- iv. Composition of its shareholder base
- v. Nationality and location of its board of directors

- vi. The currency denomination of its shares
- vii. Currency used in the reporting of annual accounts
- viii. The perception of investors
- ix. The perception of the company.

**Please note:**

- As a consequence of the proposed rules, FTSE Russell would allow “out of region” trading, e.g. a company that trades only in the US could be assigned to China.
- The definitions used for the various Chinese share classes in Step 5 are set out in [http://www.ftse.com/products/downloads/Guide\\_to\\_Chinese\\_Share\\_Classes.pdf](http://www.ftse.com/products/downloads/Guide_to_Chinese_Share_Classes.pdf)

## Consultation Questions

1. Do you agree that matching incorporation, HQ, and (any eligible) listing is an appropriate first step for determining nationality?

Yes

No

If no, please provide your justification; if yes, please feel free to provide supplementary comments that you want to add for consideration:

2. If incorporation, HQ, and listing do not match, do you agree that firstly assets and then revenues (Steps 2 and 3) should be reviewed to establish nationality?

Yes

No

If no, please provide your justification; if yes, please feel free to provide supplementary comments that you want to add for consideration:

3. Russell currently assumes that assets and revenues (Steps 2 and 3) are deemed “conclusive” if they contribute at least 20% more than the next largest contributing country, calculated using a two year average. Do you agree that 20% is an appropriate threshold?

Yes

No

If no, please provide your justification; if yes, please feel free to provide supplementary comments that you want to add for consideration:

4. Full details of the current Russell Assets and Revenues reporting guidelines (e.g. country versus regional reporting) are detailed in Appendix B of the Russell US methodology document and Appendix H of the Russell Global Index document (links provided on page 1). Under the proposal these guidelines will be followed during Steps 2 and 3. Do you agree with these guidelines?

Yes

No

If no, please provide your justification; if yes, please feel free to provide supplementary comments that you want to add for consideration:

5. Referring to Step 4:

- a. Do you agree that the Primary Listing (highest liquidity) should serve as the default assignment in Step 4?

Yes

No

- b. If no, what factor do you believe should be used as the determining factor to assign nationality?

Country of Incorporation (if not a BDI)

Headquarters (if not a BDI)

None of the above (please provide an alternative)

Please feel free to provide supplementary comments that you want to add for consideration:

#### 6. Referring to Step 5:

a) **Do you agree that a company that is one of A-share/B-share/H-share/Red-chip/P-chip/S-chip/N-share should always be assigned to China, regardless of the other factors, including assets and revenues allocation?**

Yes

No

No Opinion

If no, please provide your justification; if yes, please feel free to provide supplementary comments that you want to add for consideration:

b) **Do you agree that only companies that are one of A-share/B-share/H-share/Red-chip/P-chip/S-chip/N-share can be assigned to China?**

Yes

No

No Opinion

If no, please provide your justification; if yes, please feel free to provide supplementary comments that you want to add for consideration:

#### 7. Referring to Step 6:

a) **Do you agree that a FTSE Russell review (Step 6) is appropriate if nationality allocation using steps 1-5 could be considered illogical or unintuitive?**

Yes

No

If no, please provide your justification; if yes, please feel free to provide supplementary comments that you want to add for consideration:

b) **Do you agree with the list of factors used to consider when reviewing nationality in Step 6?**

Yes

No

If no, please provide your justification; if yes, please feel free to provide supplementary comments that you want to add for consideration:

c) **Are there any additional factors that you believe should be considered that are not included within the list?**

Yes

No

If no, please feel free to provide supplementary comments that you want to add for consideration; if yes, please provide specific factors that you think should be included, with your rationale:

**8. In conjunction with the nationality alignment, the FTSE indexes would accommodate “out of region” trading, e.g. a company that trades in the US may be assigned to China. Do you agree with this?**

Yes

No

If no, please provide your justification; if yes, please feel free to provide supplementary comments that you want to add for consideration:

**9. To accommodate “out of region” trading, FTSE Russell proposes one of the following:**

- i) To produce provisional product files for Asia and EMEA using the previous day’s closing prices for constituents trading “out of region”. Final, end-of-day product files will be provided when all markets have closed; or alternatively
- ii) To delay the production of all global product files until all markets have closed (domestic indexes will continue to be produced after their local market close).

Would you prefer option i) or option ii)?

i

ii

Please provide some comments to support your preference:

**10. Current FTSE index series rules preclude companies from being considered eligible if they trade solely via depositary receipts without a listed underlying share. Within the Russell Global Indexes (ex-US), depositary receipts are eligible regardless of listed underlying shares. Do you agree that a depositary receipt should be considered eligible within the FTSE Indices regardless of the underlying shares being listed? This would allow Alibaba (BP41ZD1) and Baidu (B0FXT17) (for example) to become eligible for inclusion and subject to the proposed nationality rules to determine country membership.**

Yes

No

If no, please provide explanation; if yes, please feel free to provide supplementary comments that you want to add for consideration:

**11. To avoid disruption to certain domestic indexes, particularly those that form the basis for derivatives and some ETFs, we are proposing to remove a local nationality assignment as a prerequisite for inclusion. For example, in order to ensure that only UK traded stocks remain eligible for inclusion in the FTSE 100 Index, rule 4.4 of the FTSE UK Index Series which is currently written as the requirements for assignment of UK nationality could be recast solely in terms of eligibility requirements for the FTSE UK Index Series. Do you support removing nationality assignment as a requirement for inclusion within certain domestic indexes?**

Yes

No

If no, please provide explanation; if yes, please feel free to provide supplementary comments that you want to add for consideration including your views as to which local index series such a treatment would be appropriate:



**12. If local index series do not implement the new nationality assignment rule (as a result of feedback received on Question 10), there may be implications for mandates that employ a broad local index as part of their asset allocation. For example, a current FTSE UK All-Share index constituent could continue to be included within the FTSE UK All-Share Index, but could also simultaneously be a constituent of a FTSE Global Equity Index Series ex-UK index thus leading to potential portfolio overlap. On the basis of the size of the potential overlap as provided in the appendix, do you consider this to be a problem?**

Yes

No

N/A

If yes, please provide your justification; if no or N/A, please feel free to provide supplementary comments that you want to add for consideration:

**13. If in Question 11 you considered that the potential portfolio overlap would be a problem, would you still object if the overlap were to be temporary, e.g. 1 or 2 years, and if a roadmap were provided with the objective of aligning the domestic index eligibility rules with the new global nationality rules? For example, the FTSE UK Series might, after a suitable notice period and further consultation, again require UK nationality assignment in accordance with the new global nationality rule, as one of the eligibility requirements for inclusion.**

Yes

No

N/A

If yes, please provide your justification; if no or N/A, please feel free to provide supplementary comments that you want to add for consideration:

**14. Current FTSE nationality rules preclude a company that is incorporated in a country that is classified as other than developed, from being assigned to a developed nationality; for example, under the FTSE nationality rules, a company incorporated in an emerging country but with a sole listing on a developed market is removed from eligibility. Do you consider that this principle should continue to be applied?**

Yes

No

If no, please provide explanation; if yes, please feel free to provide supplementary comments that you want to add for consideration:

**15. FTSE Russell aims to implement the aligned nationality guidelines in June 2017. Do you agree with this timeline?**

Yes

No

If no, please provide explanation and state when you think an appropriate implementation date would be; if yes, please feel free to provide supplementary comments that you want to add for consideration:

# Appendix

## Potential Impact

In this appendix, we provide pro-forma analysis of the potential impact to the various index series were the proposed nationality rule to be implemented. Please note that this analysis is based on the company data that was available to FTSE Russell at the time a company's nationality was last reviewed. If the proposed rule were to be implemented, actual nationality assignments would be made on the basis of more recent data and so may differ from those presented here and in the accompanying spreadsheet.

### Russell 3000E

All current constituents would automatically maintain their current nationality assignment by virtue of Steps 1-4 with the exception of 2 companies.

- 2 Russell 3000 companies would be excluded from US membership as a consequence of their having an ex US Primary Listing (combined investable market capitalisation of approximately \$2.97bn).
- There would be 27 additions to the Russell 3000 (moving from RGI) due to Step 4, with the additions triggering one way turnover of approximately 0.58% (12 to the Russell 1000 with 0.58% one way turnover; and 15 to the Russell 2000 with 0.48% one way turnover).

### RGI ex-US

#### Nationality Assignment under Steps 1 - 3

Under the proposed rule, approximately 7,000 companies would be assigned nationality under steps 1-3, all of which would match the current RGI nationality assignment.

#### Nationality Assignment under Step 4

72 companies would be assigned nationality under Step 4, all of which would default to the current FTSE nationality assignment.

All 72 companies would switch nationality in RGI:

- 45 could move to another RGI ex-US nationality by virtue of Step 4 referencing the Primary Listing as opposed to defaulting to HQ as per the current Russell RGI methodology.
- 27 could move to the Russell 3000 by virtue of their having a US Primary Listing.

#### Nationality Assignment under Step 5

A further 24 companies currently allocated a nationality of China would be assigned elsewhere as they are not an A-share, B-share, H-share, N-share, Red-chip, P-chip or S-chip. 5 companies would be allocated a nationality of China due to S share or N share designation.

27 companies move from Emerging to Developed countries by virtue of their reassigned nationalities. Of these, 21 are changes from China to Hong Kong. The same 5 companies changing nationality due to S share or N share designation are the only projected movers from Developed to Emerging countries.

### FTSE Indexes

Within FTSE indexes:

- 49 constituents of the FTSE Global Equity Index Series would switch nationality.
- 120 companies move from Developed to Emerging countries by virtue of their changed nationality. No companies move from Emerging to Developed.
- Baidu and Alibaba are currently ineligible for FTSE GEIS indexes, but if responses to Question 9 were to support their future inclusion, these companies would be assigned to China.

- 1 UK Small Cap, 4 FTSE 250 and 3 FTSE 100 companies would lose their UK nationality.
  - 4 companies currently with US nationality would be assigned UK nationality.
- Please note: as set out earlier in this consultation, we are not proposing to remove companies that are assigned non-UK nationality as a result of this proposal from the UK Series. Similarly, companies that are assigned a UK nationality will not be automatically eligible for inclusion in the UK Series. At least in the short term, FTSE UK All-Share constituents would remain in the FTSE UK All-Share by virtue of the FTSE UK All-Share Index eligibility screening being restated so as not to require a UK nationality assignment resulting from the proposed new rule.*

## For more information about our indexes, please visit [ftserussell.com](http://ftserussell.com).

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