

Market consultation

The FTSE Russell logo consists of a light blue circle containing the text "FTSE" stacked above "Russell" in a white, sans-serif font.

FTSE
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FTSE China A Index Offering



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Introduction

The opening of China's onshore equity market has afforded foreign investors greater degrees of access to what is now the world's second largest equity market.

The number of investable onshore Chinese equities has increased from 1,060 at the end of 2001 to 4,140 at the end of 2020¹. By the same token, the first phase of FTSE Russell's China A Share implementation in June 2020 saw more than 1,000 China A shares added to the FTSE Global Equity Index Series (GEIS)².

As the China A share market has grown, there has been an increase in calls from index users and investors for a larger variety of tools to assist with the management of their portfolios. To this end, indices with greater diversification have become a priority for many market participants.

FTSE China A Index Offering Market Consultation

Against the backdrop of the developments and market dynamics outlined above, FTSE Russell remains committed to offering the most representative indices for the Chinese stock market and ensuring that index users, trackers and investors can benefit from tools that provide the broadest possible market representation. On this basis, FTSE Russell is inviting index users and other stakeholders to participate in a consultation on the [FTSE China A index offering](#).

The purpose of the consultation is to ensure that the FTSE China A Indices continue to meet the requirements of index users. As a result, FTSE Russell is soliciting market feedback on a number of aspects in relation to:

- i) index market representation;
- ii) the index weighting methodology; and
- iii) index constituent accessibility.

This feedback will be sought in accordance with the [FTSE Russell Policy for Benchmark Methodology Changes](#). The consultation will close on 11 October 2021.

¹ Source: FTSE Russell.

² Source: FTSE Russell press release: [FTSE Russell completes landmark inclusion of China A Shares](#), published 22 June 2020

Responding to the consultation

The proposals set out in this consultation document are included in order to gather feedback and may or may not result in changes to our indices or data solutions.

Index users and other stakeholders are invited to respond by 11 October 2021. The responses will be reviewed by the FTSE Russell Product Governance Board and an update on FTSE Russell's proposed approach will be communicated in due course.

Please submit your response to the questions included in this consultation online at <https://www.surveymonkey.co.uk/r/FTSEChinaAIndexOffering>

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 committeesecretary@ftserussell.com.

FTSE China A Index Offering Consultation

Market Representation

China's A share market has expanded in recent decades. The number of investable equities in the China A share market as of August 2021 amounted to 4,451³. Almost 2,000 of these investable equities are members of the FTSE China A All Cap Free Index, which comprises all Large, Mid and Small Cap A share constituents that meet the index eligibility requirements.

The table below displays a selection of FTSE China A Indices, including the number of constituents and the percentage that those constituents represent in the China A Universe and the FTSE China A All Cap Free Index respectively. From this data it can be inferred that the China A share market has considerable depth beyond the small cohort of very large companies that typically characterise Emerging Markets. Given these market characteristics, FTSE Russell is looking to establish whether the index selection below provides appropriate Large and Mid market capitalisation delineation and representation for a tradeable index, or whether index users would prefer, or consider, alternative index solutions.

A selection of the FTSE China A Indices

	Number of companies	% China A Universe	% FTSE China A All Cap Free Index
China A Universe	4,451	100.00%	
FTSE China A All Cap Free Index	1,993	81.66%	100.00%
Indices with fixed number of constituents			
FTSE China A50 Index	50	25.01%	30.63%
FTSE China A 200 Index	200	45.73%	56.00%
FTSE China A 600 Index	600	65.04%	79.65%
Indices with variable number of constituents			
FTSE China A Stock Connect CNH Large Cap Index	294	47.72%	58.44%
FTSE China A Stock Connect CNH Mid Cap Index	417	11.59%	14.19%
FTSE China A Stock Connect CNH Index	711	59.31%	72.63%

Source: FTSE Russell. Data as of 23 August 2021. For further details of the FTSE China A index offering, please refer to Appendix A.

³ Source: FTSE Russell data.

Market Capitalisation Weighted Approach

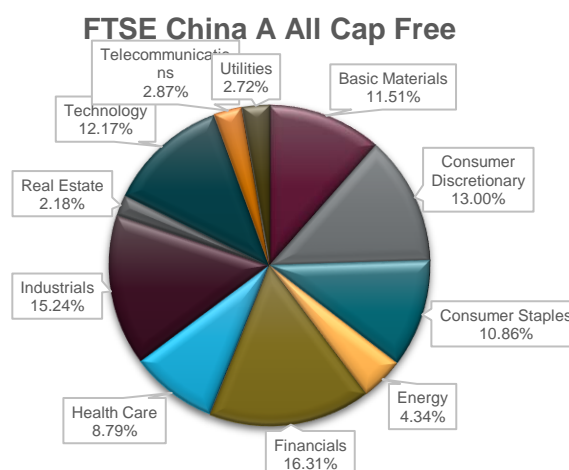
FTSE Russell imposes neither individual constituent nor sectorial capping within the FTSE China A Indices, the aim of which is to ensure the indices are representative of the China A share market.

The China A share market is diverse and has greater intra-market differentiation than most other global markets. This can be seen in Exhibit one: despite the Financials ICB industry group comprising only 91 of the almost 2,000 constituents, the Financial Industry represents more than 16% of the FTSE China A All Cap Free Index. On account of state owned banks and insurance companies being the largest listed companies by full market capitalisation, the Financial Industry comprises more than one third of the FTSE China A50 Index (see Exhibit two).

A sector capping, factor-based or an equal weighted index construction approach could lead to higher index turnover. Some stocks may be significantly under/overweight, potentially leading to industry groups being misrepresented. Consequentially, and in time, this may cause a performance deviation from the broader China A share market. On this basis, it is FTSE Russell's view that a market capitalisation weighted approach continues to offer an appropriate balance between degrees of representation, turnover and tradability for the China A share market, and the construction methodology remains well-understood and transparent.

Exhibit one – FTSE China A All Cap Free Index: number of constituents in each ICB Industry and their respective weighting % by full market capitalisation

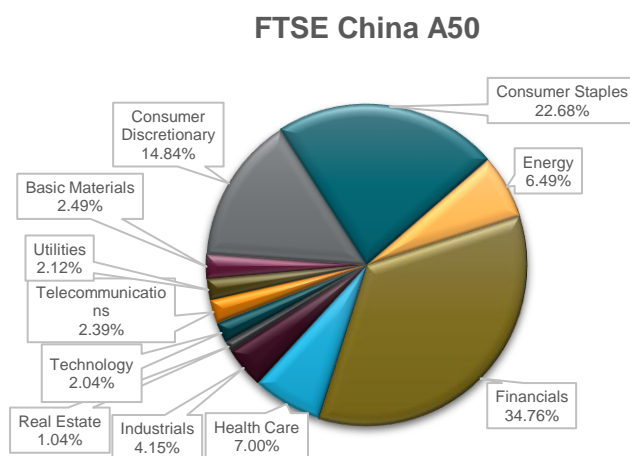
ICB Industry	Number of Constituents	% Weighting by full Mkt Cap
Basic Materials	274	11.51%
Consumer Discretionary	325	13.00%
Consumer Staples	118	10.86%
Energy	58	4.34%
Financials	91	16.31%
Health Care	192	8.79%
Industrials	431	15.24%
Real Estate	89	2.18%
Technology	268	12.17%
Telecommunications	75	2.87%
Utilities	72	2.72%
Grand Total	1993	100.00%



Source: FTSE Russell data as of
23 August 2021

Exhibit two – FTSE China A50 Index: number of constituents in each ICB Industry and their respective weighting % by full market capitalisation

ICB Industry	Number of Constituents	% Weighting by full Mkt Cap
Basic Materials	2	2.49%
Consumer Discretionary	6	14.84%
Consumer Staples	9	22.68%
Energy	3	6.49%
Financials	16	34.76%
Health Care	5	7.00%
Industrials	4	4.15%
Real Estate	1	1.04%
Technology	1	2.04%
Telecommunications	2	2.39%
Utilities	1	2.12%
Grand Total	50	100.00%



Source: FTSE Russell data as of 23 August 2021

Accessibility: Foreign Ownership Levels

International investors are able to invest in China A Shares via the Qualified Foreign Institutional Investor (QFII)/Renminbi Qualified Foreign Institutional Investor (RQFII) and the Northbound Stock Connect (Stock Connect) routes.

The Foreign Ownership Level (FOL) is restricted to 30% for QFII/RQFII and 28% for Stock Connect. Within the FTSE China A Index offering:

- indices such as the FTSE China A 200 Index, which seek to reflect the perspective of domestic investors, do not reflect FOLs;
- indices that seek to reflect the perspective of international investors, such as FTSE China A Stock Connect CNH Index via Stock Connect route, are therefore adjusted to a 28% FOL; and
- indices such as the FTSE China A50 Index, that seek to reflect the perspective of both domestic and international investors, are not FOL adjusted. Any foreign headroom adjustment is only actioned when a constituent breaches the FOL threshold (please see appendix B for a full explanation).

FTSE Russell seeks to refine the available FTSE China A index propositions in relation to the foreign ownership methodology, in order to more accurately reflect the different needs of domestic and international index users.

Accessibility: QFII/RQFII and Stock Connect Routes

The Stock Connect route is perceived by many international investors to be a more convenient method of accessing the China A share market. The FTSE Global Equity Index Series (GEIS) bases the inclusion of China A Shares on the attributes of the Stock Connect route, as this meets the requirements of an Emerging Market when assessed against the applicable [FTSE Equity Country Classification criteria](#).

For a broadly used and highly liquid, tradable index such as the FTSE China A50 Index, FTSE Russell feels that it is appropriate to capture the set of investable securities that is offered through both the QFII/RQFII and Stock Connect routes. As such, FTSE Russell would like to understand whether the FTSE China A indices, with their fixed number of constituents (see table on page four):

- i) should only derive index constituents from the universe of stocks available through the Stock Connect route; or
- ii) should also include the stocks which are accessible via the QFII/RQFII route, in addition to the Stock Connect route.



Consultation Questions

1. FTSE Russell seeks to understand whether index users:

- A: believe that any of the current FTSE China A Indices, with a fixed number of constituents (see page four), provide appropriate market representation for use as a tradable index; or,
- B: would prefer or consider an alternative tradable index with a different number of constituents – for example, the top 100 companies by full market capitalisation, which would represent approximately 40% of the FTSE China A All Cap Free Index;

Number of companies	% China A Universe	% FTSE China A All Cap Free Index
100	33.38%	40.88%

Please enter your comments here:

2. FTSE Russell seeks to understand whether index users:

- A: support the retention of the market capitalisation weighted approach across all of the indices listed on page four, particularly for those with a fixed number of constituents;
- B: support individual stock capping;
- C: support sectorial capping; or
- D: would prefer or consider an alternative index weighting solution.

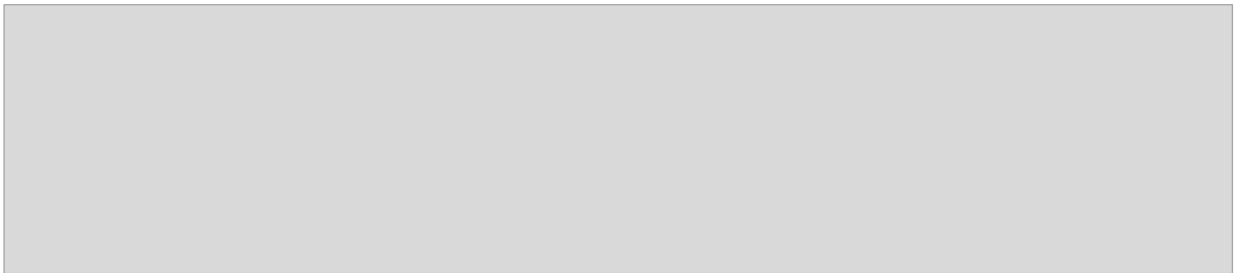
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3. FTSE Russell seeks to understand whether the policy for foreign ownership management should be aligned across the FTSE China A index offering. Index users are asked to indicate whether they:

- A: do not support the alignment of the FOL management policy and instead would prefer to keep to the status quo (as outlined on page seven);
- B: support the alignment of the FOL management policy across all FTSE China A indices; or
- C: would prefer or consider an alternative proposal.

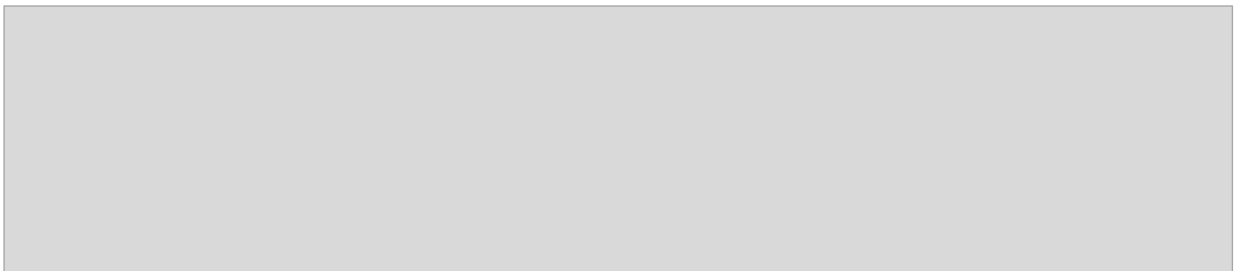
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4. For the FTSE China A indices, which have a fixed number of constituents (see page four), FTSE Russell seeks to understand whether index users support:

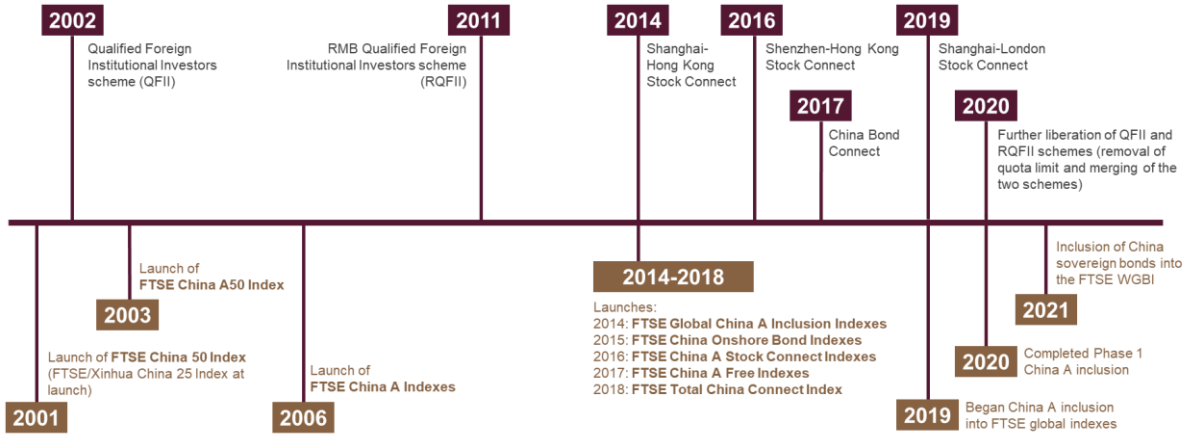
- A: the derivation of the eligible stocks from both the QFII/RQFII and Stock Connect routes;
- B: the derivation of the eligible stocks from the Stock Connect route only; or
- C: an alternative proposal.

Please enter your comments here:

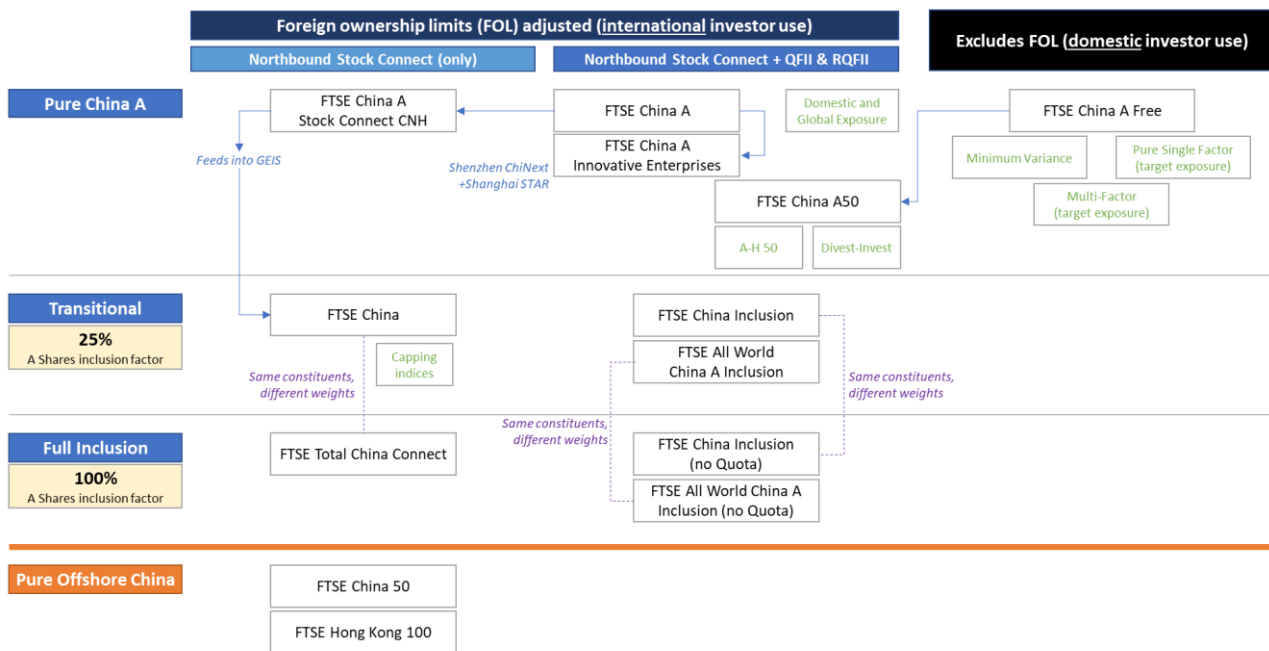


Appendix A

FTSE Russell China Index Offering



Source: CSRC, SAFE, PBOC, FTSE Russell, April 2021



For illustration purpose only. Does not represent all available China index products (e.g. does not list out all available market cap variants, sector indices, etc.). Green text boxes represent select derived indices.

Appendix B

FTSE China A50 Index Ground Rule – 4.4.3 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. $(49\% - 39\%)/49\%$.

- A)** 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.
- B)** For an existing constituent that is subject to foreign ownership limit, a minimum headroom of 10% must be available.
- C)** Headroom tests are conducted in conjunction with the March, June, September and December quarterly reviews.
- D)** Where the headroom of an existing constituent falls below 10% and its free float is greater than its foreign ownership limit⁵, its investability weight will be lowered to its foreign ownership weight in four steps, i.e. the next four consecutive quarterly reviews, in equal proportion. The reduction will not be reversed in the case that the foreign headroom rises above 10%.

For example, if Company A’s free float is 60% (i.e. Free Float is greater than the 28% FOL), its investability weight will be reduced in the following steps:

Company A’s free float subsequently decreases from 60% to 40%	
(Q1) First Headroom Adjustment	52% (8% reduction from 60%, where $8\% = (60 - 28\%)/4$)
(Q2) Second Headroom Adjustment	40% (reflects reduced free float from 60% to 40%)
(Q3) Third Headroom Adjustment	34% (6% reduction from 40%, where $6\% = (40 - 28\%)/2$)
(Q4) Fourth Headroom Adjustment	28% (6% reduction)

- E)** Where the headroom of an existing constituent falls below 10%, and its free float is less than its foreign ownership limit or following the weight adjustments in 4.4.3 D) its headroom remains 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%.
- F)** For example, if Company B’s current investability weight is 20% (i.e. free float is more restrictive than FOL), a 10% absolute reduction will result in an adjusted investability weight of 10% $(20\% - 10\%)$.
- G)** 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% $(49\% * 0.9)$.
- H)** Where the aggregate foreign shareholding of an existing constituent has reached the foreign ownership limit of 28% intra-review, 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.
- I)** 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.

- J)** Following the first headroom adjustment of 10% as described in E) and F), 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 subject to the rules outlined 4.4.2.
- K)** 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 the condition that either the company's foreign ownership is no longer flagged by the stock exchanges and when the headroom remaining minimum 20% post reversal. The adjustment will continue until its investability weight reaches the free float (where free float is less than FOL as illustrated in example 1 below) or reaches the FOL (where the FOL is less than the free float as illustrated in example 2 below).
- L)** Example 1, Company A has an FOL of 28%, foreign holdings of 17%, and it has a free float of 25% with a current headroom adjusted investability weight of 10%.
- M)** Step 1: The foreign headroom test is calculated as 39.3% (i.e. $(28\% - 17\%) / 28\%$), highlighting a potential reversal.
- N)** Step 2: The post reversal foreign headroom test is calculated as 21.4% (i.e. $(28\% - (17\% + 5\%)) / 28\%$), the headroom adjusted investability weight will be increased from 10% to 15% (i.e. $10\% + 5\%$).
- O)** Step 3: Step 1 & 2 will be repeated until the headroom adjusted investability weight reaches 25% (i.e. free float).
- P)** Example 2, Company B has an FOL of 28%, foreign holding of 17% and it has a free float of 75% with a current headroom adjusted investability weight of 10%.
- Q)** Step 1: The foreign headroom test is calculated as 39.3% (i.e. $(28\% - 17\%) / 28\%$), highlighting a potential reversal.
- R)** Step 2: The post reversal foreign headroom test is calculated as 21.4% (i.e. $(28\% - (17\% + 5\%)) / 28\%$), the headroom adjusted investability weight will be increased from 10% to 15% (i.e. $10\% + 5\%$).
- S)** Step 3: Step 1 & 2 will be repeated until the headroom adjusted investability weight reaches 28% (i.e. FOL).

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