
FTSE Russell Consultation on the Treatment of Suspensions

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 Index rules.

FTSE Russell Consultation on the Treatment of Suspensions

Responding to the Consultation

Please submit your response to the questions included in this consultation online at <https://www.surveymonkey.co.uk/r/5C6KPP8>

If you have any questions about this survey, or if you encounter any technical issues, please contact rpawson@FTSERussell.com.

Introduction

The presence of suspended constituents in an equity index can create tracking difficulties for investment firms managing passive funds and ETFs, particularly in the presence of significant cash flows. Accordingly, index providers will typically delete suspended constituents from their indexes after some specified time period. However, the timing of the deletion, and the price at which the deletion takes place, can cause problems in their own right. The difficulties are exacerbated if the investment manager is using swaps or other derivatives to obtain the requisite exposure.

Suspensions are uncommon in the majority of stock exchanges that are included in the FTSE Global Equity Index Series (GEIS) and historically stock suspensions have not proved unduly problematic for users of that series. Those suspensions that do occur tend to do so as part of the delisting process, as a result of capital restructuring or because of particular corporate events such as equity issuance. However, stock suspensions are far more common in China. As China has recently increased access to its equity markets for international investors and is now being considered for inclusion as an emerging market in global stock market indexes, the formulation of an appropriate stock suspension policy has assumed increased importance.

The importance of the issue is demonstrated when comparing the FTSE Global All Cap Index and the FTSE China A All Cap Index. On 29 September 2017, only 17 of the 7,796 constituents in the FTSE Global All Cap Index were suspended, two of which were China P-chips and one a China H-share. Four of the 17 had been suspended for over 80 business days; two of these were P-chips. In contrast, for the FTSE China A All Cap Index, 91 of the 1,916 constituents were suspended on the same day and 28 had been suspended for over 80 business days. Appendix A provides further analysis of stock suspensions in China including the potential reasons for the propensity of Chinese securities to effectively self-suspend and the regulatory initiatives which have been taken to reduce that trend.

This consultation paper details FTSE Russell's existing rule for the treatment of suspended companies and describes how the rule was formulated. It then provides a series of questions to establish whether further enhancements might be made.

Current Rule on Suspended Companies

The intention of the FTSE Russell suspension policy is to remove those companies that can no longer be tracked, and to provide transparency around how long suspended companies will remain in FTSE Russell indexes and the price and date at which suspended companies will be removed.

A summary of the suspension rule is provided below. For full details please refer to section 4.18 of the [Corporate Actions and Events Guide](#).

- If a constituent is declared bankrupt without any indication of compensation to shareholders, the last traded price will be adjusted down to zero value and it will subsequently be removed from the index with T+2 notice.
- In all other cases, the constituent will continue to be included in the index for a period of up to 20 business days at its last traded price.
- If the constituent continues to be suspended at the end of that period, it will be subject to review and a decision will be taken to either allow the constituent to remain in the index for a further period of up to 20 business days or to remove it at zero value. In making this determination, FTSE Russell will take into account the stated reasons for the suspension. These reasons may include announcements made by the company regarding a pending acquisition or restructuring, and any stated intentions regarding a date for the resumption of trading.
- This procedure will be repeated at successive 20 business day intervals thereafter until either trading recommences or the suspension period reaches 80 business days.
- If the suspension period reaches 80 business days, FTSE Russell will provide notice that the constituent will be removed at zero value at the index review immediately following the expiry of a minimum 40 business day notice period.
- In certain limited circumstances where the index weight of the constituent is significant and FTSE Russell determines that a market-related value can be established for the suspended constituent, for example because similar company securities continue to trade, deletion may take place at the market-related value instead. In such circumstances, FTSE Russell will set out its rationale for the proposed treatment of the constituent at the end of the 80 business day period.
- If following the end of the 80 business day period, a suspended constituent resumes trading before the Wednesday before the first Friday of March, June, September or December, the deletion notice will be rescinded and the constituent will be retained in the index. If the constituent resumes trading after these dates but before the review effective date, the constituent will continue to be removed from the index as previously announced but in these circumstances the deletion may instead be implemented at market value.
- If a constituent has been removed from the index and trading is subsequently restored, the constituent will only be re-considered for inclusion after a period of 12 months from its deletion. For the purposes of index eligibility it will be treated as a new issue.

Background to the Current Rule

FTSE Russell suspension policies have evolved over time as listing regulations have changed, additional markets have been added to the global equity indexes and in order to support the differing requirements from both buy-side and sell-side investors.

The impact of China A-share suspensions on FTSE Russell indexes and its clients in 2015 led to a change in policy on how suspensions were treated. Prior to 2015, the suspension policy excluded constituents from the index if they were declared bankrupt or in the process of delisting. Suspended companies that were undergoing restructuring or pending acquisition would remain in the index and be reviewed for eligibility on a

rolling 20 business day basis. In practice, suspended companies were rarely removed as a result of an active decision and could remain in the index for extended periods. From 21 December 2015, the suspension policy changed to limit the amount of time a suspended company could be retained in the index.

In formulating the current rule, FTSE Russell consulted extensively with market participants including market makers and users of the FTSE China A50 index. ETF product providers were generally in favour of retaining a suspended stock in the index for a maximum of 80 days, deleting it thereafter as any large suspended constituent made the basket creation and redemption process difficult to manage. It was also noted that whilst deletion at zero price might be preferred by long only managers, the opposite was true for swap counterparties providing P-notes to synthetic ETFs.

Although deleting a constituent at fair value rather than zero would mitigate the pricing risk incurred by P-note issuers, it was accepted that in most cases it would be difficult to get a consensus on fair value and therefore would be applied in very limited circumstances. China Vanke was such an example: the tradeable H-share was used as a proxy valuation for the suspended A-share (see the text box in Appendix A).

The 80 business day monitoring period during which a suspended security is retained in the index was deemed appropriate to allow for the complexity of any restructuring activity which might delay a resumption of trading. However, in the event of a confirmed deletion, market participants, including those using FTSE China A50 swaps and other derivatives, advised of a requirement for adequate notice of deletion so that they could adjust their positions and so manage their risk. Those adjustments could well take place over several days, and this observation informed the choice of a minimum 40 business day notice period to deletion.

However, if the deletion decision were subsequently to be reversed, for example because the constituent announced it would resume trading, those adjustments would need to be unwound. In order to provide sufficient time for that process to be completed, the rule further stipulates that a deletion decision would only be rescinded where resumption of trading occurs before the Wednesday before the first Friday of March, June, September or December,

This Consultation

Given the regulatory initiatives surrounding suspended stocks in China, and the tendency for ETFs based on China indexes to move away from synthetic (P-note) exposure, FTSE Russell would like to consult index users on whether the rationale underlying the current suspension rule remains valid, including whether the 80 day hard suspension limit remains appropriate and whether extended notice before a stock is removed from an index is still required. In addition, the consultation takes the opportunity to solicit feedback from index users on a current topic of debate: whether to render ineligible companies that have recently been suspended for an extended period but which have recommenced trading prior to a forthcoming index review.

Consultation Questions

The following questions relate to the current FTSE Russell suspension policy, but also include potential changes/ enhancements. Please refer to Appendix A for analysis of Chinese stock suspensions.

1. What is the maximum number of days that a company should be allowed to remain suspended in a FTSE Russell index before a notice is published stating that the company will be removed?

- A. 20 days
- B. 40 days
- C. 60 days
- D. 80 days
- E. A company should only be excluded if it is in the process of being delisted
- F. Other

If 'Other' is selected please provide any comments in the box below:

2. When publishing a notice stating a company will be removed for reasons other than bankruptcy (where the rules prescribe T+2 notice), how much notice should FTSE Russell provide to market participants before the exclusion is effective?

- A. 5 days
- B. 10 days
- C. 20 days
- D. 40 days
- E. Other

If 'Other' is selected please provide any comments in the box below:

3. Subject to the provision of the notice period in Question 2, when should FTSE Russell exclude the suspended company?

- A. At the next index review
- B. At the expiry of the notice period
- C. Other

If 'Other' is selected please provide any comments in the box below:

4. If FTSE Russell announces the removal of a suspended company from an index at the next review (option A in question 3), but prior to being removed the company resumes trading, should the company remain a constituent of an index?

- A. Yes, providing the company resumes trading before the review announcement date (i.e. the Wednesday before the first Friday of March, June, September and December)
- B. Yes, providing the company resumes trading before the review implementation week (i.e. it resumes trading in advance of the Monday before the third Friday of March, June, September and December)
- C. No, after FTSE Russell announces its deletion, the company should be removed regardless of whether it resumes trading
- D. Other

If 'Other' is selected please provide any comments in the box below:

5. If FTSE Russell announces the removal of a suspended company from an index at expiry of the notice period from question 2 (option B in question 3), but prior to it being removed the company resumes trading, should the company remain a constituent of an index?

- A. Yes, providing the company resumes trading two days ahead of the expiry of the notice period
- B. Yes, providing the company resumes trading five days ahead of the expiry of the notice period
- C. No, after FTSE Russell announces its deletion, the company should be removed regardless of whether it resumes trading
- D. Other

If 'Other' is selected please provide any comments in the box below:

6. When a suspended company is removed from a FTSE Russell index and subsequently resumes trading, how long a period should pass after the resumption of trading before the company is again considered eligible for inclusion at a subsequent index review?

- A. Three months (this is the minimum period of trading data required to ascertain eligibility in GEIS)
- B. Six months
- C. Twelve months
- D. Other

If 'Other' is selected please provide any comments in the box below:

7. Should FTSE Russell exclude non-constituent companies as part of the review process when they have previously been suspended for a set number of days? Please refer to Appendix B for analysis of future suspension probabilities.

- A. Yes, companies should be excluded from an index if they have previously been suspended for a set number of days regardless of passing the standard eligibility criteria
- B. No, companies that have been suspended in the past should be eligible providing they pass the standard eligibility criteria
- C. Other comments

If 'Other' is selected please provide any comments in the box below:

8. If you answered 'Yes' to question 7 (option A), for how many days should a company be suspended before it should be considered as ineligible for index inclusion?

- A. Suspended for at least 20 business days in the 12 month period prior to a review
- B. Suspended for at least 80 business days in the 12 month period prior to a review
- C. Some other period

If 'Other' is selected please provide any comments in the box below:

9. Any further comments?

Any further comments can be included in the box below:



Appendix A

China A-share Suspensions

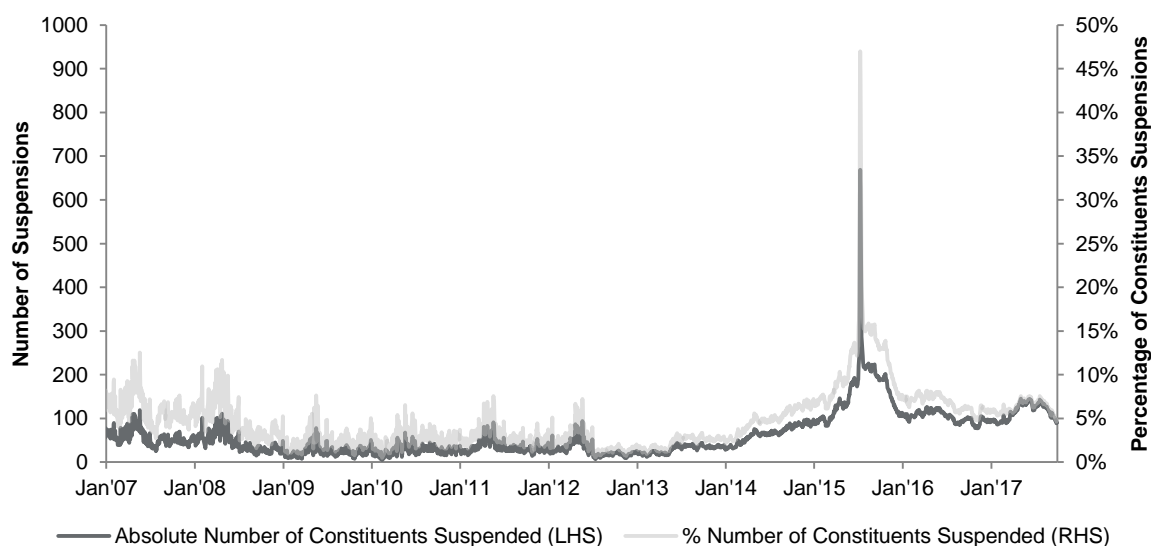
In China the suspension of trading rule allows companies listed on the domestic stock exchanges to apply for a trading halt (hereinafter used interchangeably with suspension). The reasons for a company to seek suspension include:

- a) undergoing or planning to undergo a major asset restructuring;
- b) having a significant event to disclose;
- c) having an abnormal fluctuation of share price or trading volume, and
- d) being unable to release financial reporting on time.

The suspension mechanism, which was originally intended to facilitate information disclosure and prevent excessive speculation, has historically led to frequent suspensions. In certain circumstances the number of suspensions can increase dramatically.

Figure 1 shows the absolute number and the percentage of constituents suspended in the **FTSE China A All Cap Index** from 4 January 2007 to 29 September 2017. On average, 5% of the constituents by number (4% by index weight) have been suspended on a daily basis. At its peak on 9 July 2015, 669 out of the 1,424 constituents (47% by constituent number or 33% by index weight) were suspended.

Figure 1: Absolute and percentage number of suspensions in the FTSE China A All Cap Index



Source: FTSE Russell, WIND, data as at 29 September 2017.

Suspension Example: China Vanke

Although there are general guidelines on the length of a suspension depending on the scenario chosen, in practice the suspension period can be determined by the listed companies themselves. As an example, China Vanke, one of the largest property companies in China, applied to Shenzhen Stock Exchange for a trading halt of its A-shares from the afternoon of **18 December 2015** on the grounds that the company was planning a major asset restructuring.

On **21 December 2015**, the company issued a suspension notice, stating it expected to disclose the restructuring details within 30 calendar days. The company subsequently issued weekly notices on the progress of the restructuring, with little new information being provided.

On **16 January 2016**, the company announced that it had applied for a continuation of its suspension due to the complexity of the restructuring.

It was not until **14 March 2016** that the company disclosed further information including a memorandum of understanding. However, on **18 March 2016** the company announced that owing to its undergoing a major asset restructuring, its A-shares would continue to be suspended until a future date set to be no later than 18 June 2016.

On **18 June 2016** the company issued an indicative notice, stating that the resumption of trading in its A-shares would be postponed and disclosing its plan to acquire assets by issuing new shares.

On **2 July 2016** the company announced that it had replied to an enquiry from the Shenzhen Stock Exchange regarding the restructuring and that it had applied for trading in its A-shares to be resumed on **4 July 2016**.

In total, the A-shares of China Vanke were suspended for 131 days during this corporate event.

It is worth noting that the H-shares of China Vanke that are listed on the Hong Kong Stock Exchange were suspended on the same date as the A-shares. On 5 January 2016 the company announced that it had made an application for resumption of trading in its H-shares. The H-shares resumed trading the following day, after having been suspended for 12 days, and remained active during the suspension period of its A-shares. This reflects the difference in regulatory requirements, even for similar securities of the same company.

The example above not only highlights the length of time a suspension can last, but also the limited information that might be made available. Many corporate events provide limited information and included statements such as 'significant asset reorganization', 'planning for significant event', 'discussing a significant issue' or 'shareholding plan for staff' with little information around the resolution of the event. Therefore, it becomes difficult for investors to determine for how long companies will remain suspended.

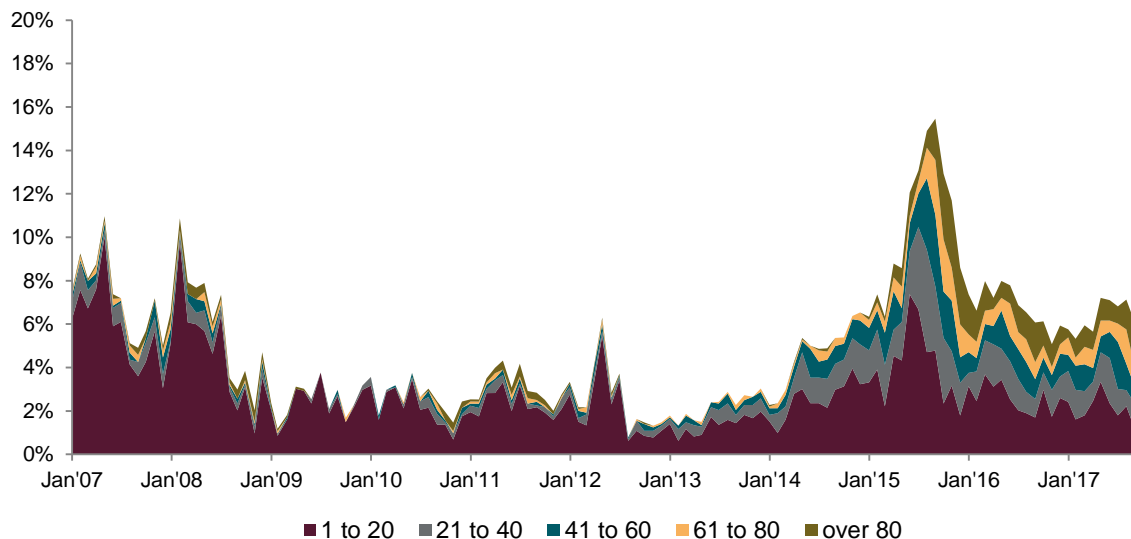
Changes in Suspension Regulations

To maintain market order and protect investors' rights, the Chinese authorities have sought to improve the management of trading suspensions. In May 2016, the Shanghai and Shenzhen Stock Exchanges both announced regulatory changes intended to limit share trading suspensions to three months for companies involved in major asset restructuring. The Shanghai Stock Exchange further stipulated that the cumulative suspension period could not exceed five months for companies planning a major asset restructuring, while the Shenzhen Stock Exchange required the maximum suspension period to be six months for all types of events. In September 2016, the China Securities Regulatory Commission (CSRC) tightened the policy regarding major asset restructurings by requiring listed companies to state in their restructuring plan whether they had obtained the necessary licence or written approval from the relevant authority. In September 2017,

the CSRC simplified the disclosure requirements so as to further shorten the suspension time arising from a major asset restructuring.

As can be seen in Figure 2, the percentage of constituents suspended in the FTSE China A All Cap Index has fallen dramatically since its peak in July 2015, especially with regard to suspensions of less than 20 days. However, there is no clear trend for companies suspending for over 20 days, even after the implementation of the regulatory changes since May 2016.

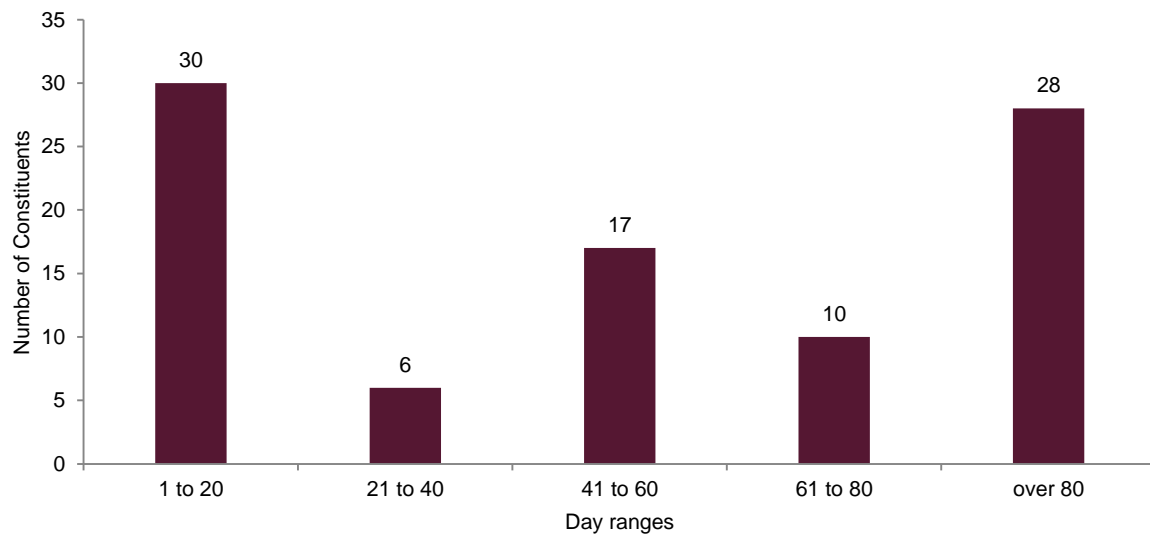
Figure 2: % number of constituents suspended for different ranges of days in the FTSE China A All Cap Index



Source: FTSE Russell, WIND, data as at 29 September 2017.

Figure 3 shows the number of constituents suspended for different ranges of days in the FTSE China A All Cap Index as of 29 September 2017. In total there were 91 out of the 1,916 constituents suspended, 28 of which had been suspended for over 80 business days. In contrast, on the same day, only 17 out of the 7,796 constituents in the FTSE Global All Cap Index were suspended, four of which had been suspended for over 80 business days.

Figure 3: Number of constituents suspended in the FTSE China A All Cap Index as of 29 September 2017



Source: FTSE Russell, WIND, data as at 29 September 2017.

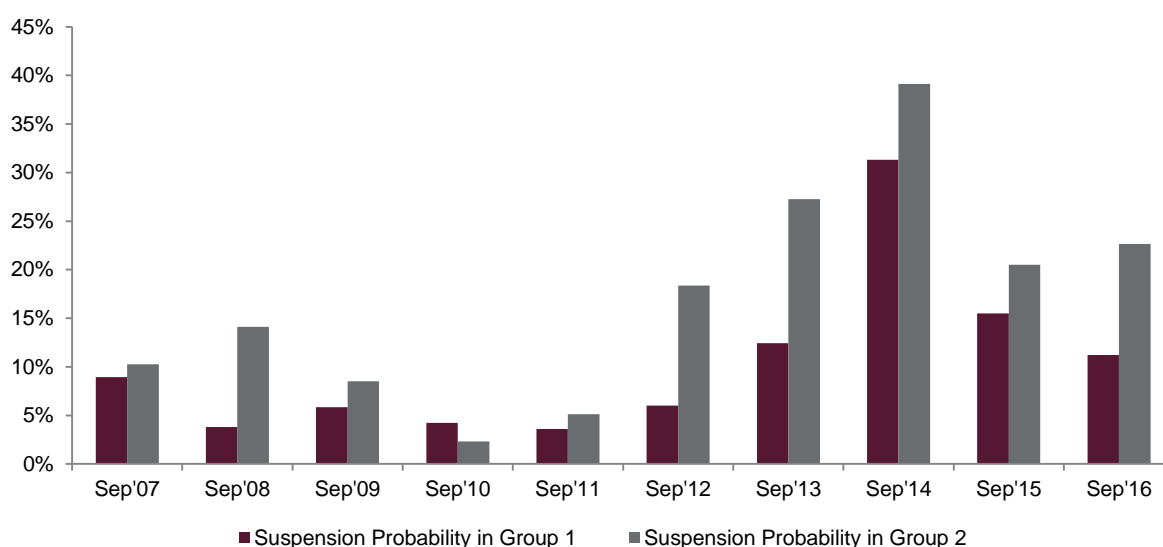
Appendix B

Should companies be excluded from indexes based on their past suspension record?

To assess whether a company's past suspension record is correlated with its future propensity to suspend, we analysed the trading (non-suspended) constituents of the FTSE China A All Cap Index that resulted from a September semi-annual review (as of the third Friday of the review month). These companies were divided into two groups: Group 1 contained those companies suspended for fewer than 20 consecutive business days in the past year ending on the third Friday, and Group 2 contained those suspended for 20 consecutive business days or more in the same period. For each group, the future suspension probability was calculated as the number of constituents suspended for 20 consecutive business days or more in the next one year divided by the total number of constituents in the group. A scenario of 20 days was selected as it represents a reasonable suspension period, but also has one of the highest probability profiles.

Figure 4 shows the results of the suspension probability analysis from 2007 to 2016.

Figure 4: Suspension probability analysis in the FTSE China A All Cap Index



Source: FTSE Russell, WIND, data as at 29 September 2017.

The analysis shows that during the majority of the periods tested, the suspension probability in Group 2 was higher than that in Group 1. From a statistical perspective (using a paired t-test), it was found that the suspension probability in Group 2 on average was relatively higher at a 95% confidence level. However, from a practical perspective, whether a previous track record of suspensions is a significant indicator of future suspensions is not conclusive. For example, in 2016 the probability of being suspended again in the following twelve months indicated that for every 23 companies suspended another 77 were not.

Further studies were conducted using 40, 60 and 80 day suspension periods. Although the results were not as strong as with 20 days, the average suspension probability between Group 1 and Group 2 was statistically different only in the case of 40 days.

The analysis leads to the conclusion that a previous track record of suspensions does not in itself provide sufficient evidence to exclude a company from the index. However, using such a test as an exclusion criterion might still potentially act as a deterrent to potential index constituents and so discourage future suspensions.

For more information about our indexes, please visit ftserussell.com.

© 2018 London Stock Exchange Group plc and its applicable group undertakings (the "LSE Group"). The LSE Group includes (1) FTSE International Limited ("FTSE"), (2) Frank Russell Company ("Russell"), (3) FTSE TMX Global Debt Capital Markets Inc. and FTSE TMX Global Debt Capital Markets Limited (together, "FTSE TMX"), (4) MTSNext Limited ("MTSNext") and (5) Mergent, Inc. ("Mergent"). All rights reserved.

FTSE Russell® is a trading name of FTSE, Russell, FTSE TMX, MTS Next Limited and Mergent. "FTSE®", "Russell®", "FTSE Russell®", "MTS®", "FTSE TMX®", "FTSE4Good®", "ICB®", "Mergent®" and all other trademarks and service marks used herein (whether registered or unregistered) are trademarks and/or service marks owned or licensed by the applicable member of the LSE Group or their respective licensors and are owned, or used under licence, by FTSE, Russell, MTSNext, FTSE TMX, or Mergent.

All information is provided for information purposes only. All information and data contained in this publication is obtained by the LSE Group, from sources believed by it to be accurate and reliable. Because of the possibility of human and mechanical error as well as other factors, however, such information and data is provided "as is" without warranty of any kind. No member of the LSE Group nor their respective directors, officers, employees, partners or licensors make any claim, prediction, warranty or representation whatsoever, expressly or impliedly, either as to the accuracy, timeliness, completeness, merchantability of any information or of results to be obtained from the use of the FTSE Russell products or the fitness or suitability of the products for any particular purpose to which they might be put. Any representation of historical data accessible through FTSE Russell is provided for information purposes only and is not a reliable indicator of future performance.

No responsibility or liability can be accepted by any member of the LSE Group nor their respective directors, officers, employees, partners or licensors for (a) any loss or damage in whole or in part caused by, resulting from, or relating to any error (negligent or otherwise) or other circumstance involved in procuring, collecting, compiling, interpreting, analysing, editing, transcribing, transmitting, communicating or delivering any such information or data or from use of this material or links to this material or (b) any direct, indirect, special, consequential or incidental damages whatsoever, even if any member of the LSE Group is advised in advance of the possibility of such damages, resulting from the use of, or inability to use, such information.

No member of the LSE Group nor their respective directors, officers, employees, partners or licensors provide investment advice and nothing contained in this material or accessible through FTSE Russell, including statistical data and industry reports, should be taken as constituting financial or investment advice or a financial promotion.

This publication may contain forward-looking assessments. These are based upon a number of assumptions concerning future conditions that ultimately may prove to be inaccurate. Such forward-looking assessments are subject to risks and uncertainties and may be affected by various factors that may cause actual results to differ materially. No member of the LSE Group nor their licensors assume any duty to and do not undertake to update forward-looking assessments.

No part of this information may be reproduced, stored in a retrieval system or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without prior written permission of the applicable member of the LSE Group. Use and distribution of the LSE Group data requires a licence from FTSE, Russell, FTSE TMX, MTSNext, Mergent and/or their respective licensors.

About FTSE Russell

FTSE Russell's expertise and products are used extensively by institutional and retail investors globally. Approximately \$15 trillion is currently benchmarked to FTSE Russell indexes. For over 30 years, leading asset owners, asset managers, ETF providers, and investment banks have chosen FTSE Russell indexes to benchmark their investment performance and create investment funds, ETFs, structured products and index-based derivatives. FTSE Russell indexes also provide clients with tools for asset allocation, investment strategy analysis and risk management.

With the recent addition of The Yield Book business, FTSE Russell extends its expertise in analytics to a highly respected analytics platform that serves approximately 350 institutions globally including investment management firms, banks, central banks, insurance companies, pension funds, broker-dealers, hedge funds and investment management firms. The Yield Book offers analytical insights into a broad array of fixed income instruments with specific focus on mortgage, government, corporate and derivative securities.

FTSE Russell is also major provider of data solutions, from top down economic and demographic information, to detailed equity, debt and sustainability fundamental data analysis, to corporations, financial institutions, business academics and reference libraries. Through its acquisition of Mergent, a provider of business and financial information on public and private companies globally for more than 100 years, FTSE Russell provides solutions including advanced data collection, cloud-based applications, desktop analytics and print products.

FTSE Russell is a unit of London Stock Exchange Group's (LSEG) information Services Division. FTSE Russell is a wholly owned subsidiary of LSEG.

For more information, visit ftserussell.com.

To learn more, visit ftserussell.com; email info@ftserussell.com; or call your regional Client Service Team office:

EMEA

+44 (0) 20 7866 1810

North America

+1 877 503 6437

Asia-Pacific

Hong Kong +852 2164 3333

Tokyo +81 3 3581 2764

Sydney +61 (0) 2 8823 3521