January 2026

Foreign Ownership Restrictions and Minimum Foreign Headroom Requirement

v2.4

This document applies to the FTSE Global Equity Index Series and any indices directly derived from it.

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A. Initial weighting

Free float is calculated using available published information rounded to 4 decimal places.

Except where the investable market capitalisation of the security exceeds 10 times the regional inclusion percentage level (see the FTSE Global Equity Index Series Ground Rules), securities with a free float of 5.0% or below are excluded from the index

Details on free float restrictions can be accessed through the following link:

Free_Float_Restrictions.pdf

B. Foreign ownership restrictions

FTSE Russell's index methodology takes account of the restrictions placed on the equity holdings of foreign investors in a company where these have been imposed by a government, regulatory authority or the company's constitution.

Where the presence of a foreign ownership restriction creates a limit on foreign ownership (the Foreign Ownership Limit or FOL) that is more restrictive than the calculated free float for a company, the precise FOL is used in place of the free float for the purposes of calculating the company's investability weight.

If the foreign ownership restriction is less restrictive or equal to the free float restriction, the free float restriction is applied, subject to Rule A above.

In the event that a company's foreign ownership restriction is increased, a reduction in the FOL will be implemented with the provision of a T+2 advanced notification from the date of discovery. Decreases in foreign ownership restrictions and associated increases in the FOL will be implemented in FTSE Russell indices during the quarterly review, and subject to the shares in issue and free float updates' cut-off and to Rule C minimum foreign headroom requirement detailed below.

In some jurisdictions, a company's foreign ownership restriction applies to the company's share classes in aggregate, and not to share classes individually. However, not all of the share classes of a restricted company might be eligible for index inclusion. In such cases, the aggregate (company level) foreign ownership restriction will be allocated pro-rata across those share classes that are eligible for index inclusion.

In certain jurisdictions (for example Japan), despite the presence of a foreign ownership restriction the acquisition of shares above the stated FOL is still permitted but certain shareholder rights may be denied (such as voting rights or dividend distributions). In the event that the acquisition of shares above the FOL is permitted and the forfeit is to dividend distributions, FTSE Russell will treat the company has having reached its FOL and evaluate the company under the minimum foreign headroom requirement.

India - Foreign Ownership Limit (FOL) data is sourced from the National Securities Depository Limited (NSDL) and the Central Depository Services Limited (CDSL).

Effective from 1 April 2020, the aggregate Foreign Portfolio Investors (FPI) limit for Indian companies is equivalent to the sectoral limit as per the Ministry of Finance in India. Consequently, an Indian company's FOL is generally assigned to its sectoral limit based on 'Automatic Route' as defined by the Ministry of Finance, except:

– at a higher limit approved under the 'Government Route' as defined by the Ministry of Finance and such information is publicly available or;

– at a limit approved by the company's board of directors and its general body.

FTSE Russell may exercise discretion in determining whether a stock should be subject to the minimum foreign headroom test. Where discretion is being applied FTSE Russell will provide appropriate advance notice. FTSE Russell will be implementing the new sectoral limits for India commencing from September 2020. Additional details are provided in the India FAQ FTSE_Russell_FAQ_Document_India_FOL.pdf.

Saudi Arabia – Designated Foreign Strategic Investors (FSI's) are not subject to foreign ownership limits however, all other non-domestic foreign investors are subject to a 49% foreign ownership limit. As a result, when assessing Saudi Arabian securities for headroom, the FSI holding will not be considered as foreign ownership.

Please note: A foreign investor may only invest in a single listed company as either a FSI or a non-domestic foreign investor.

Japan – From May 2020, the Japan Foreign Exchange and Exchange Trade Act (FEFTA) introduced a new framework for Foreign Direct Investment (FDI) that requires pre-approval for holdings within Japanese companies in designated sectors that exceeds 1%. After review, FTSE Russell concludes that foreign financial institutions have no requirement to seek pre-approval if their holding exceeds 1%, but must report holdings greater than 1% post-settlement. This reporting requirement does not impact the foreign ownership limit or require a headroom adjustment to Japanese companies.

C. 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 FOL, i.e. (FOL – 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%.

i. For a non-constituent that is subject to foreign ownership limit, a minimum headroom of 20.0% must be available in order to be added to the index.

ii. For an existing constituent that is subject to foreign ownership limit, a minimum headroom of 10.0% must be available.

   Headroom tests are conducted in conjunction with the March, June, September and December quarterly reviews.

   For constituent securities, headroom is tested based on data as of the quarterly shares in issue and free float cut-off date in March, June, September and December.

   For non-constituent securities, headroom is tested based on data as of the review cut-off date in March, June, September, December.

   Please note:

   – The headroom test will take into account any foreign ownership limit changes scheduled to take effect up to and including the review effective date, based on information as of the shares in issue and free float cut-off date;

   – The China and India markets provide disclosures of securities which are close to or have reached permissible foreign ownership limits, therefore any securities which are being removed from the North Bound Stock Connect Buy List (China) or being added to the Red Flag and/or Breach List (India) (based on data as of one day prior to the review announcement date), will not be eligible for index addition.

iii. Where the headroom of an existing constituent is below 10.0%, its investability weight will be reduced at the next quarterly reviewby an absolute value of 10%. For example, if Company A's current investability weight is 49% (i.e. equal to the FOL), a 10% absolute reduction will result in an adjusted investability weight of 39% (49%-10%). Any subsequent headroom adjustment will also be at 10% and result in the investability weight decreasing to 29% (39%-10%)

   If Company B's current investability weight is 30% (i.e. the free float is more restrictive than the FOL), a 10% absolute reduction will result in an adjusted investability weight of 20% (30%-10%).

   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). Between March 2016 and June 2019, existing constituents that had a headroom of less than 10%, had their investability weight reduced by an absolute value of 5%.

iv. Where the FOL for an existing constituent has been reached intra-review and zero headroom is available, its investability weight will be reduced by an absolute value of 10% with the provision of a T+2 advanced notification from the date of discovery.

v. 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

vi. Where the foreign ownership of an existing constituent is reported as approaching its FOL, a headroom test will be conducted at the subsequent quarterly review and if headroom falls below 10.0%, its investability weight will be reduced by 10% in conjunction with the review effective date

vii. Following the first headroom adjustment of 10%, the investability weight will continue to be reduced at subsequent quarterly reviews in increments of 10% until the headroom level increases to 10.0% or above. As a result of these quarterly 10% downward adjustments, should the investability weight of the security fall to 5.0% or below under this process, the security will no longer be eligible to remain in the index.

viii. The investability weight of an existing constituent which has been subject to headroom adjustments will have its most recent 10% adjustment reversed at a quarterly review subject to a minimum 20.0% headroom being available at the quarterly testing period (as illustrated below).

For example, Company A has an FOL of 49%, foreign holdings of 32% and a current headroom adjusted investability weight of 29%.

Step 1: The foreign headroom test is calculated as 35% (i.e. (49%-32%)/49%), resulting in the headroom adjusted investability weighting being increased from 29% to 39%.

ix. In the event a security with a headroom adjustment increases its FOL, the increase in the FOL will implemented in two 50% tranches, subject to 20.0% or above headroom availability at the testing period

For example, Company A had two headroom adjustments down from a FOL of 29% to a current investability weight of 9.00%

Company A – Initial FOL of 29%	
(Q1) First headroom adjustment	19.00% (10% reduction from 29%)
(Q2) Second headroom adjustment	9.00% (10% reduction from 19%)

The Company announces an increase to its FOL from 29% to 40%. The increase in the FOL will be implemented in the following steps:

Company A announces an FOL increase to 40% (11% increase)	
(Q1) Subject to 20% headroom availability, FOL is increased by 50% of the 11% increase	9.00% + 5.50% = 14.50%
(Q2) Subject to 20% headroom availability, FOL is increased by remaining 50% of the 11% increase	14.50% + 5.50% = 20.00%
(Q3) Subject to 20% headroom availability, reverse second headroom adjustment of 10.0%	20.00% + 10.00% = 30.00%
(Q4) Subject to 20% headroom availability, reverse first head room adjustment in increments of 10.0%	30.00% + 10.00% = 40.00%

– First quarterly review following the announcement of an increase in FOL to 40%; 50% of the FOL increase (in this case 5.50%) will be implemented (subject to 20.0% or above headroom availability);

– Second quarterly review; the remaining 50% of the FOL increase will be implemented (subject to 20.0% or above headroom availability);

– Subsequent quarterly reviews; if the headroom availability remains at 20.0% or above, the previous headroom adjustments will be reversed on a quarterly basis in increments of 10%.

In the event a security decreases its foreign ownership limit, the decrease in the FOL will be implemented in full with the provision of a T+2 advanced notification from the date of discovery.

Where the effective date of an FOL decrease is during the review week, then the FOL decrease will be implemented in conjunction with the index review effective date, subject to any prior scheduled FOL changes related to the minimum foreign headroom requirement (see rules A and B above).

For example, Company A had a headroom adjustment down from a FOL of 29% to a current headroom adjusted investability weight of 19.0%. The Company announces a decrease in the FOL to 21% (a decrease of 8% from the previous FOL of 29%).

The existing headroom adjusted investability weight will be decreased by the 8% reduction in FOL at the next quarterly review, resulting in Company A having a new headroom adjusted investability weighting of 16.0% (19% - 8%).

x. An existing constituent with a headroom adjustment, that passes the index eligibility screens (for example – liquidity, minimum size, investability weight) will not be eligible for index promotion from Micro Cap to Small Cap or from Micro Cap or Small Cap to All-World (Large/Mid) until all headroom adjustments have been reversed. An index demotion from All-World (Large/Mid) to Small Cap or Micro Cap will proceed for an existing constituent with a headroom adjustment.

xi. Where foreign ownership restrictions are not universally applied to all foreign investors, but only impact a particular set of foreign investors, a downward headroom adjustment will be applied where there is evidence of these restrictions being enforced. This headroom restriction will be reassessed on a quarterly basis and will not be lifted until either foreign ownership restrictions are removed or all foreign investors are treated equally.

xii. Securities are assigned their official foreign ownership limit. However, if permission is required from a local regulator to purchase additional shares beyond a certain permission threshold, then the more restrictive permission level is assigned as the foreign ownership limit. For example, a security may have a foreign ownership limit of 24%, however, any purchase beyond 22% requires prior permission from the local regulatory authority. In this example, the security would be assigned a foreign ownership limit of 22%.

xiii. Where a non-constituent passes the relevant headroom test, but individual foreign investors or institutions are only permitted to hold a maximum of 1% of the free float adjusted shares in issue, the security will not be eligible for index membership.

xiv. Unless there is an increase in the foreign ownership limit, a headroom adjustment will not be reversed for a period of 6 months (i.e. if a headroom adjustment has been implemented at the June review then the earliest it can be reversed is at the following March review).

xv. If a constituent has been removed from the index as a result of its investability weight falling to 5.0% or below following a headroom adjustment, it will only be reconsidered for inclusion after a period of 12 months from its deletion. For the purposes of index eligibility it will be considered as a new issue.

xvi. Securities which are deleted for failing headroom, but which after a period of 12 months meet the minimum 20.0% headroom test, will initially be added to the index at a minimum free float of 5.0%, subject to them having a foreign ownership limit. If a foreign ownership limit no longer applies, then the security will be added at its free float.

xvii. Subsequent headroom reversals will be implemented in increments of 10% until the security reaches its foreign ownership limit, subject to the security continuing to meet the minimum 20.0% headroom test.

B. Thailand Non-Voting Depositary Receipts

A Non-Voting Depositary Receipt (NVDR) is a trading instrument issued by the Thai NVDR Company Ltd to overcome foreign investment barriers such as foreign investment limits. NVDRs entitle holders to the same financial benefits as those who invest directly in a company's ordinary shares, except that they have no voting rights. The NVDR price is equal to the price of the underlying securities on the Local Board.

If NVDRs are available FTSE Russell may, under certain circumstances, represent them in the index in order to fully represent the investable shares available to foreign investors.

i. Where a security is **not** subject to a foreign ownership restriction, it is included in the index at its calculated free float.

ii. Where a security is subject to a foreign ownership restriction, there is no NVDR or the NVDR does not satisfy the minimum foreign headroom requirement as outlined in Section C, and its Foreign Board share passes liquidity, it is included at its Foreign Board price with an investability weight equivalent to its FOL or calculated free float, whichever is more restrictive.

For example, Company A has an FOL of 25% and a free float of 90%. It has a maximum NVDR issuance limit of 35%, of which 30% has already been issued. As the NVDR fails the minimum foreign headroom requirement of 20.0%, the Foreign Board share is included with an investabiity weight of 25%.

iii. Where a security is subject to a foreign ownership restriction and an NVDR is available which satisfies the minimum foreign headroom requirement as outlined in Section C, both the Foreign Board share and the NVDR are included in the index.

The Foreign Board share is included in the index with an investability weight equivalent to the FOL and the separate NVDR with an investability weight equivalent to its NVDR limit or the difference between its Free Float and FOL, whichever is more restrictive.

For example, Company A has an FOL of 49% and a free float of 80%. It has a maximum NVDR issuance limit of 35%, of which 20% has already been issued. It passes the minimum foreign headroom requirement.

Company A will be included in the index with 2 separate lines:

- Foreign Board share is included in the index with an investability weight of 49% (FOL);
- NVDR is included in the index at an investability weight of 31% (i.e. 80%-49%), as it is more restrictive than its NVDR limit of 35%

iv. Where a security is subject to a foreign ownership restriction and its Foreign Board share fails liquidity, subject to the local share passing all eligibility screenings and the NVDR satisfying the minimum foreign headroom requirement as outlined in Section C, the local share is included with an investability weighting equivalent to its FOL + NVDR or its calculated free float, whichever is more restrictive.

For example, Company A has an FOL of 49% and a free float of 60%. There is no limit on its NVDR issuance, so effectively its can be 100% invested. Therefore the local share is included in the index at an investability weight of 60%.

Appendix A

Further information

A glossary of terms used in FTSE Russell's Ground Rule documents can be found through the following link:

Glossary.pdf

For contact details please visit the FTSE Russell website or contact FTSE Russell client services at info@ftserussell.com.

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