
FTSE Russell Voting Rights Consultation – Next Steps



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Introduction

FTSE Russell recently consulted index users and other stakeholders on whether FTSE Russell indexes should include a minimum hurdle rate for the percentage of a company's voting rights in the hands of non-restricted shareholders.

The results of the consultation showed broad support for the introduction of such a hurdle. A summary of the results from the consultation is available [here](#).

The main results are provided below:

- 68% of the respondents agreed that some minimum hurdle for the percentage of voting rights in public hands should be imposed.
- Of the respondents who thought a minimum voting rights hurdle was sensible, 23% thought the rate should be set at 5%, and 55% thought it should be set at 25%.
- Of these respondents, 29% thought that companies that fail to meet the threshold should have all their securities rendered ineligible for index inclusion; 31% thought only their non-voting securities should be made ineligible, 21% thought that the weight of all the companies' securities should be reduced; and 13% thought that non-voting securities should be ineligible and the weight of voting securities reduced.
- For potential new constituents, 83% of those respondents who agreed with a minimum voting rights hurdle thought the restriction should remain in place until such time as the company's capital structure becomes compliant.
- For existing constituents, 32% of those respondents who agreed with a minimum voting rights hurdle thought the restrictions should apply immediately; 60% thought there should be a grandfathering period lasting from three to seven years before the eligibility hurdle was applied.
- There was strong support for FTSE Russell global indexes (88%) and Russell US indexes (77%) to follow the proposal.

These results were discussed at FTSE Russell's external advisory committees and as a result of those discussions FTSE Russell has developed the following proposal.

Proposal

In the light of the consultation results, FTSE Russell proposes to proceed as follows:

- Developed market constituents of all FTSE Russell indexes will in future be required to have greater than 5% of the company's voting rights (aggregated across all of its equity securities, including, where identifiable, those that are not listed or trading) in the hands of unrestricted (free-float) shareholders as defined by FTSE Russell.
- The hurdle will apply to all standard FTSE Russell indexes, including the Russell US indexes, FTSE Global Equity Index Series (GEIS) and non-cap weighted indexes including the FTSE and Russell RAFI™ Index Series and factor indexes. It will also apply to the FTSE UK Index Series; however its application there is likely to have minimal effect given that constituents of that index are already required to have a minimum free float of 25% for UK incorporated companies, or 50% for non-UK incorporated companies.
- Companies that have 5% or less of their voting rights in the hands of unrestricted shareholders will have their securities rendered ineligible for index inclusion. For potential new constituents, including IPOs, the rule will apply with effect from the September semi-annual and quarterly reviews.
- For existing constituents, the rule will apply with effect from September 2022, thus affording a five-year grandfathering period to allow constituent companies to change their capital structure if they so wish.
- The rate at which the hurdle is set, along with its definition, will be reviewed in the light of subsequent developments on an annual basis. If, following an annual review, FTSE Russell should determine that a more restrictive threshold would be appropriate, the grace period will be extended by a further year.

Rationale for the Proposal

The results of the consultation showed broad support for the introduction of a voting rights threshold. However, a significant minority of respondents argued that no such eligibility criterion was necessary. These respondents argued that the role of an index provider was to reflect the investable universe, and not to require minimum governance standards from constituent companies, at least not in standard, as distinct from ESG, indexes. One respondent presented an academic paper that argued that the issue price of an IPO would reflect the economic value of any loss of voting rights. The inclusion of such an eligibility hurdle might in addition discourage future tech IPOs should companies prefer to stay private rather than lose a degree of control; this would reduce the opportunity set for investors in public markets. Against this it was argued that without the imposition of a hurdle, future tech IPOs in the US would have little incentive to offer voting rights to public shareholders.

There were two broad types of response with respect to the appropriate size of the threshold for voting rights. Some 23% were in favour of a 5% threshold; this would be consistent with the current minimum free float for most FTSE Russell indexes. However, 55% were in favour of a higher 25% threshold, consistent with the minimum free float requirement for eligibility to the FTSE UK Index Series. The results of an indicative analysis of the impact of applying 5% and 25% voting rights hurdles is provided [here](#).

Further analysis of the responses suggests that those in favour of a 25% hurdle were predominantly users of the FTSE UK Series where a minimum free float threshold of 25% already applies. Although FTSE Russell recognises the desire of these users to extend the standards embedded in the UK Index Series more widely, we consider that the application of a 25% threshold would be unduly disruptive to global indexes. In contrast, a 5% hurdle would have a limited, but non-zero, impact. FTSE Russell is therefore minded to impose a 5% hurdle in the first instance but to review the threshold on an annual basis in case subsequent events might lead it to conclude that a higher threshold would be more appropriate.

With regard to whether the hurdle should apply to all constituents or to only a subset, FTSE Russell considers that it should apply only to constituents from developed markets, at least in the first instance. Under the FTSE Russell country classification scheme, emerging markets are not expected to meet the same criteria as developed markets; it might be considered unreasonable to hold constituent companies to the same standards as their developed market peers. Further, foreign ownership restrictions are not uncommon in emerging markets. In some countries these can be overcome through the purchase of non-voting securities. For example, FTSE GEIS includes Thai Non-Voting Depositary Receipts in addition to Thai local shares. Additional support for the exclusion of emerging markets from the voting hurdle requirement is provided by the recent willingness of FTSE Russell index users to allow the inclusion of securities from Variable Interest Entity structures such as Alibaba and Baidu to FTSE GEIS with effect from September 2017. The publicly available securities of these entities trade in the US, but although the US securities themselves have substantial voting rights in public hands, investors in the US securities have no direct control of the local operating companies. Instead, there are contractual arrangements to bind the US entities to the local operating companies. As happened in the case of Alipay, there is the possibility that these contractual links can be broken.

The consultation asked two questions as to whether there were certain FTSE Russell indexes to which the hurdle should definitely be applied and whether there were others to which it definitely should not. The responses suggested a lower appetite for the application of the hurdle to alternatively weighted indexes. It is possible that some respondents felt that the hurdle was less applicable to factor indexes where the holding period might be shorter than in a capitalisation weighted index. Nevertheless, FTSE Russell is minded that the hurdle should apply to all standard FTSE Russell indexes. It was pointed out in discussions at the FTSE Russell external advisory committees that, from a fiduciary perspective, institutional asset owners and managers might find it hard to justify an investment in a standard alternatively weighted index that had lower governance standards than a capitalisation weighted equivalent.

With regard to the sanctions to be applied to companies that fail to meet the voting rights hurdle, respondents were evenly split between those that thought all of the securities of non-compliant companies should be excluded, and those that thought only the non-voting securities should be excluded. Some respondents were in favour of down-weighting the securities of companies that failed to meet the hurdle. Others argued that the investability weight of all companies should be determined by their voting rights in public hands rather than their free floats.

FTSE Russell considers that weighting securities according to their voting rights has strong theoretical appeal but would add a layer to index complexity. In contrast, the imposition of a straightforward hurdle is likely to prove more transparent and have less impact on the constitution of existing indexes. With regard to whether all the securities of non-compliant companies should be excluded, or only those securities with no voting rights, FTSE Russell is minded to exclude all the securities of non-compliant companies. Excluding only non-voting securities risks companies seeking to avoid the sanction by replacing these securities with share classes that confer only minimal voting rights.

Conclusions

FTSE Russell believes that the proposals set out in this document represent a pragmatic compromise between those that believe the SNAP Inc. IPO set a dangerous precedent for companies to come to the market with few, if any, voting rights attached to their securities, and those respondents who believe the role of the index provider is to represent the investable opportunity set as comprehensively as possible.

By including a low threshold for the minimum percentage of a company's voting rights that can be held by unrestricted shareholders, future IPOs of companies that confer few if any voting rights will be discouraged without there being any untoward impact on long-standing existing index constituents such as Facebook and Alphabet which have securities with differential voting rights.

The proposal set out here effectively draws a principled line in the sand. However, in recognition of the novelty of this approach, the potential impact to FTSE Russell indexes and the possibility that constituents might seek to adapt their capital structures as a result of this initiative, FTSE Russell undertakes to review both the level of the threshold and the sanction to be applied to non-compliant companies on an annual basis.

Next Steps

Subject to any further feedback that might be received as a result of this proposal, FTSE Russell will publish the consequent changes to the ground rules and methodology documents of affected FTSE Russell standard indexes on Friday 25 August 2017. The modified eligibility rules will become effective at the September quarterly and semi-annual index reviews.

Summary of Results from the Consultation on Voting Rights

[FTSE Russell Voting Rights Consultation Results](#)

Analysis of Securities affected by Voting Right Hurdles set at 5% and 25%

[Indicative List of Affected Securities](#)

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

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FTSE Russell index expertise and products are used extensively by institutional and retail investors globally. \$12.5 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.

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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