

# **S&P/ASX Index Consultation:**

## **Index Eligibility and Treatment of**

### **Un-sponsored Depository Receipts**

**March 2012**

**JOINT S&P / ASX**

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### Assumed Knowledge

This consultation paper assumes that readers are familiar with the S&P/ASX index suite and the methodology relating to index eligibility.

The S&P/ASX index suite is recognised as Australia's principal investable equity indices and the S&P/ASX 200 is regarded as Australia's equity benchmark. With over A\$ 250 billion managed and benchmarked to the S&P/ASX 200, the index is used by institutional investment managers, mutual fund managers, and professional advisors. S&P/ASX 200 covers approximately 80% of the Australian equity market by capitalisation, with a constituency that is highly liquid and tradable. Such characteristics ensure that the S&P/ASX 200 is representative of the Australian market while maintaining a limited number of eligible securities.

Further information on the S&P/ASX index suite can be obtained from the Standard & Poor's website at [www.standardandpoors.com](http://www.standardandpoors.com).

### Background

The Australian Securities Exchange (ASX) has identified considerable interest in ASX providing investors with exposure to international equities. Consequently, ASX is proposing to broaden the range of international equities available on ASX by quoting UDRs (unsponsored depositary receipts). UDRs are conceptually similar to Chess Depositary Interests (CDIs), and will allow investors in the Australian market to obtain an equitable interest in international securities through a security that is traded, cleared and settled on the ASX market.

The number of offshore securities over which UDRs would be quoted via the proposed ASX program will be determined in consultation with the market, with well-known global companies listed on major exchanges expected to be the UDRs most likely to be in demand.

The introduction of the UDR program has given rise to the question of the index eligibility of UDRs. Current index methodology requires index constituents to be listed on ASX. UDRs would be quoted rather than listed and hence would be ineligible for index inclusion.

Given the interest in the index eligibility aspect of the UDR program, S&P and ASX are conducting this consultation to determine whether to amend the current index methodology to enable UDRs to be included in the index (upon the other existing criteria being met as per normal).

ASX has also engaged with ASIC on the regulatory clearance for the rule amendments for the UDR program. The program is subject to that clearance being obtained.

### Proposed Structure of UDR Program

The key features of the proposed UDR program are as follows:

- The key participants in the program are as follows:
  - ASX – provides for trading, clearing and settlement of UDRs.
  - Market maker - incentivised to 'make a market' and provide liquidity.
  - Depositary – issues the UDRs.
  - Custodian – appointed by the depositary and holds the underlying securities for the UDRs.
  - Local registrar – maintains the register of holders of UDRs in Australia.
- UDRs will be securities issued by a depositary that meets criteria set out in the ASX Operating Rules.

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- Each UDR will represent one share in the underlying company. An exception may occur should ASX decide to quote a high denomination security using a ratio of UDRs to each share.
- The company whose shares underlie the UDRs will not be listed by ASX but will be listed by another major exchange.
- UDRs will not be leveraged.
- The investor will be entitled to the same rights as if they were the holder of the underlying security (i.e. votes, corporate actions and dividends), except where it is not possible to pass on a corporate action.
- Investors have the ability to cancel the UDR and hold the underlying security directly.
- UDRs will not be derivatives.
- It is a requirement that the depository bank (or a custodian appointed by that bank) holds the underlying securities for the benefit of the investor.

### Trading

The UDRs will be available for trading on ASX order books available on the ASX Trade platform, and traded in the same manner as shares and CDIs are traded on ASX.

### Clearing and Settlement

The UDRs will be cleared and settled via CHESS in the same manner as shares and CDIs (where the issuer is listed on ASX).

### Focus of Feedback sought

ASX and S&P are interested to understand:

- The benefits stakeholders anticipate from having UDRs eligible for inclusion in the index.
- Any concerns (both conceptual and operational) stakeholders anticipate from having UDRs eligible for inclusion in the index.
- The preferred index methodology approach given alternatives.

### Methodology Alternates

#### Alternate 1: UDRs to be Eligible for Index Inclusion in the S&P/ASX 200 Benchmark and other S&P/ASX Indices

Under this scenario UDRs would be subject to the same index eligibility criteria as existing equity securities. The two primary determinants of index eligibility are:

- Market capitalisation – companies are ranked by their daily average market capitalisation for the last six months. Only those companies large enough to meet the market capitalisation requirements of the index in question are eligible.
- Liquidity – the liquidity of a company's securities are compared to that of the All Ordinaries to determine the company's relative liquidity.

To ensure that the S&P/ASX indices are representative of the Australian equity market, market capitalisation and liquidity measurements would be determined using the UDRs available on ASX and not the equity capital available on the home exchange.

#### Alternate 2: Index Inclusion Criteria to Remain Unchanged

Assuming no change to the current index methodology, UDRs would remain ineligible for index inclusion.

### Arguments for including UDRs in the index suite

- This would broaden the S&P/ASX index suite as a representation of the most liquid securities traded on ASX and could provide investors benchmarked to that index with a broader range of available products.
- This would be consistent with the decision to re-admit News Corp (NWS) into the S&P/ASX index suite (despite being domiciled in the US) and to make exempt foreign listings on ASX eligible for index inclusion.
- The presence of sufficiently liquid global companies could diversify the index both on a sector and company specific basis.
- Those investors seeking indices that solely reflect domestically domiciled Australian companies would still have access to the current S&P/ASX All Australian 50 and S&P/ASX All Australian 200 indices.
- Broadening of the range of index eligible securities would be consistent with Australia's aspiration to be a regional financial centre.

### Arguments against including UDRs in the index suite

- Inclusion of eligible UDRs would necessarily displace listed Australian companies from the index and would therefore dilute the index's ability to reflect the performance of Australian domiciled companies.
- Some investors may have the view that movement away from domestic domiciled companies is inconsistent with the core purpose of benchmark exchange indices.
- Allowing UDRs to be eligible for index inclusion may increase concentration both on a sector and company level if the UDRs are quoted over dual listed companies (e.g. BHP and RIO).
- Index management overhead could increase due to the offshore nature of index constituents.
- Any change to the index constituents results in a cost to index tracking funds.

### Next Steps

S&P and ASX invite submissions to this consultation paper from index stakeholders. Respondents are invited to comment on index eligibility with respect to UDRs, any UDR-related issues not detailed in this document, and any alternate solutions not listed in this document.

Submissions should be lodged no later than Tuesday, 17 April 2012.

All responses will be kept confidential by ASX and S&P.

Submissions can be addressed to either Douglas Beem or Brian Goodman at the contact details provided below. If you wish to arrange a face-to-face consultation, please contact either party.

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## Index Consultation

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