Standard Life Investments

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Dear Mr Makepeace,

FTSE UK Index Series User Consultation

Thank you for your invitation to participate in a market consultation on the index methodology. Standard Life Investments is a major UK institutional investor with assets under management of £150bn as at 30th September 2011. A large proportion of this is invested, on behalf of our clients, in the listed securities of UK companies. As a user of the FTSE UK Index Series, we have a strong incentive to ensure that the methodology used in the compilation of the indices reflects our clients' best interests as well as reflecting the opportunities available to investors more generally. We share the concerns of a number of our clients and other market participants about certain aspects of the index methodology. The evidence suggests that the current criteria used by FTSE that are related to UK incorporation and free float are attracting an increasing number of companies with poor or underdeveloped governance practices. Where these companies have large residual controlling shareholdings following listing, the opportunity for outside investors to influence these governance arrangements is in proportion to the size of the free float. While we do not believe that it is the role of FTSE to enforce governance standards or company law in respect of minorities, we consider that it does have a role in mitigating the impact of deficiencies on users of the FTSE UK Index Series.

Accordingly, we support the proposed harmonisation of the minimum free float threshold used for index eligibility with the threshold (25%) that UKLA requires of a company seeking a premium or standard listing on the London market. We think that FTSE should apply this minimum threshold in all cases and should not vary it, for example in response to the UKLA granting a waiver to its own rules. We would also like to the see the harmonisation of the criteria used to define a free float. A case can also be made to amend the investability weighting bands across the UK Index Series. There is evidence to suggest pricing distortion in the secondary market, in the period following listing, where a company's actual free float does not correspond with its weight in the indices. This distortion (and consequential risk to investors in general), typically arises from the demand from those investors who either track or closely align themselves with the company's index weighting. A current example is Glencore plc. Once the current "lock-ups" on cornerstone investors come off, its free float will increase from 12% to 17%. However, its weighting in the indices under current banding rules will increase from 12% to 20%, thus creating a potentially significant increase of demand for stock that will not be satisfied by the existing free float. We would therefore support the use of an actual free float based weighting in the indices, subject to the minimum free float as described above.

We would also encourage FTSE to examine the desirability and practicality of raising this minimum threshold to 50%. While we accept that the primary role of the FTSE UK Index Series is to reflect investment opportunities, there is a balance to be struck between the availability of such opportunities and their quality. The use of a 50% free float threshold would, for example, help to address the concerns of index users that are related to the protection of minorities. In the event that a minimum 25% or higher threshold for free float is applied by FTSE, we support an appropriate period of "grandfathering" for current index companies which are below that level.

For the reason to which we refer above, we remain to be persuaded about a possible introduction of a new index series to which companies would only be admitted if they met minimum governance criteria. As the UK Corporate Governance Code 2010 operates on a "comply or explain" basis, such an index might unfairly penalise a company which did not meet the criteria but had otherwise offered a persuasive reason for so doing. Further, the Code is neither exhaustive nor does it address those issues (such as related party transactions) that have been at the source of a number of governance failures (for example, at ENRC) in the recent past. We therefore consider that it might be difficult to derive a set of objective criteria for such an index series that would be of assistance to potential users. As an alternative, we would support the further development of the FTSE4Good Index series and welcome the recent introduction of a system of ratings by which companies are measured as to how well they manage social, environmental and governance risk.

We hope that this submission will assist the review of the FTSE UK Series and the achievement of a higher level of confidence amongst users.

Yours sincerely

Jonathan Cobb

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Investment Director
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