How New Index Rules Expose Ordinary Savers to Overvalued IPOs

— Illustrated Through the Fashion Industry

Content:

Executive Summary

This report examines how recent changes to global index-construction rules have created a structural vulnerability in modern pension systems. As passive investing has become dominant, pension funds now replicate major indices mechanically, meaning they must purchase every company included in those indices regardless of valuation, profitability, or financial stability. Regulatory shifts—particularly around dual-class governance, free-float thresholds, and accelerated inclusion timelines—have made it easier for newly listed companies to enter indices within days of going public. This transfers early-stage valuation risk from private investors to ordinary savers.

The fashion industry provides a clear illustration of this mechanism. Fashion IPOs frequently debut at ambitious valuations driven by brand narratives and private-market enthusiasm, only to experience significant post-listing declines. Under the new index rules, such declines are absorbed not only by discretionary investors but also by pension funds compelled to buy these companies upon index inclusion.

The report quantifies how much of a pension is typically exposed to new entrants, models the potential impact of forced buying, and proposes policy reforms aimed at rebalancing risk. These include reinstating seasoning periods, introducing financial-stability screens, enabling prudential overrides for pension schemes, and recognising index providers as quasi-regulatory actors. Together, these reforms would help ensure that ordinary savers are not involuntarily exposed to untested IPO-level valuations.

I. Introduction

Global equity markets have undergone a structural transformation driven by the rise of passive investing and significant changes to index-construction rules. These developments have created a new mechanism through which financial risk is transferred from private investors to ordinary savers. When a large company goes public, its rapid inclusion in major indices such as the FTSE 100, S&P 500, or MSCI World triggers automatic buying by pension funds and passive investment vehicles. This process applies across all sectors, including fashion, and operates independently of a company's valuation, profitability, or financial stability. Most savers are unaware that their pensions are now governed by index rules rather than active investment decisions. This report explains how the new index rules work, why they expose pension savers to overvalued IPOs, and how the fashion industry provides a clear and relatable example of this modern structural vulnerability.

II. How Index Inclusion Works in the Modern Market

Passive investing has become the dominant force in global markets. Pension funds increasingly track indices mechanically, meaning they must hold every company included in the index, in exact proportion to its index weight. When a company is added to an index, passive funds are required to purchase it automatically. This is not a discretionary choice; it is a rule-based obligation.

Recent index-rule changes have accelerated the speed at which newly listed companies can enter major indices. Adjustments to free-float requirements, dual-class share allowances, and governance criteria have made it easier for companies to qualify for inclusion shortly after IPO (S&P Dow Jones Indices, 2023; FTSE Russell, 2022). As a result, a company can list on public markets and be inside millions of pension portfolios within days. This mechanism is largely invisible to the public. Most savers assume their pensions are actively managed, when in reality the index rules—not fund managers—determine what they own.

III. Fashion IPOs as a Case Study

Fashion provides a clear illustration of how overvalued IPOs can affect pension savers under the new index rules. The fashion industry has a long history of ambitious IPO valuations followed by significant post-listing declines.

Historical Examples

Allbirds (2021)
Listed at a valuation of approximately $4.1 billion. Within two years, the stock had fallen by over 90 percent as revenue growth slowed and losses widened (Bloomberg, 2023).

Farfetch (2018)
Entered public markets at a valuation exceeding $6 billion. The share price later collapsed due to profitability challenges and market saturation in luxury e-commerce (Financial Times, 2022).

Birkenstock (2023)
IPO valuation exceeded $8 billion. Shares fell sharply in the months following listing due to concerns about pricing power and inventory cycles (Reuters, 2023).

Golden Goose (planned)
Analysts have raised concerns about valuation multiples relative to cashflow, reflecting a broader pattern of fashion IPOs entering markets at elevated prices (Vogue Business, 2024).

These examples demonstrate a consistent pattern: fashion companies often list at high valuations driven by brand hype, private-market enthusiasm, and growth narratives. When post-IPO performance fails to meet expectations, share prices decline significantly.

Under the new index rules, such declines would be absorbed not only by discretionary investors but also by pension funds forced to buy these companies upon index inclusion.

IV. Regulatory and Index-Rule Changes

Index rules are not neutral; they are design choices that determine who bears risk and when. Over the last decade, three shifts have fundamentally altered how newly listed companies enter indices: governance eligibility, free-float treatment, and timing of inclusion.

The first shift concerns governance and dual-class shares. Historically, major indices such as the S&P 500 applied governance screens that excluded companies with extreme dual-class structures, on the basis that unequal voting rights weakened minority-shareholder protections (S&P Dow Jones Indices, 2023). Over time, pressure from issuers and exchanges led to a softening of these constraints. Companies can now list with founder-controlled voting structures and still qualify for index inclusion, provided they meet size and liquidity thresholds. This matters because it allows companies to retain control while still accessing the vast pool of passive capital. The risk–control balance shifts: insiders keep control; public investors, including pension funds, absorb the economic risk without corresponding governance power.

The second shift concerns free-float and liquidity thresholds. Free float is the proportion of shares actually available for trading. Earlier index regimes often excluded companies with low free float, on the logic that illiquid stocks distort index tracking and price discovery (FTSE Russell, 2022). Recent rule updates have recalibrated these thresholds, allowing companies with relatively small free floats—typical of modern IPOs where insiders retain large stakes—to enter indices sooner. This concentrates price impact when passive funds are forced to buy a limited pool of tradable shares and amplifies volatility because a small float is being used to set the market price for the entire company. For pension savers, this means their funds may be buying into a price that is more a function of index-driven demand than of fundamental value.

The third shift concerns accelerated inclusion timelines. Historically, many indices imposed a seasoning period—often six to twelve months—before a newly listed company could be considered for inclusion. This allowed time for earnings reports, trading history, and a clearer sense of fair value to emerge (MSCI, 2023). In the current regime, inclusion can occur within weeks or even days, particularly for large IPOs that would otherwise create tracking error if excluded. The rationale is operational: passive funds want to minimise deviation from the benchmark. The consequence is structural: pensions are now exposed to IPO-level valuations before the market has had any meaningful opportunity to test them.

Taken together, these changes mean that companies can list with concentrated control, limited free float, and untested valuations, yet still be rapidly embedded into the core holdings of pension funds worldwide. The rulebook has shifted from “prove yourself, then join” to “join now, prove yourself later,” with the proving phase occurring while ordinary savers are already exposed.

V. How Much of a Pension Is Exposed to New Index Entrants

Understanding exposure requires moving beyond simple percentages to a layered view of asset allocation, index weight, and cohort-specific sensitivity.

Most defined contribution pensions in the UK, US, and EU now default into target-date or lifecycle funds. These funds follow a glide-path: high equity exposure when the saver is young, gradually shifting towards bonds and cash as retirement approaches. A typical glide-path might allocate 80 to 90 per cent to equities for someone in their 30s, 60 to 70 per cent in their 40s, 40 to 50 per cent in their 50s, and 20 to 40 per cent in their 60s (BlackRock, 2023). A saver aged 45 with a £150,000 pot and 70 per cent in equities therefore has £105,000 effectively tied to equity indices.

Within that equity slice, exposure to a new index entrant is determined by its index weight. Suppose a large fashion IPO is added to a global developed-markets index with a weight of 0.4 per cent. A saver with £105,000 in equities has £420 notionally allocated to that single stock. If several such companies enter over a short period, the cumulative exposure can reach low single-digit percentages of the equity allocation. For a £300,000 pot with 60 per cent in equities and a combined 2 per cent weight in recent entrants, £3,600 is effectively tied to the fate of a small cluster of newly listed, relatively untested companies.

Sensitivity is not uniform across age cohorts. Younger savers have higher equity exposure and longer time horizons; they can, in theory, ride out volatility. Near-retirement savers have lower equity exposure but much less time to recover from drawdowns. A 62-year-old with a £250,000 pot and 40 per cent in equities has £100,000 in equity indices. If a group of new entrants with a combined 1.5 per cent weight suffers a 50 per cent decline, the direct impact is £750. This may sound modest, but if it occurs alongside broader market stress, it compounds other losses at precisely the wrong moment in the life cycle.

There is also an indirect channel: correlation and sentiment. New index entrants in a hot sector—whether fashion, tech, or another theme—can drive narrative cycles. If several high-profile IPOs disappoint, it can drag down sector ETFs and style factors, which are themselves embedded in multi-asset pension products. Thus, the exposure is not only the direct weight of the new stock, but also the way its performance propagates through factor and sector allocations.

Mathematically, an individual saver's exposure (E) to new entrants can be expressed as:

$$E = A \cdot \alpha \cdot \sum_{k=1}^{n} w_k$$

where (A) is total pension assets, (α) is the equity allocation share, and (w_k) are the index weights of the (n) new entrants. The potential loss from a shock of size (d_k) to each entrant is:

$$\Delta A = A \cdot \backslash\, \alpha \cdot \sum_{k=1}^{n} w_k\, d_k$$

This makes clear that even small individual weights can aggregate into non-trivial exposure when multiple entrants and non-negligible drawdowns are involved.

VI. Mathematical Model: Forced-Buying and Pension Impact

To formalise the mechanism, consider a simplified model of a pension fund tracking an index. Let (w_i) be the index weight of the new entrant, (P_0) the IPO price, (P_i) the post-correction price, (A) the total pension assets, and (L) the loss to the pension from the new entrant. The forced-buying loss is:

$$L = A \cdot w_i \cdot \left(\frac{p_0 - p_1}{p_0} \right)$$

If w_i = 0.8%, A = £200,000, and the stock falls 40 per cent, then:

L = 200,000 ▪ 0.008 ▪ 0.4 = £640

This is the loss from one overvalued entrant. If multiple companies enter at inflated valuations, the losses accumulate linearly:

$$L_{total} = \sum_{k=1}^{n} A \cdot w_k \cdot d_k$$

where (d_k) is the decline for company (k). The model shows that the risk is not total loss, but meaningful erosion, especially for savers close to retirement.

VII. Policy Reforms to Protect Savers (In Depth)

Protecting savers in this structure is not about eliminating risk—equity investing is inherently risky—but about rebalancing who bears the earliest, most speculative phase of that risk. Effective reform must operate at three levels: index methodology, pension regulation, and disclosure.

At the index-methodology level, the most powerful lever is timing. A mandatory seasoning period before eligibility for inclusion—say, twelve to twenty-four months—would ensure that IPO-level valuations are tested by at least four to eight quarters of public reporting before passive capital is compelled to buy. During this period, only active investors who consciously choose to hold the stock would be exposed. This would restore a temporal buffer between private-market hype and public-market obligation. Index providers could also introduce a graduated inclusion rule, where a new stock enters at a fraction of its full weight and scales up over time, reducing the immediate impact on pensions.

A second methodological reform is the introduction of basic financial-stability screens. Indices could require positive operating cashflow or earnings over a rolling period, or at minimum exclude companies with extreme cash burn relative to revenue. This would not prevent speculative listings, but it would prevent the most fragile business models from being hard-wired into the core holdings of retirement savers. For sectors like fashion, where cycles,

inventory risk, and brand volatility are high, such screens would act as a filter against structurally unsound listings being treated as core exposures.

At the pension-regulation level, policymakers could allow or require schemes to maintain a prudential override on index composition. This would give trustees the legal ability to deviate from pure index replication when certain risk flags are triggered—for example, when a new entrant fails governance, cashflow, or concentration tests. Rather than being forced to hold every constituent, schemes could operate with a small exclusion list justified on fiduciary-duty grounds. This would preserve the cost advantages of passive investing while acknowledging that not all index constituents are equally appropriate for retirement portfolios.

A further reform would be to require explicit disclosure to savers of their exposure to recent IPOs and high-volatility constituents. Annual pension statements could include a simple metric: the percentage of the portfolio allocated to companies listed within the last three years, along with a historical volatility band. This would not change the exposure mechanically, but it would change the information environment, making it harder for structural risks to remain invisible.

Finally, at the legal and policy level, regulators could clarify that index providers are systemically important actors whose methodologies have public-interest implications. Currently, index rules are largely treated as private technical choices. Recognising them as quasi-regulatory instruments would justify oversight where methodology changes materially alter the risk profile of millions of savers. Any rule change that accelerates IPO inclusion or relaxes governance criteria could be subject to consultation with pension regulators and consumer-protection bodies.

In economic terms, these reforms aim to realign the sequence of risk-bearing. Private investors, who have access to information, diversification, and risk-management tools, should bear the early-stage valuation risk. Ordinary savers, whose exposure is involuntary and mediated through passive products, should enter later in the cycle, once prices have been tested and business models partially validated.

VIII. Conclusion

The new index rules have created a modern structural vulnerability in pension systems. When a large company goes public—whether in fashion, retail, or any other sector—its rapid inclusion in major indices forces pension funds to buy it automatically. If the company is overvalued or financially weak, the resulting losses fall on ordinary savers, particularly those close to retirement. This is not a banking crisis and not a repeat of any historical collapse. It is a new kind of pensions-exposure shock created by the interaction of passive investing, index-rule changes, and ambitious IPO valuations. Understanding this mechanism is essential for protecting savers in an era where index rules, not investment managers, determine what millions of people own.

Historical Fashion IPO Valuations vs Post-IPO Performance

Company	IPO Year	IPO Valuation	Post-IPO Share Price Decline	Primary Causes of Decline
Allbirds	2021	~$4.1 billion	~90% decline within 24 months	Slowing revenue, rising losses, weak unit economics
Farfetch	2018	~$6.2 billion	~80% decline over several years	Profitability issues, luxury e-commerce saturation
Birkenstock	2023	~$8.6 billion	~20–30% decline in early months	Pricing-power concerns, inventory cycles
Warby Parker	2021	~$6.8 billion	~70% decline within 18 months	Margin pressure, customer-acquisition costs
Victoria's Secret (spinoff)	2021	~$7 billion	~50% decline over two years	Brand fatigue, declining sales, competitive pressure
Golden Goose (planned)	—	Targeting €3–4 billion	— (pre-IPO)	Analyst concerns over valuation multiples vs cashflow

Mathematical model used, with Golden Goose example

The basic loss function: $L = A \cdot w_i \cdot \left(\frac{p_0 - p_1}{p_0}\right)$

where (A) total pension assets, w_i the index weight of the new entrant, P_0 the IPO price and P_1 the post-correction price.

For Golden Goose, assume:

- IPO valuation: €3.5 billion
- Index weight on inclusion: w_i = 0.25% (0.0025)
- Saver's pension pot: A = £250,000
- Equity allocation share: $\alpha = 0.6$ (60%)
- Post-IPO decline: 35%

First, compute the equity slice: $A_{eq} = A \cdot \alpha = 250{,}000 \cdot 0.6 = £150{,}000$

Then apply the loss function to that equity slice:

$L = A_{eq} \cdot w_i \cdot 0.35 = 150{,}000 \cdot 0.0025 \cdot 0.35$ $\quad L = 150{,}000 \cdot 0.000875 = £131.25$

So, for a single saver with a £250,000 pot and 60% in equities, a 35% post-IPO drop in Golden Goose at a 0.25% index weight implies a direct loss of about £131. At system level, multiplying this by millions of similar savers turns a seemingly small individual effect into a meaningful aggregate transfer of wealth from pension holders to pre-IPO insiders and early investors.

Appendix A: Mathematical Annex

A1. Expected-Loss Framework for New Index Entrants

The realised-loss model in the main report captures the impact of a specific post-IPO decline. However, pension exposure can also be expressed in *expected* terms, which is more appropriate for ex-ante risk assessment. Let p_k denote the probability of a drawdown of size d_k for new entrant (k). The expected loss across all new entrants is:

$$E[\Delta A] = A \cdot \sigma \cdot \sum_{k=1}^{n} w_k \, p_k d_k$$

This formulation highlights that even if individual drawdowns are uncertain, the *expected* transfer of risk from private investors to pension savers can be quantified. It also makes clear that the risk is additive across multiple entrants, which is particularly relevant in periods of clustered IPO activity.

A2. Cohort-Sensitivity Model (Younger vs Near-Retirement Savers)

The impact of new index entrants differs sharply across age cohorts because equity exposure varies along the glide-path. Let α_y and α_o denote the equity-allocation shares for younger and older savers respectively, with $\alpha_y > \alpha_o$. The loss for each cohort is:

$$\Delta A^y = A^y \cdot \alpha_y \cdot \sum_{k=1}^{n} w_k \, d_k$$

$$\Delta A^o = A^o \cdot \alpha_o \cdot \sum_{k=1}^{n} w_k \, d_k$$

This makes the "sequence-of-returns" problem mathematically explicit: older savers experience smaller proportional exposure but have far less time to recover from losses, making the same shock more damaging in practical terms.

A3. Variance Contribution of Newly Listed Companies

Loss is only one dimension of risk. Newly listed companies also contribute disproportionately to portfolio volatility because they typically exhibit higher variance and unstable correlations. The incremental variance added to a pension portfolio by the set of new entrants is:

$$\Delta\sigma^2_{portfolio} = \alpha^2 \left\{ \sum_{k=1}^{n} \omega_k^2 \sigma_k^2 + 2 \sum_{k=1}^{n} w_k \, d_k \sigma_{kj} \right\}$$

where σ_k^2 is the variance of entrant k and σ_{kj} the covariance between entrants (k) and (j). This expression shows that even small index weights can materially increase portfolio volatility when entrants are highly volatile or correlated — a common feature of fashion, luxury, and consumer-trend IPO clusters.

A4. Worked Example: Golden Goos

Assume Golden Goose lists at a valuation of €3.5 billion and enters a major index with weight w_i = 0.0025. A saver with a £250,000 pension pot and a 60% equity allocation has:

A_{eq} = 250,000 ▪ 0.6 = £150,000

If Golden Goose declines by 35% after inclusion, the loss is:

L = A_{eq} ▪ w_i ▪ 0.35 = 150,000 ▪ 0.0025 ▪ 0.35 = £131.25

While this appears modest at the individual level, the aggregate effect across millions of pension savers represents a significant transfer of value from passive savers to pre-IPO insiders and early investors. When multiple IPOs enter in close succession, the cumulative effect becomes materially larger.

Appendix B: Volatility Scenarios and IPO-Cluster Stress-Test Matrix

B1. Volatility-Scenario Table for Newly Listed Fashion Companies

New index entrants typically exhibit higher volatility than established constituents. This table models how different volatility regimes translate into potential pension-portfolio variance when a newly listed fashion company enters an index with a weight of w_i= 0.25% and the saver has a 60% equity allocation.

Volatility Scenario	Annualised Volatility of Entrant σ_i	Incremental Portfolio Variance $\Delta\sigma^2$	Interpretation
Low Volatility	25%	Very small (<0.01%)	Typical of stable, mature brands; limited impact on pensions
Moderate Volatility	40%	Small but noticeable	Common for mid-market or trend-driven brands
High Volatility	60%	Meaningful increase	Typical for fashion IPOs with hype-driven valuations
Extreme Volatility	80–100%	Significant increase	Seen in speculative listings or companies with low free float

This table illustrates that even small index weights can materially increase portfolio volatility when the entrant is highly volatile — a common feature of fashion IPOs.

B2. IPO-Cluster Stress-Test Matrix

Periods of market enthusiasm often produce **clusters** of IPOs within the same sector. Fashion is particularly prone to this pattern, with luxury, athleisure, and DTC brands frequently listing within short windows. The following matrix models the impact of clustered declines on a pension portfolio.

Assumptions:

- Three new entrants (A, B, C)
- Combined index weight: 1.2%
- Saver's equity allocation: 60%
- Pension pot: £250,000
- Equity slice: £150,000

The stress-test matrix shows losses under different cluster-decline scenarios:

Scenario	Entrant A Decline	Entrant B Decline	Entrant C Decline	Total Portfolio Loss	Interpretation
Mild	–10%	–10%	–10%	£54	Normal post-IPO adjustment
Moderate	–20%	–25%	–20%	£162	Typical of overvalued listings correcting
Severe	–40%	–45%	–35%	£414	Comparable to historical fashion IPO collapses
Extreme	–60%	–70%	–55%	£756	Clustered failure during sector-wide sentiment shock

Formula used $\Delta A = A_{eq} \cdot \sum_{k=1}^{3} w_k \, d_k$

where A_{eq}= £150,000), w_k are the weights summing to 0.012, and d_k are the declines.

B3. Interpretation

This appendix shows that:

- Even small index weights can meaningfully increase portfolio volatility when entrants are highly volatile.
- Clustered IPO declines amplify losses because the effects are additive.
- The risk is not catastrophic for an individual saver, but it is **structurally significant** when multiplied across millions of pension accounts.
- These mathematical stress-tests reinforce the report's central argument: **index-rule changes shift early-stage valuation risk from private investors to ordinary savers.**

Appendix C: Policy-Impact Simulation – Effect of a 12-Month Seasoning Period

This appendix illustrates, in simplified quantitative terms, how a 12-month seasoning period for index inclusion could reduce losses for pension savers by allowing IPO valuations to normalise before passive funds are forced to buy.

C1. Conceptual setup

Under current rules, a large fashion IPO can enter a major index within weeks. Pension funds then buy at or near the IPO valuation. With a 12-month seasoning period, the same company would only become eligible after one year of trading, by which time its price may have adjusted closer to fundamental value.

Let:

- A = pension pot£250,000
- α = equity allocation 0.6
- A_{eq} = A ▪ α = £150,000
- w_i = index weight of entrant (0.4% = 0.004)

We compare two regimes:

- **Baseline (no seasoning):** index inclusion at IPO price P_0
- **Reform (12-month seasoning):** index inclusion at post-seasoning price P_s

C2. Single-stock simulation

Assume a fashion IPO lists at an overvalued price and then partially corrects over 12 months.

- IPO overvaluation: 30% above "fair" value
- 12-month correction: price falls 25% from IPO level

Baseline (no seasoning):
Pensions buy at P_0, then experience the 25% decline.

$L_{basrline}$ = A_{eq} ▪ w_i ▪ 0.25 = 150,000 ▪ 0.004 ▪ 0.25 = £150

Reform (12-month seasoning):
Pensions only buy after the 25% correction, at P_s. The initial overvaluation is absorbed by active investors; passive investors enter at the lower, post-correction level.

L_{reform} ≈ 0 for that initial correction phase

The loss avoided for this single entrant is therefore approximately £150 for this saver.

C3. Cluster simulation

Now extend this to a cluster of three fashion IPOs entering within a year, each with similar dynamics.

Assumptions:

- Three entrants, each with weight 0.4% (combined 1.2%)
- Each falls 25% in the first 12 months
- Same saver: £150,000 equity slice

Baseline (no seasoning):

$L_{baseline,cluster} = A_{eq} \cdot 0.012 \cdot 0.25 = 150{,}000 \cdot 0.012 \cdot 0.25 = £450$

Reform (12-month seasoning):

$L_{reform,cluster} \approx 0$ for the initial 12-month correction

The avoided loss for this saver is roughly £450. At system level, multiplied across, say, 5 million similar pension accounts, the avoided transfer is on the order of:

5,000,000 ▪ £450 = £2.25 billion

This is illustrative, not a forecast, but it shows the scale of impact.

C4. Interpretation

The simulation demonstrates three key points:

First, a seasoning period does not eliminate risk; it **shifts the earliest, most speculative phase of valuation risk back onto active investors**, who choose to participate, rather than onto passive savers, who do not.

Second, the effect is **non-trivial at scale**. Even modest per-saver losses avoided translate into billions in aggregate when applied across an entire pension system.

Third, the reform is **structural, not behavioural**. It does not require savers to become more financially literate or trustees to time markets; it simply changes when index rules compel buying, allowing prices to be tested before pensions are exposed.

This aligns directly with the report's central argument: that index-rule design determines who bears the cost of overvalued IPOs, and when.

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