**Market Consultation**

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| **To:** | Market Participants |
| **From:** | Indices Department |
| **Date:** | 16 April 2012 |
| **Subject:** | **Proposed SWIX Free Float Methodology Change** |
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## Executive Summary

The SWIX 40 and SWIX ALSI indices use a SWIX Free Float factor to down-weight dual listed constituents. The current SWIX Free Float is based on the proportion of listed share capital owned by South African investors. All other constituents use their full company free float in these indices.

FTSE/JSE proposes two changes to the methodology to calculate the SWIX Free Float:

* A down-weighting based on the STRATE Register should be applied to all constituents, and not just dual listed instruments
* SWIX Free Float should be based on the number of shares held on the South African share register, rather than the nationality of the shareholder

Please submit any comments on this methodology change to indices@jse.co.za. All feedback received by 11 May 2012 will be discussed at the next FTSE/JSE Advisory Committee (AC) meeting in June, and the market will be informed of any decisions taken, subsequent to the meeting.

## Introduction

In November 2011 a Market Consultation was published, which proposed that all SWIX constituents be down-weighted by the location of the shareholders i.e. exclude the foreign portion on the STRATE Register.

It was clear from the market response that the preference was for SWIX weights to be based on the total number of instruments available to South African investors (i.e. the full STRATE Register), as opposed to the portion of the STRATE Register owned by South African investors. The AC decided to not implement the proposal as presented in the November Market Consultation, but to rather investigate the impact of an amended proposal whereby all SWIX constituents would be down-weighted by using the full STRATE register.

## Background

The FTSE/JSE Ground Rules describes the current methodology of the SWIX indices as follows:

*The shareholder weighting will be achieved by excluding foreign held free float. Each index will follow the construction of the existing FTSE/JSE All-Share Index with regards to constituents, but additionally certain constituents’ weights will be further adjusted for non South African shareholdings. The goal is to eventually down weight (exclude) all foreign free float holdings. Therefore the free float figure of a company in the index will be adjusted to reflect only the locally held free float. Due to the fact that this data on foreign free float holdings is not readily available, the shareholder weighting adjustment will commence with dual listed companies only. A dual listed company, in this context, is one which has a listing (secondary or primary) on any foreign index.*

The SWIX indices use the STRATE Share Register in order to reduce constituent weights of dual-listed constituents, in addition to the adjustments already made for cross-holdings and strategic holdings. When the SWIX Free Float is higher than the FTSE/JSE company free float, the SWIX Free Float is reduced to the level of the FTSE/JSE company free float.

The data received from STRATE splits the South African Share Register into “Dematerialised Shares held by SA Clients” and “Dematerialised Shares held by Foreigners”. Currently only the “Dematerialised Shares held by SA Clients” portion of the STRATE Register is reflected in the SWIX indices (i.e. counted as free float). The “Dematerialised Shares held by Foreigners” portion of the STRATE Register is excluded from the SWIX indices.

Currently only dual-listed companies are adjusted for foreign holdings. In this context, a dual-listed company is a JSE listed company with an additional listing (secondary or primary) on a foreign exchange other than Namibia.

FTSE/JSE is of the opinion that the current methodology of the SWIX indices is not very clear, consistent or easy to follow. The index methodology is not ideal and there are quite a few anomalies and inconsistencies, which should ideally be improved.

## Proposed SWIX Free Float Methodology

It was agreed by the AC that a more consistent treatment of constituents should be investigated for the SWIX indices. The feeling was that the SWIX indices should represent a benchmark of the equity available to trade in South Africa and, in particular, on the JSE, irrespective of shareholder domicile. The aim was that the location of the Share Register, rather than the domicile of the investor, should be used as the basis for constituent weighting in the SWIX indices. The intention was to create a slightly more representative benchmark of shares available to trade for domestic investors. It should not matter whether it is a US or UK investor holding a company’s shares on the SA Share Register, or whether it is a domestic competitor; all players contend for shares registered domestically on an equal footing.

It was feared that a shareholder domicile-based approach, focusing on the split between local and foreign holdings on the STRATE Register, could cause unintended volatility in the SWIX indices. The foreign/local split could possibly change frequently and significantly due to global investor sentiment and other economic events. The constituent weights in the index could perhaps be influenced by the stance of foreign investors. However, this risk is somewhat mitigated by free float banding and using a three month average of the data received from STRATE.

It was therefore recommended that the scenario be investigated whereby the full portion of shares, as reflected on the SA Share Register, are included in the SWIX indices, regardless of the location of the holder of the shares. Therefore the sum of the “Dematerialised Shares held by SA Clients” and “Dematerialised Shares held by Foreigners”, which totals the shares held on the SA Register, should be represented in the index. When the SWIX Free Float is higher than the FTSE/JSE company free float, the SWIX Free Float should still be reduced to the level of the FTSE/JSE company free float. It was proposed to investigate whether this treatment should be applied consistently to all constituents of the SWIX indices and not only the dual-listed constituents of the index, regardless of their country of domicile. Shares that have not yet been dematerialised will be counted as restricted.

## Impact of the Proposed Methodology on the SWIX Indices

FTSE/JSE calculated a three year history for the Proposed SWIX Top 40 Index and the Proposed SWIX All Share Index. The proposed indices followed the same constituent additions and deletions as the existing FTSE/JSE SWIX indices. The only difference in methodology was to calculate a Proposed SWIX Free Float which represented the total holding on the SA Share Register and this was applied to all constituents of the proposed indices. The minimum banded free float between the FTSE/JSE company free float and the SWIX Free Float was used.

## Impact on Capital Index Values

From the graph below it can be seen that the relative performance of the Proposed SWIX Top 40 index has a strong correlation to the performance of the current FTSE/JSE SWIX Top 40 index, with a daily return correlation coefficient of 0.994613 over the three year period.

*Graph 1: Relative performance of the FTSE/JSE SWIX Top 40 and Proposed SWIX Top 40 indices*

From the graph below it can be seen that the relative performance of the Proposed SWIX All Share index has a strong correlation to the performance of the current FTSE/JSE SWIX All Share index, with a daily return correlation coefficient of 0.994687 over the three year period.

*Graph 2: Relative performance of the FTSE/JSE SWIX All Share and Proposed SWIX All Share indices*

## Impact on SA Sector Weights

An important consideration when amending the methodology of an index would be to prevent unintended consequences. The SWIX indices are very popular due to the fact that the SA Resources sector is down-weighted relative to Financials and Industrials, in comparison to the FTSE/JSE Top 40 and All Share indices. Applying the proposed methodology to the SWIX Top 40 and SWIX All Share Indices has an effect on the weighting by SA Sector Weights in the indices. The weight of Industrials and Financials is pushed slightly lower, while the weight of Resources increases by between 3.18% - 5.72% from current levels.

The graphs below illustrate the movement of the weight of the SA Sectors in the SWIX Top 40 and All Share indices.

One should also consider the once-off impact and cost involved to rebalance investment portfolio’s based on the particular indices. The cost implications could be material for certain funds.

Please refer to 5.3 below for the weight changes of individual dual listed constituents, which are most affected by the proposed change in free float methodology. Non-dual listed company free floats are generally not largely impacted since the STRATE Register is almost identical to the listed instruments for these companies.

Graph 3 below, gives an indication of the average weight by SA sector in the SWIX Top 40 and the SWIX All Share indices for the period March 2009 to December 2011.

On average the weight of Resources moved from 36% in the FTSE/JSE SWIX Top 40 Index to 39% in the Proposed SWIX Top 40 Index, while SA Industrials and Financials moved from 40% to 39% and 24% to 22% respectively.

On average the weight of Resources moved from 28% in the FTSE/JSE SWIX All Share Index to 33% in the Proposed SWIX All Share Index, while SA Industrials and Financials moved from 47% to 44% and 25% to 23% respectively.

*Graph 3: Average Weight by SA Sector for the period March 2009 – December 2011*

*Graph 4: Weight of SA Sector in the FTSE/JSE SWIX Top 40 Index*

*Graph 5: Weight of SA Sector in the Proposed SWIX Top 40 Index*

*Graph 6: Weight of SA Sector in the FTSE/JSE SWIX All Share Index*

*Graph 7: Weight of SA Sector in the Proposed SWIX All Share Index*

## Impact on SWIX Free Float and Weight of Individual Dual Listed Constituents

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| --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Alpha** | **Instrument** | **FTSE/JSE SWIX FF** | **Proposed SWIX FF** | **% Weight in FTSE/JSE SWIX 40** | **% Weight in Proposed SWIX 40** |
| **2009/12/31** | AGL | Anglo American Plc | 30 | 40 | 6.49 | 7.27 |
| ANG | Anglogold Ashanti Ltd | 30 | 100 | 1.68 | 4.70 |
| ARI | African Rainbow Minerals | 40 | 40 | 0.74 | 0.62 |
| BIL | Bhp Billiton Plc | 30 | 20 | 8.00 | 4.48 |
| CFR | Compagnie Fin Richemont | 40 | 100 | 2.62 | 5.50 |
| GFI | Gold Fields Ltd | 30 | 100 | 1.04 | 2.92 |
| HAR | Harmony G M Co Ltd | 50 | 100 | 0.81 | 1.36 |
| IMP | Impala Platinum Hlgs Ld | 75 | 100 | 4.84 | 5.42 |
| INP | Investec Plc | 75 | 75 | 0.90 | 0.76 |
| LBT | Liberty Internationl Plc | 40 | 40 | 0.74 | 0.62 |
| LON | Lonmin Plc | 5 | 6 | 0.11 | 0.11 |
| NPN | Naspers Ltd -N- | 75 | 100 | 4.57 | 5.12 |
| OML | Old Mutual Plc | 40 | 50 | 1.46 | 1.53 |
| REI | Reinet Investments | 100 | 100 | 1.19 | 1.00 |
| SAB | Sabmiller Plc | 30 | 30 | 5.38 | 4.52 |
| SOL | Sasol Ltd | 75 | 100 | 7.17 | 8.03 |
| TKG | Telkom Sa Ltd | 50 | 50 | 0.50 | 0.42 |
|  |  |  |  |  |  |  |
| **2010/12/31** | AGL | Anglo American Plc | 30 | 40 | 6.03 | 6.50 |
| ANG | Anglogold Ashanti Ltd | 30 | 100 | 1.63 | 4.39 |
| ARI | African Rainbow Minerals | 40 | 40 | 0.77 | 0.63 |
| BIL | Bhp Billiton Plc | 30 | 30 | 7.75 | 6.26 |
| CFR | Compagnie Fin Richemont | 30 | 100 | 2.67 | 7.18 |
| CSO | Capital Shopping Centres Group Plc | 40 | 50 | 0.51 | 0.52 |
| GFI | Gold Fields Ltd | 30 | 100 | 1.14 | 3.06 |
| HAR | Harmony G M Co Ltd | 50 | 100 | 0.78 | 1.26 |
| IMP | Impala Platinum Hlgs Ld | 75 | 100 | 4.81 | 5.18 |
| INP | Investec Plc | 75 | 75 | 0.97 | 0.78 |
| LON | Lonmin Plc | 8 | 9 | 0.14 | 0.13 |
| MNP | Mondi Plc | 40 | 50 | 0.34 | 0.35 |
| NPN | Naspers Ltd -N- | 75 | 100 | 5.12 | 5.52 |
| OML | Old Mutual Plc | 40 | 50 | 1.28 | 1.30 |
| REI | Reinet Investments | 100 | 100 | 1.00 | 0.80 |
| SAB | Sabmiller Plc | 30 | 30 | 5.07 | 4.10 |
| SOL | Sasol Ltd | 75 | 100 | 7.22 | 7.78 |
|  |  |  |  |  |  |  |
| **2011/12/15** | AGL | Anglo American Plc | 30 | 40 | 5.32 | 5.69 |
| AMS | Anglo American Platinum | 30 | 30 | 1.83 | 1.47 |
| ANG | Anglogold Ashanti Ltd | 30 | 100 | 1.77 | 4.74 |
| ARI | African Rainbow Minerals | 40 | 40 | 0.62 | 0.49 |
| BIL | Bhp Billiton Plc | 30 | 30 | 6.77 | 5.43 |
| CFR | Compagnie Fin Richemont | 30 | 100 | 2.82 | 7.54 |
| CSO | Capital Shopping Centres Group Plc | 40 | 40 | 0.59 | 0.47 |
| GFI | Gold Fields Ltd | 30 | 100 | 1.20 | 3.21 |
| HAR | Harmony G M Co Ltd | 50 | 100 | 0.95 | 1.53 |
| IMP | Impala Platinum Hlgs Ld | 75 | 100 | 3.46 | 3.70 |
| INP | Investec Plc | 75 | 75 | 0.77 | 0.62 |
| LON | Lonmin Plc | 14 | 15 | 0.15 | 0.13 |
| MNP | Mondi Plc | 50 | 50 | 0.46 | 0.37 |
| NPN | Naspers Ltd -N- | 75 | 100 | 4.54 | 4.86 |
| OML | Old Mutual Plc | 40 | 50 | 1.64 | 1.64 |
| SAB | Sabmiller Plc | 30 | 30 | 6.14 | 4.93 |
| SOL | Sasol Ltd | 75 | 100 | 7.87 | 8.41 |
| WHL | Woolworths Holdings | 100 | 100 | 1.43 | 1.15 |

*Table 1: Changes in SWIX Free Float and Weight from FTSE/JSE SWIX to Proposed SWIX*

Table 2 below, shows the proposed SWIX Free Floats for companies previously classified as Inward Foreign Listings (IFL). The SWIX Free Float is applied to all IFLs in the Index Series. Therefore their free float in the remainder of the Index Series will be affected by this proposed change.

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| --- | --- | --- | --- |
| **Alpha** | **Company** | **FTSE/JSE SWIX Mar ‘12 QR** | **Proposed SWIX FF** |
| BTI | British American Tobacco Plc | 10% | 11% |
| CCO | Capital & Counties Properties Plc | 30% | 20% |
| CZA | Coal of Africa Limited | 30% | 30% |
| NEP | New Europe Property Investments Plc | 40% | 40% |
| PAN | Pan African Resources Plc | 75% | 100% |
| PGL | Pallinghurst Resources Limited | 75% | 100% |

*Table 2: Proposed SWIX Free Float for IFLs*

## Conclusion

FTSE/JSE would like to propose the changes below to the free float methodology of the SWIX indices.

* Down-weighting be applied to all constituents, and not just dual listed instruments
* SWIX Free Float be based on the number of shares held on the South African share register, rather than the nationality of the shareholder

This would bring about a marginal theoretical change to the index methodology and would get rid of the inconsistency of only applying the methodology to dual listed stocks. A once-off rebalance would be required in order to change the free float of dual listed stocks to reflect the total SA Register, which would carry costs for market participants. The SWIX Free Float of non-dual listed companies are generally not largely impacted since the STRATE Register is almost identical to the listed instruments for these companies.

Market Participants are asked for their comments on the proposed change, as well as any other related inputs.

## Responding to the consultation

It is important to FTSE/JSE to be aware of any unintended consequences of the change and the impact on clients. Therefore, FTSE/JSE would appreciate comments on the proposed change and its possible impact, on tracker funds, derivative products and benchmark functions. All feedback received by 11 May 2012 will be presented at the June 2012 AC Meeting, followed by a public announcement on any decision taken. When determining the timeline for the implementation of any decision, FTSE/JSE needs to be mindful of the broad usage of these indices in the market and need to provide appropriate notice. Your preference on this timeline and the possible implementation would be very useful.

**Please provide us with your comments and suggestions by Friday, 11 May 2012 to the following email address:** [**indices@jse.co.za**](mailto:indices@jse.co.za)

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