

Memorandum

To: Market Participants
From: FTSE/JSE
Date: 1 February 2013
Subject: **Explanatory Note: Free Float & SWIX Methodology Changes Effective March 2013**

1. Background

As previously published on SENS and the JSE website, FTSE/JSE will be moving from a banded to an actual free float methodology in the FTSE/JSE Africa Index Series from March 2013. This is in line with a global change to index methodology being applied by FTSE International in March 2013. This will improve the market representation of the index and potentially reduce large changes to constituent weights.

With this upcoming change to actual free float it seemed to be an opportune time to simultaneously improve the SWIX index methodology. Various proposals to improve the SWIX indices have been debated with market participants, starting in 2011.

2. Free Float Methodology Change

2.1 Current Free Float Methodology

The current methodology, when applying free float in the FTSE/JSE Index Series, is to calculate the actual free float figure as:

$$\text{Actual Free Float} = 1 - \frac{\text{Sum Free Float Restricted Holdings}}{\text{Total Shares In Issue}}$$

Restricted holdings are shares deemed not freely traded in the market (see Ground Rule 4.3.1 for more detail). FTSE/JSE then bands the calculated actual free float figure in line with the free float bands stipulated in the FTSE/JSE Ground Rules (Rule 4.3). This effectively rounds the free float up to 20%, 30%, 40%, 50%, 75% and 100%. For example, an actual free float of 56.7% will band up to the company free float of 75%. This rounded free float number is referred to as company free float. Note that the company free float for a particular instrument will be the same across all indices (e.g. Top 40 and All Share).

Following the application of an initial free float restriction, a constituent's free float will only be changed if its actual free float moves to more than 5 percentage points above the minimum or 5 percentage points below the maximum of an adjacent new band.



2.2 Problem Statement

The banding structure has worked well over the past 10 years. However, an undesired consequence of the bands was that a relatively small change in actual free float could sometimes result in a change in the banded free float from 50% to 75 % (an increase of 50%) or from 75% to 100% (an increase of 33%). These large moves had the potential to cause a short term liquidity squeeze. Furthermore, since the introduction of the free float structure, there has been a substantial improvement in the quality of information available on major shareholders in the SA market resulting in free float data that is more precise.

2.3 New Free Float Methodology Effective March 2013

With effect from start of business on the 18th of February 2013 FTSE/JSE will implement the move from banded free float to actual free float (rounded up to the next 1%) in the Index Series. Furthermore, a 3% buffer will apply, which means that the free float for a constituent will only be adjusted if the move in free float is larger than 3%.

It is important to note that the frequency of the free float reviews will not change. These will still be done once per year for each constituent and in the event of any large corporate action that affects the shareholding.

FTSE/JSE is of the opinion that the new actual free float methodology will be a more accurate representation of the market. In addition, the potentially large movements in free float due to the current banding system will be largely eliminated. While this change to index methodology will result in a large once off churn at the March review, FTSE/JSE and many market participants believe the long term benefits outweigh this once off cost.

3. Shareholder Weighted Index (SWIX) Methodology Change

The change from banded to actual free float will also be implemented across the SWIX indices. In addition to this change in rounding, a modification to the down-weighting methodology of dual listed companies will be applied.

3.1 Current SWIX Methodology

The SWIX free float is used to down-weight dual listed companies and is currently applied in the SWIX 40 (J400) and SWIX All Share (J403) indices.

Currently the SWIX free float for dual listed constituents is based on the portion of listed share capital, on the South African share register, owned by South African investors in dematerialised form. This information is obtained from Strate. All non-dual listed constituents use their full company free float in these indices.

An average of the dematerialised shares held by South Africans, in the 3 months prior to the review month, with a one month lag, is used to calculate the SWIX free float. In the event that this figure is not available, the FTSE/JSE company free float is used. The normal free float banding and buffer algorithms are applied to determine the banded SWIX free float. Where the company's free float is lower than its SWIX free float, the company free float will be used.

The SWIX free float is only calculated for dual listed constituents of the SWIX indices. A dual listed company, for the purposes of the SWIX indices, is defined as “a JSE listed company with an additional ordinary share listing on a foreign exchange other than Namibia”. All non-dual listed constituents use their company free float in the SWIX Indices.

Current SWIX Free Float Formula:

If a constituent is not dual listed:

$$SWIX \text{ free float} = \text{Company free float}$$

If a constituent is dual listed:

$$\text{Min} \left[\frac{\text{SA Owned Strate}}{\text{Total Shares In Issue}} \quad \text{AND} \quad \text{Company Free Float} \right]$$

3.2 Background

Market participants polled for their opinion seemed nearly unanimous in their desire for an index that represents the investable universe available to South African investors and felt this would be best represented by the total Strate Register holdings for all constituents, rather than using the SA ownership criteria. Market participants seemed to be in principle agreement that all securities deemed not available for local trade, but included on the Strate register, should be excluded from the available investable universe, specifically including shares held to back listed Depository Receipt programs.

3.3 New SWIX Methodology Effective March 2013

Under the new methodology *all* constituents will be down-weighted in the SWIX indices. The SWIX free float represents the proportion of a constituent’s share capital that is held in dematerialised form on the South African share register. It differs from the current methodology in that it does not consider shareholder nationality. This information will still be obtained from Strate.

An average of the total holdings on the South African share register, in the 3 months prior to the review month, with a one month lag, is used to calculate the SWIX free float. In the event that this figure is not available, the FTSE/JSE company free float is used. Where the company’s free float is lower than its SWIX free float, the company free float will be used.

In addition all securities deemed not available for local trade, but included on the Strate register will be subtracted from the free float number calculated as per above. This will initially include holdings confirmed to back a listed, sponsored Depository Receipt program.

The SWIX free float will also be provided as an actual free float number (rounded up to the next 1%) and not a banded number.

New SWIX Free Float Formula:

$$\text{Min} \left[\frac{\text{Total Strate Register} - \text{Locally unavailable scrip}}{\text{Total Shares In Issue}} \quad \text{AND} \quad \text{Company Free Float} \right]$$

4. Additional Information

Additional information on the upcoming changes can be obtained using the following links to the JSE website:

- i. Actual company free float and SWIX free float numbers that will be applied on 18 March 2013, presented per company:
<http://www.jse.co.za/Products/FTSE-JSE/ICA-Announcements/2013.aspx>
(Notice name: 20130318-Actual_Free_Float_March_2013_Final)
- ii. Indicative impact to constituent weightings for the Top 40, SWIX 40, All Share and SWIX All Share indices:
<http://www.jse.co.za/Products/FTSE-JSE/ICA-Announcements/2013.aspx>
(Notice name: 20130318 Free Float & SWIX Methodology Change Projection)
- iii. Comprehensive current FTSE/JSE Ground Rules
http://www.jse.co.za/Libraries/FTSE-JSE_-_Ground_Rules/FTSE_JSE_Ground_Rules.sflb.ashx
- iv. For any further queries please contact the FTSE/JSE Indices Department directly
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