**To:** Market Participants
**From:** FTSE/JSE
**Date:** 24 June 2016
**Subject:** **FTSE/JSE Index Construction and Final Changes**

## 1. Introduction

FTSE/JSE embarked on a market consultation process in November and December 2015 in order to obtain feedback on a number of proposed changes to the methodology of the FTSE/JSE Index Series. The feedback received was broadly supportive of the proposed changes, and in particular of the key principles. FTSE/JSE received a number of very practical suggestions on specific implementation concerns, and has incorporated many of these into an updated methodology proposal. This updated proposal was presented to the FTSE/JSE Advisory Committee (AC) at the March 2016 meeting, who supported its implementation as soon as practically possible.

FTSE/JSE is pleased to announce that the final changes to the index construction will be implemented at the September 2016 Quarterly Review, effective on 19 September 2016. FTSE/JSE believes that the proposed index changes have matured significantly over the past six months and will improve the quality of the index offering materially.

## 2. Final Changes to Index Construction

Based on feedback received from market participants and the FTSE Russell Governance structures, and approval from the FTSE/JSE Advisory Committee, FTSE/JSE would like to present the final changes to the Core Index Methodology of the FTSE/JSE Africa Index Series:

- Keep the minimum free float rules (both the 5% and the 5% - 15% rules) and do not introduce the proposed minimum weight requirement. However, the 5% - 15% free float rule will now be based on a median investable market capitalisation measure rather than an average.
- Do not consider the exceptional free float restrictions relating to inward listings when applying the 5% and 5% - 15% minimum free float rules. Inward listings could thus enter the indices with a FTSE/JSE free float of 5% or less as long as their global free float meets the minimum free float criteria. Inward listings will require a minimum of 1% of their issued shares to be accounted for on the South African share register. *Refer to paragraph 3 for additional details.*
- Change the focus of the Top 40 Index from a Top 40 "largest company" index to a Top 40 "most investable company" index. The constituents for the Top 40 Index will be selected based on net market capitalisation, which is adjusted for free float, instead of gross market capitalisation. *Refer to paragraph 4 for additional details.*
- Select the constituents of the SWIX 40 (J400) using SWIX-adjusted investable market capitalisation. As such, the constituents of the SWIX 40 may differ from that of the Top 40 Index. *Refer to paragraph 5 for additional details.*

- The SWIX All Share index (J403) will continue to have the same constituents as the All Share index (J203), because the index selection for both indices is based on gross market capitalisation.
- Review the All Share Index constituents semi-annually instead of annually. Introduce selection buffers for additions and deletions to manage turnover. Reviews will occur in March and September, in line with the FTSE Global Equity Indices timelines.
- Remove the 160 minimum number of constituents for the All Share Index. The index selection will be based solely on the target 99% market representation level and may thus include fewer constituents. *Refer to paragraph 6 for additional details.*
- Introduce a Large Cap Index, targeting 85% market representation, to replace the Top 40 Index as a cap-defined benchmark.
- Introduce a new Large & Mid Cap Index, targeting 96% market representation, which provides a benchmark to larger funds that find the All Share Index impractical to use.
- Retain the Mid Cap Index as a benchmark index, although the constituent selection methodology changes to a market representation percentage rather than a fixed number of constituents. The All Share Index will thus be divided into three capitalisation-based sub-indices, namely the Large Cap, Mid Cap and Small Cap, which will all be reviewed semi-annually.
- The Dividend Plus index (J259) is currently derived from the Top 40 and Mid Cap indices at the semi-annual review of the index. The universe for the Dividend Plus index will change to the Large & Mid Cap index.

For clarity, there is no change to the way that free floats for individual companies are calculated, nor is there any change to the way that any index is *weighted*.

## 3. Free Float of Inward-Listed Companies

Instruments that are classified as foreign for index purposes currently have an additional free float restriction in that the shares that are not accounted for on the Strate Register are restricted for free float purposes. With the implementation of the new methodology the true global free float of instruments classified as foreign for index purposes will be used when considering the minimum free float levels, and not the Strate adjusted free float.

**Example:**
ABC International has a global free float of 40% due to director and strategic holdings. Currently only 3% of the total share register is accounted for on the Strate Register. The global free float of 40% will be screened against the two minimum free float rules, e.g. the minimum of 5% and the 5% - 15% free float band. This treatment will be in line with the company's true underlying restricted holdings. However, the 3% of total shares accounted for on the Strate Register will be used in the index as the free float for selection and ranking purposes.

In addition to the amendment set out above, any inward-listed instrument will require more than 1% of its total share register to be accounted for on the Strate Register.

## 4. Top 40 Index

The Top 40 index universe will be ranked on free float adjusted market capitalisation on review cut date each quarter. This net market capitalisation will be used for all selection purposes. The index will still consist of a fixed number of 40 constituents and the index buffers will remain in place at rank 35 and above for auto addition and 46 or below for auto deletion.

## 5. SWIX 40 Index

The SWIX 40 Index (J400) will no longer be derived from the Top 40 index and will thus not necessarily have the same constituents as the Top 40. The constituents to be included in the SWIX 40 index will be independently ranked and selected on their SWIX net market capitalisation as on review cut date. The review methodology of the SWIX 40 Index will mirror that applied to the Top 40 Index, in that the index will also have 40 constituents with auto addition and auto deletion buffers at ranks 35 and 46 respectively.

## 6. Benchmark Indices

The broad benchmark index offering in the Series will be based on a target market representation percentage (MRP) as follows:

| Existing Code | Name | Target MRP | Auto-Add | Auto-Del | Notes / Changes |
|---|---|---|---|---|---|
| J203 | All Share | 99% | 98.5% | 99.5% | 160 constituent minimum removed. |
| NEW | Large & Mid Cap | 96% | 95.0% | 97.0% | |
| NEW | Large Cap | 85% | 83.0% | 87.0% | Replacement for Top 40 Index as a large cap benchmark. |
| J201 | Mid Cap | 85%-96% | 95.0% | 97.0% | Changes from current selection on rank 41-100. No longer a fixed number of constituents (60). |
| J202 | Small Cap | 96%-99% | 98.5% | 99.5% | Changes from current selection on rank 101-160. |
| J204 | Fledgling | 99%-100% | | | Fledgling Index will continue to have no liquidity screen applied. |

The benchmark indices will continue to be selected on gross market capitalisation, but will now be selected purely on market representation and will not have a fixed minimum number of constituents. Note that the minimum weighting hurdle at a constituent level that was previously proposed will no longer be introduced. The benchmark indices will be reviewed semi-annually.

At a high level, the following steps define the proposed semi-annual index review process:

- The list of eligible instruments is identified. This includes the existing screens to include only active instruments classed as equity, listed on the Main Board, that have a last traded price. The existing exclusions on classes of eligible security remain unchanged (e.g. Pyramid Companies, Special Purpose Acquisition Vehicles, Instruments classified as foreign for portfolio allowance purposes, etc.)
- The existing liquidity screen is applied unchanged. This requires each instrument to trade at least 0.5% of its free float adjusted shares in issue per month for 8 of the previous 12 months for existing constituents, and 10 of the previous 12 months for non-constituents. Any instrument that fails the liquidity screen is not eligible for inclusion to any index in the Index Series, except for the Fledgling Index and the Alternative Exchange Index.
- Instruments that do not meet the minimum free float criteria are removed from the eligible universe.
- Companies are valued by full market capitalisation as on review cut date (shares in issue x price). Where a company has multiple classes of eligible instruments that are eligible, these are grouped and the companies are then ranked by the combined full market value.
- The total market capitalisation of the eligible universe is calculated by aggregating the full market capitalisation of all eligible companies.

- Companies are ranked by full market capitalisation in descending order. The cumulative market capitalisation and corresponding cumulative market weight is calculated for all stocks.
- To reduce turnover, existing and potential constituents are subject to a series of "buffer zones" to determine the cut-off points between the Large, Mid and Small Cap. The buffers are detailed in the table above and define the constituent additions and deletions in each index at the semi-annual review, based on the cumulative market weight of each company. The All Share Index consists of the combined Large & Mid Cap and Small Cap Indices. The remaining eligible instruments form the Fledgling Index.
- Where there are multiple lines of equity capital in a company, each line must pass all eligibility screens in its own right. As such, the cumulative market capitalisation weight must meet the buffer zone defined in the table above for both the combined company and the individual lines.

## 7. Conclusion

The Index Ground Rules will be fully updated to reflect the changes to the impacted indices. The updated Ground Rules will be published to the market on or before 22 July 2016.

An illustration of the impact of the methodology changes is available on the JSE website:
20160919 Methodology Change Illustrative Impact

The JSE Indices team would like to meet with market participants should further context or analysis be needed regarding the impact of the changes. Should you wish to arrange a meeting in this regard, please contact us at the following email address: **indices@jse.co.za**

This document is not confidential and should be distributed as widely as possible to all stakeholders.