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# FTSE RAFI™ Index Series Methodology Enhancements

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# FTSE RAFI™ Index Series

## Methodology Enhancements Summary

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# FTSE RAFI™ Index Series

## Overview

- FTSE and Research Affiliates® launched the FTSE RAFI™ Index Series in 2005 comprised of:
  - *FTSE RAFI™ US 1000 Index*
  - *FTSE RAFI™ Developed ex-US 1000 Index*
- There are currently over 100+ indexes within the FTSE RAFI™ Index Series
- FTSE Russell and Research Affiliate's® indexes are currently used as the basis of over \$90 billion in investment products<sup>1</sup>
- The proposed methodology enhancements will be implemented during the March 2017 Index Review

**The proposed methodology enhancements will simplify methodology and index construction while streamlining the ongoing maintenance of the FTSE RAFI™ Index Series.**

<sup>1</sup> "FTSE Russell Benchmark AUM" report as of December 31, 2015

# Single Review Universe

**Issue: The current methodology used to construct FTSE RAFI™ Index Series is not globally consistent and relies on various starting universes.**

<b>Current Approach</b>	<b>Proposed Approach</b>
<p>Country indexes are built separately using individual country-level indexes such as:</p> <ul style="list-style-type: none"><li>• FTSE All-Share Index (UK)</li><li>• FTSE ASFA Australia All-Share Index</li><li>• FTSE/JSE Africa All-Share Index</li></ul>	<p>Single starting universe for entire FTSE RAFI™ suite consisting of:</p> <ul style="list-style-type: none"><li>• FTSE Global All Cap Index</li><li>• Russell 3000® Extended Index</li><li>• FTSE ASFA Australia All-Share Index</li><li>• FTSE UK All-Share Index</li><li>• FTSE/JSE All Share Index</li></ul>
<b>Benefit</b>	
<p>The proposed methodology enhancements will provide a transparent and consistent framework for the FTSE RAFI™ Index Series. The new methodology will allow users to tailor their requirements and address future needs in an easy to understand building block approach.</p>	

**Q1. Do you agree with moving to a single review universe to be used as the basis of constructing all FTSE RAFI™ Indexes?**

# Regional Review Process

**Issue:** The current methodology relies on a fixed number of securities to determine index membership.

Current Approach	Proposed Approach
<p>FTSE RAFI™ Index Series are constructed using different approaches:</p> <ul style="list-style-type: none"><li>• All regional and some country indexes are built using a fixed number of securities</li><li>• Developed country indexes (excluding US) are built as a carve out of the FTSE RAFI™ Developed ex-US 1000 index.</li></ul>	<p>Six regions will be constructed from the starting universe: US, UK, Japan, Developed Europe ex-UK, remaining Developed countries, remaining Emerging countries.</p> <p>Individual indexes will be built from each region using a fixed percentage of cumulative unadjusted FTSE RAFI™ weight as follows:</p> <ul style="list-style-type: none"><li>• Large Company: Top 68%</li><li>• Mid Company: 68% - 86%</li><li>• Small Company: 86% - 98%</li></ul>
Benefit	
Allows for consistent and deeper selection within regions and a clearer representation of regions within global indexes. Increased capacity for the FTSE RAFI™ Emerging Markets Index.	

**Q2. Do you favor constructing the FTSE RAFI™ indexes using a fixed cumulative weight percentage as opposed to a fixed number of stocks?**

# Regional Universe Banding

**Issue:** The current methodology does not utilize banding to limit migration of index members across indexes.

<b>Current Approach</b>	<b>Proposed Approach</b>
The FTSE RAFI™ Indexes do not currently employ banding.	Existing constituents of any region will remain in the portfolio as long as they fall within a fixed percentage range of cumulative unadjusted FTSE RAFI™ weights as follows: <ul style="list-style-type: none"><li>• Large Company: 71%</li><li>• Mid Company: 89%</li><li>• Small Company: 99%</li></ul>
<b>Benefit</b>	
Reduced turnover leading to lower cost of implementation.	

**Q3. Are you in favor of using a banding approach to limit index membership changes?**

# Constituent Selection and Weighting

**Issue:** The current methodology excludes companies with small float.

<b>Current Approach</b>	<b>Proposed Approach</b>
<p>Companies are both selected and weighted by float/liquidity adjusted FTSE RAFI™ weight.</p> <p>As a result, large companies with small float are not represented in large company indexes</p>	<p>Eligible companies are selected based on unadjusted FTSE RAFI™ weight, i.e. before applying free float or liquidity adjustment.</p> <p>Selected companies are then assigned a weight based on free-float and liquidity adjusted FTSE RAFI™ weights.</p>
<b>Benefit</b>	
<p>Allows for accurate representation of large companies even if their free floats are smaller.</p> <p>Aligns our methodology with that of parent FTSE Russell benchmarks and other standard industry benchmarks.</p>	

**Q4. Do you agree with qualifying eligible companies based on their weight prior to applying free float or liquidity adjustment?**



# Phased Deletions within FTSE RAFI™ QSR Index Series

**Issue:** The current treatment of index deletions is inconsistent across various FTSE RAFI™ indexes.

<b>Current Approach</b>	<b>Proposed Approach</b>
Deletion of securities for the FTSE RAFI™ QSR Index Series occurs immediately at index reconstitution on the third Friday of March.	Deletion of securities from the index will be phased out across each quarterly rebalance.
<b>Benefit</b>	
Improved implementation as securities are phased out over time versus sold immediately.  Creates consistency between the FTSE RAFI™ Index Series and the FTSE RAFI™ Low Volatility Index Series.	

**Q5. Do you favor a single approach to security deletions that allows for a phased removal of stocks from the FTSE RAFI™ QSR Index Series?**

# Estimated Turnover and Holdings

Region	Methodology		One Way Turnover (%) at Reconstitution			Number of Securities at Reconstitution		
	Current	Proposed	Current	Proposed	Incremental	Current	Proposed	Incremental
All-World	Top 3000	Top 86%	10.7	13.3	2.6	3038	2361	-677
Developed	Top 1000	Top 86%	9.9	14.4	4.5	1019	1803	784
Developed ex US	Top 1000	Top 86%	9.9	12.2	2.3	1016	1137	121
Developed ex US Small	1001 to 2500	86% to 98%	23.7	33.5	9.8	1500	1536	36
Europe	Dev ex US	Top 86%	9.2	11.9	2.6	481	349	-132
Eurozone	Dev ex US	Top 86%	11.4	12.4	1.0	253	209	-44
Emerging	Top 350	Top 86%	17.0	20.4	3.4	360	558	198
UK	Top 300	Top 98%	8.3	13.2	4.9	302	286	-16
US	Top 1000	Top 86%	8.8	11.3	2.5	1008	666	-342
US Small	1001 to 2500	86% to 98%	22.1	58.0	35.8	1500	1162	-338
Canada	Top 100	Top 86%	10.4	10.3	-0.1	101	101	0

# Proposed Timeline

- **21 October 2016:**
  - Complete Client Consultation
- **November 2016:**
  - Notify clients regarding proposed methodology enhancements
- **December 2016 / January 2017:**
  - Provide clients with sample files
- **15-January – 28-February 2017:**
  - Conduct parallel testing and file delivery
- **17-March-2017:**
  - Implement new FTSE RAFI™ Index Series methodology and file deliverables

**Q6. Does the proposed timeline provide sufficient time to implement the methodology enhancements and new file deliverables?**

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**Thank you**

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