Country Classification

Methodology

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S&P Dow Jones Indices Country Classification

Country classification is both an art and a science. While S&P Dow Jones Indices uses quantitative criteria as a guide to classifying countries, the opinions and experiences of global investors are equally important. Many of the issues in determining if a market is developed, emerging or frontier are not amenable to quantitative decisions. Regulations, rules and procedures for foreign exchange trading, trade settlement, availability of company financial data and other factors vary from market to market. At the same time, the operating costs imposed on investors by these differences will also vary from investor to investor. While both quantitative measures and a substantial majority of investors may agree on the classification of some markets, there are many cases that are open to debate.

Recognizing this, S&P Dow Jones Indices use a two step process. First, a series of quantitative criteria provide an initial classification. If this analysis results in a classification change, S&P Dow Jones Indices conducts a client consultation. The final decision is made by the S&P Dow Jones Indices Global Equity Index Committee based on both the consultation and the quantitative criteria. The quantitative criteria cover a range of factors reflecting macroeconomic conditions, political stability, legal property rights and procedures, and trading and settlement processes. The client consultation seeks to incorporate opinions from major institutional investors on a global basis.

Quantitative Criteria Process

Countries must meet certain initial criteria to be considered for the S&P Dow Jones Indices’ Developed, Emerging or Frontier Indices, meet a certain number of additional criteria to be considered for the Developed and Emerging classifications, and meet a final measure of country economic status. Countries meeting these criteria will then be the subjects of an in-depth client consultation assessing operational standards in those countries before reassigning any countries from their current status.

Initial Criteria for S&P Dow Jones Indices’ Global Equity Index Series Eligibility

Countries must meet a minimum of two of the following three criteria to be considered for the S&P Dow Jones Indices Country Indices.

- **Full domestic market capitalization of over US$ 2.5 bn.**
  Market size is important. S&P Dow Jones Indices uses the full market capitalization of an exchange’s primary market as its measure, sourced from independent data vendors. Float-adjusted market capitalization is not used, as the availability of float information for smaller markets is not of the required standard for consistency across all markets.

- **Annual turnover value of over US$ 1 bn.**
  An exchange must have significant turnover in order that trading is unlikely to be characterized as difficult by market participants. S&P Dow Jones Indices uses independent data vendors to ascertain the total value of trading of a market’s domestic companies over the calendar year prior to the review.
• **A market development ratio of over 5%**
  Many countries have very small equity markets that do not provide a sufficiently robust representation of the domestic market economy. To ensure that only markets that have developed sufficiently are used, S&P Dow Jones Indices calculates a “market development ratio” by dividing the full domestic market capitalization of the exchange by the country’s nominal GDP. To be considered for the S&P Dow Jones Indices Country Indices this figure must be over 5%.

**Additional Requirements for S&P Dow Jones Indices’ Emerging Market Status**

Countries must meet all three of the baseline criteria above and, in addition, must meet a minimum of three of the following five criteria to be considered for emerging market status. All must have a total market capitalization of over US$ 15 bn.

- **Settlement period of T+3 or better.**
  Efficient, rapid settlement of trades is necessary for investors to be able to trade with confidence. S&P Dow Jones Indices requires markets to settle trades on a T+3 timescale or sooner. Settlement information is always publicly available; S&P Dow Jones Indices sources it from the State Street Global Market information Database.

- **Major ratings agencies rate the sovereign debt at investment grade.**
  A company’s ability to operate is directly affected by its home country’s financial situation. Sovereign ratings should be BB+ or higher by S&P and Fitch, and Baa or higher by Moody’s.

- **Non-occurrence of hyperinflation**
  S&P Dow Jones Indices defines hyperinflation as an annual rate of change in the market’s consumer price index of over 25% at the time of the review.

- **No significant foreign ownership restrictions.**
  Foreign ownership restrictions cause issues in achieving the required exposure to stocks in a given market. While S&P Dow Jones Indices recognizes that stocks in certain industries are commonly restricted; markets should be broadly open.

- **The country’s currency should be freely traded.**
  Difficulties buying or selling a domestic currency, or repatriating capital from a market, hugely complicate the process of investing in a given market.

**Further requirements for S&P Dow Jones Indices Developed Market Status**

To be considered for developed market status, countries must meet all eight of the initial and additional criteria above, and have a nominal Gross Domestic Product (GDP) per capita, at Purchasing Power Parity (PPP), of greater than US$ 15,000.
Summary of S&P Dow Jones Indices Country Classification requirements

<table>
<thead>
<tr>
<th>S&amp;P Country Classification Criteria</th>
<th>Frontier</th>
<th>Emerging</th>
<th>Developed</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Initial Eligibility Criteria</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Full domestic market capitalisation of over $2.5bn</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Domestic turnover value of over $1bn</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Exchange development ratio of over 5%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td><strong>Additional Criteria</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Full domestic market capitalisation of over $15bn</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Settlement period of T+3 or better</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Sovereign Debt rating of BB+ or above</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Non-occurrence of hyperinflation</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>No significant foreign ownership restrictions</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Freely-traded foreign currency</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td><strong>GDP Criterion</strong></td>
<td></td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>GDP (PPP) per capita of greater than $15,000</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

✓ - Required criterion
Deviations from Baseline

Where this assessment indicates a possible change of classification, a more in-depth study is undertaken by S&P Dow Jones Indices covering both the primary and additional criteria and, in addition, the following quantitative and qualitative areas:

**Economic & Political**

- Further macroeconomic measures, such as the rate and variability of real GDP growth and the overall size of the economy. Macroeconomic information is available from many sources; however, S&P Dow Jones Indices focuses on the IMF as a definitive source of consistent data across countries.
- Political factors including war, civil disruption and disturbance, and the risk of war or civil unrest.
- Restrictions on investments imposed by other governments.

**Related Investment Conditions**

- Settlement procedures.
- Foreign exchange (FX) access and procedures.
- Rules on short sales, availability of futures contracts, etc. S&P Dow Jones Indices uses the State Street Global Market Information database as its primary source for information concerning areas of difficulty in trading in individual markets.
- Availability of alternative means of investment in the country’s stocks, such as depository receipts (DRs) or liquid listings on other markets in other countries.
- The number of domestic listings.
Client Consultation on Operational Standards

Where S&P Dow Jones Indices full assessment indicates a possible change of classification, an in-depth client consultation will be carried out. This consultation will primarily assess operational matters, such as the following:

**Regulatory Environment**

- **Regulatory authority**
  The existence of a strong regulatory structure which plays an important role in regulating the market.

- **Equitable treatment of minority shareholders**
  All shareholders receive equal benefits without bias towards domestic versus foreign investors, or large versus small.

- **Ease of repatriation of capital or income**
  Foreign investors can repatriate capital and gains without limitations on holding for specific periods of time, or steep taxes applied on them.

- **Ease of entry for foreign investors**
  No excessive regulations for registration as foreign investors.

**Market Structure**

- **Foreign exchange market**
  Developed trading facilities exist for currencies (FOREX) and that there are sufficient reserves available for trading.

- **Futures and options market**
  Suitable size and liquidity in a derivatives market, where it exists.

- **Custodial market**
  The presence of many custodians and reasonable custodial costs.

**Trading Environment**

- **Broad market liquidity**
  The ability to trade as and when one wants, without restrictive liquidity.

- **Short sales, stock lending and trading-on-margin accounts**
  A well-developed market for short sales and stock lending is preferred, and trading-on-margin is permitted.

- **Access to prices, trading and other market information**
  Transparent and timely information on pricing, corporate actions and other company level news should be equally available to all market participants.

- **Reasonable transaction costs**
  All costs are reasonable and transparent.

- **Quality of brokerage services**
  Local brokerage services should be of a suitable quality.
• **Smooth settlement of trades**
  No or a low percentage of failed trades.

• **Taxes on capital gains**
  Capital gains taxes should be appropriate, not punitive.

**Market Consensus**

• **Desire for change**
  There must be a market consensus desiring the change to a country’s market status.
  (S&P Dow Jones Indices’ staff is in constant contact with the investor community, and
  regularly canvas opinion concerning new countries of interest and issues of concern
  with existing S&P Dow Jones Indices Global Equity Index countries).

• **The actions of other market participants**
  All market participants attempt to incorporate the wishes of the investor community
  when assessing markets for country classification and investment purposes. Changes in
  country classifications are of relevance as they reflect changes in the sentiment of both
  the provider’s customers and of the broader market.
Model Review, Client Consultation and Advisory Panel Timeline

S&P Dow Jones Indices will conduct an annual review following the timeline outlined below for data gathering, client consultation, advisory panel discussion, announcement and implementation of changes, if any.

<table>
<thead>
<tr>
<th>Timeframe</th>
<th>Action Item</th>
</tr>
</thead>
<tbody>
<tr>
<td>First quarter</td>
<td>Data collection, validation, and research and analysis, based on our published Country Classification Methodology. A list of countries will be presented to clients for an in-depth consultation.</td>
</tr>
<tr>
<td>Second quarter</td>
<td>Client consultation distributed by email and published on the Web site.</td>
</tr>
<tr>
<td>Third quarter</td>
<td>S&amp;P Dow Jones Indices’ Global Advisory Panel meeting, followed by an announcement of decisions and any changes in classification.</td>
</tr>
<tr>
<td>September and/or December of the following year (during annual reconstitutions)</td>
<td>Implementation</td>
</tr>
</tbody>
</table>
Removal of S&P Dow Jones Indices’ Frontier Markets

Existing S&P Dow Jones Indices’ Frontier Markets generally will not cease calculation if they fail to meet the requirements detailed above, unless there are significant data availability or data accuracy issues.

For further information, please refer to the S&P Dow Jones Indices Web site at www spdji com.
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