

Research

FTSE  
Russell

# FTSE country classification process

## Introduction

This paper describes the FTSE country classification process which is designed to be transparent and evidence-driven. External advisory committees ensure that the criteria used to determine country classification meet the needs of global investors and are judged objectively. Consistent with the Principles for Financial Benchmarks published by IOSCO in 2013, the operation of the country classification process is overseen by FTSE's strong internal governance structure.

By classifying countries according to objective criteria, and engaging with stock exchanges, regulators and central banks in those countries where the market is being considered for potential promotion or demotion, the process provides portfolio managers and asset allocators with a clear view of expected future index evolution.

## History

The FTSE Global Equity Index Series had its genesis in 1985 with the creation of the FT-Actuaries World Index. As the name suggests, the index was a collaborative venture between the Financial Times and the Institute and Faculty of Actuaries; the other founding partners were the investment bank Goldman Sachs and broker Wood Mackenzie and Co. At inception the index covered 27 countries and there was no distinction between developed and emerging markets.

In 1995, Wood Mackenzie sold its stake to Standard and Poor's, giving rise to the FT/S&P Actuaries World Index, and in 1997 when FTSE took over the calculation the index was renamed as the FTSE/S&P- Actuaries World index. FTSE, which had been formed as a joint venture between the London Stock Exchange and the Financial Times in 1995, bought out the other partners in 1999 and the index was renamed the FTSE World Index.

Country and capitalisation coverage were expanded further with the incorporation of the Barings Emerging Market Index in 2000. This added 20 countries and extended coverage to 90% of global equity markets. At the time of this expansion, the opportunity was taken to classify the countries in the existing World Index into "Developed" and "Advanced Emerging" markets. The additional countries from the Barings index were classified as "Emerging" markets and their combination with the World Index was termed the All-World Index. A fourth grouping, "Frontier" markets, was introduced in 2008 to capture those markets not yet sufficiently evolved to be categorised as Emerging. As of September 2015, the FTSE All-World index included 46 countries with a further 26 countries classified as Frontier markets.

## Classification Schemes

Early distinctions between developed and emerging markets were somewhat arbitrary and tended to focus on the relative wealth of countries as the distinguishing measure together with subjective judgements about the quality of the market. This lack of transparency made it hard for investors to gauge the likelihood of countries moving between categories, and did not foster the spirit of engagement that would encourage countries to adopt global best practice in pursuit of promotion. The expansion of the FTSE global index series prompted FTSE to launch a client consultation in 2003 that proposed a structured framework for classifying markets

that would be consistent with FTSE's philosophy of rules-based, objective indexes. As well as consideration of country per capita income, the proposal set out other guiding principles for market classification. These were:

- **Quality of Market** – the quality of regulation, the dealing landscape, custody and settlement procedures, and the presence of a derivatives market would all be taken into account;
- **Materiality** – a country needed to be of material size to warrant inclusion in a global benchmark;
- **Consistency and Predictability** – a pathway to classification changes would be set out by announcing a “Watch List” of countries that were being considered for promotion and demotion as well as the criteria by which countries would be judged;
- **Cost Limitation** – the cost of implementing a change would be taken into account when assessing a market for promotion or demotion;
- **Stability** – a phased approach would be taken to the introduction of new countries; a new country would only join as an emerging market; and promotion would only occur in response to permanent changes in market status and global acceptance; and
- **Market Access** – international investors should be able to invest and withdraw funds in a timely and secure manner at reasonable cost.

The results of the consultation were published in November 2003. These showed very strong support for the inclusion of Quality of Markets criteria along the lines summarised above. The majority of respondents were also in favour of the other principles. On the basis of the support received, FTSE moved ahead with implementing this country classification scheme in 2004.

## The FTSE Country Classification Process

Following the 2003 client consultation, FTSE put in place a formal process for assessing markets. This process had the following elements:

- A Quality of Markets matrix against which markets could be objectively judged and compared.
- A questionnaire with which to engage stock exchanges and regulatory authorities, the responses to which would help form the basis of the initial Quality of Markets assessment and subsequent upgrades.
- A new Country Classification Committee reporting to the FTSE Policy Group that would undertake objective assessments of markets against the Quality of Markets criteria.
- A Watch List consisting of those countries that are judged to meet, or to be close to meeting, the Quality of Markets criteria for promotion or demotion that would act as a staging post for subsequent country classification changes.
- A policy of engagement with markets that were placed on the Watch List to help them understand what steps would need to be taken to improve their current assessments to make them eligible for promotion (or to prevent their demotion).

- An annual schedule for determining country classification and Watch List changes culminating in country classification and Watch List changes being announced in September.
- A defined communication and implementation timetable to allow portfolio managers to make the necessary preparations for changes to classifications.

Further details regarding these elements are provided below.

## Quality of Markets Matrix

The Quality of Market Matrix is central to the above process. An example of the Quality of Markets matrix for the Emerging Europe region is provided in Appendix 1. The Czech Republic, Hungary, Poland and Turkey are currently classified as Advanced Emerging markets, and Russia as a Secondary Emerging market. Poland is on the Watch List for potential promotion to Developed status. The matrix also includes figures for Gross National Product per capita as calculated by the World Bank; this was one of the original criteria used to help distinguish between the different classifications. The size of the market and the number of listed companies are also included to assist in the assessment of materiality. The country's credit rating is a more recent addition to the criteria.

The rest of the matrix is divided into four sections: Dealing Landscape and Brokers, Custody and Settlement, Regulation, and Derivatives. Each section is further broken down into those factors that are considered essential ingredients for each classification. Markets are scored as "Pass", "Restricted" (partial failure) or "Not Met" on each of these factors. Developed markets should not fail on any category, although a very small number of Restricted scores may be accepted. Advanced Emerging markets have to pass fewer categories, and Secondary Emerging and Frontier markets fewer still. Appendix 2 shows the relevant categories for each classification.

## Questionnaire

In the case of countries that have not previously been evaluated, or countries where a re-assessment is considered timely, a questionnaire is sent to country contacts, usually at the stock exchange, inviting responses on the criteria covered by the Quality of Markets matrix. The questionnaire breaks each criterion into its essential details and requests information on these aspects so as to facilitate a reasoned determination of the country's score.

## The FTSE Country Classification Advisory Committee

The FTSE Country Classification Advisory Committee is formed of market practitioners with technical expertise in trading, portfolio management, and custody who are able to provide first hand experience of each of these areas. Each country's scores on the Quality of Markets matrix are kept under review by FTSE and proposals for changes to scores are debated at the meetings of the FTSE Country Classification Advisory Committee. Any changes to the scores recommended by the Committee are duly minuted and changes to country scores are formally communicated by FTSE to the relevant authorities each year in March and September.

The FTSE Country Classification Advisory Committee also reviews the responses received to the engagement questionnaire. In many cases the Committee will ask for further research to be undertaken, or will themselves check with colleagues as to whether a response is confirmed by their practical experience of market conditions, before finally deciding on a country's scores on the Quality of Markets criteria.

## **The FTSE Russell Policy Group**

The FTSE Russell Policy Group is the most senior of FTSE Russell's external advisory committees and draws its membership from senior personnel at investment management companies, investment consultants and asset owners. For the country classification process, the FTSE Russell Policy Group provides the important role of ensuring in the final analysis that proposals for classification changes initiated by reference to the requisite number of criteria being judged to exceed the requirements for country promotion, or failing to meet the requirements to prevent country demotion, are consistent with the perceptions of seasoned investors at that time.

## **The Watch List**

To enable investors to plan for potential classification changes, FTSE operates a Watch List of those countries with scores on the Quality of Markets matrix that have been judged to have met, or are becoming close to meeting, the technical criteria required for promotion. The Watch List also includes those countries with scores that have been judged to have fallen below those required to maintain the countries' current classifications and are being considered for demotion.

Absent any extraordinary circumstances, a country must stay on the Watch List for at least one year, and may potentially remain there for several years, before it is considered ready for promotion or demotion. This is consistent with the principles set out earlier that countries should only change classification infrequently, when the appropriate standards have been confirmed for a period of time, and that investors should be forewarned of the prospect. A seasoning period on the Watch List thus allows investors to become comfortable that the technical criteria assessed through the Quality of Markets framework are indeed being met in practice.

## **Engagement**

To encourage those markets on the Watch List to adapt their procedures to meet international best practice, FTSE actively engages with the appropriate authorities of those countries that have been added to the Watch List with a view to helping them understand the standards required for their future promotion, or to prevent their future demotion.

## **Annual Schedule**

The FTSE country classification process operates to an annual schedule starting in January and finishing in September. The process starts with in-depth assessments of those markets on the Watch List as agreed in the previous September, and those countries highlighted for possible addition to the Watch List in the next September.

Between January and September, the Quality of Markets scores for current and potential Watch List countries are reviewed by the FTSE Country Classification Advisory Committee. Throughout this period, evidence of improvements or deterioration in a country's scores is actively sought through engagement with the appropriate authorities of the country concerned.

The concluding debate on changes to the Watch List takes place at the September meeting of the FTSE Country Classification Advisory Committee. Also at this meeting, the countries on the Watch List are formally reviewed for promotion or demotion and the Committee's recommendations for country promotions and demotions, if any, are presented to the September meeting of the FTSE Russell Policy Group. Those promotion and demotion recommendations that are endorsed by the FTSE Russell Policy Group are forwarded to the FTSE Russell Governance Board in September for final approval.

## Communication

Following the September meeting of the FTSE Russell Governance Board, promotion and demotion decisions and Watch List changes are formally communicated to the countries affected together with the rationale as evidenced by their scores on the Quality of Market matrix. Promotion, demotion and Watch List decisions are subsequently published in a public notice along with the timetable for their implementation.

Unless there are extraordinary circumstances, implementation of classification changes is ordinarily timed to coincide with one of the semi-annual reviews for the FTSE Global Equity Index Series and a minimum notice period of six months is always provided to allow investors and asset owners adequate time to prepare.

## Conclusion

FTSE's country classification process has been in place for eleven years, and over time has matured into a transparent and objective mechanism of classifying markets in a way that is designed to meet the ongoing needs of institutional investors. The existence of a Watch List, and the provision of indices based around the Watch List, enables investors to plan for potential classification changes and implement these at a time of their own choosing if they so wish. The process also encourages those markets on the Watch List to engage with FTSE to adapt their environment to meet international best practice. The result is a forward-looking, proactive framework that managers can trust.

FTSE keeps the criteria used to determine a country's classification under continuous review. FTSE's acquisition of the Russell indices provides another opportunity to revisit this process and FTSE welcomes the views of all stakeholders on the future evolution of its country classification scheme to ensure it continues to exhibit thought leadership and meets their needs. Comments can be sent to [committeesecretary@ftserussell.com](mailto:committeesecretary@ftserussell.com).

**Appendix 1. example of the Quality of Markets matrix for the Emerging Europe region (as at September 2015)**

Criteria	Country names							
	DEV Watch	ADV EMG	Czech Republic	Hungary	Poland	Turkey	EMG	Russia
World Bank GNI Per Capita Rating, 2014			High	High	High	Upper Middle		High
Credit Worthiness			Investment	Speculative	Investment	Speculative		Speculative
<b>Market and Regulatory Environment</b>								
Formal stock market regulatory authorities actively monitor market (e.g., SEC, FSA, SFC)	X	X	PASS	PASS	PASS	PASS	X	RESTRICTED
Fair and non-prejudicial treatment of minority shareholders	X	X	PASS	PASS	PASS	PASS		NOT MET
Non or selective incidence of foreign ownership restrictions	X	X	PASS	PASS	PASS	PASS		NOT MET
No objection to or significant restrictions or penalties applied to the investment of capital or the repatriation of capital and income	X	X	PASS	PASS	PASS	PASS	X	PASS
Free and well-developed equity market	X	X	PASS	PASS	PASS	PASS	X	RESTRICTED
Free and well-developed foreign exchange market	X	X	PASS	PASS	PASS	PASS	X	PASS
Non or simple registration process for foreign investors	X	X	PASS	PASS	PASS	PASS	X	RESTRICTED
<b>Custody and Settlement</b>								
Settlement - Rare incidence of failed trades	X	X	PASS	PASS	PASS	PASS	X	PASS
Custody-Sufficient competition to ensure high quality custodian services	X	X	PASS	PASS	PASS	PASS	X	PASS
Clearing & settlement - T + 3 , T + 5 for Frontier	X	X	T+2	T+2	T+2	T+2	X	T+2
Stock Lending is permitted	X		RESTRICTED	RESTRICTED	PASS	PASS		NOT MET
Settlement - Free delivery available	X		PASS	PASS	PASS	PASS		PASS
Custody - Omnibus account facilities available to international investors	X	X	PASS	PASS	RESTRICTED	RESTRICTED		PASS
<b>Dealing Landscape</b>								
Brokerage - Sufficient competition to ensure high quality broker services	X	X	PASS	PASS	PASS	PASS	X	PASS
Liquidity - Sufficient broad market liquidity to support sizeable global investment	X	X	PASS	PASS	PASS	PASS	X	PASS
Transaction costs - implicit and explicit costs to be reasonable and competitive	X	X	PASS	PASS	PASS	PASS	X	PASS
Short sales permitted	X		RESTRICTED	PASS	PASS	PASS		RESTRICTED
Off-exchange transactions permitted	X	X	PASS	PASS	PASS	PASS		PASS
Efficient trading mechanism	X	X	PASS	PASS	PASS	PASS		PASS
Transparency - market depth information/visibility and timely trade reporting process	X	X	PASS	PASS	PASS	PASS	X	PASS
<b>Derivatives</b>								
Developed Derivatives Market	X		NOT MET	PASS	PASS	RESTRICTED		PASS
<b>Size of Market</b>								
Market Capitalisation \$mn (as at 31 December 2014)			27,544	14,513	168,896	219,763		385,927
Total Number of Listed Companies (as at 31 December 2014)			13	48	872	226		254

 Shading indicates a change from March 2015

## Appendix 2. Quality of Markets matrix

Criteria	Developed	Advanced emerging	Secondary emerging	Frontier
<b>World Bank GNI Per Capita Rating</b>				
<b>Credit Worthiness</b>				
<b>Market and Regulatory Environment</b>				
Formal stock market regulatory authorities actively monitor market (e.g., SEC, FSA, SFC)	X	X	X	X
Fair and non-prejudicial treatment of minority shareholders	X	X		
Non or selective incidence of foreign ownership restrictions	X	X		
No objection to or significant restrictions or penalties applied to the investment of capital or the repatriation of capital and income	X	X	X	X
Free and well-developed equity market	X	X		
Free and well-developed foreign exchange market	X	X		
Non or simple registration process for foreign investors	X	X		
<b>Custody and Settlement</b>				
Settlement - Rare incidence of failed trades	X	X	X	X
Custody-Sufficient competition to ensure high quality custodian services	X	X	X	
Clearing & settlement - T+3 or shorter , T + 5 or shorter for Frontier	X	X	X	X
Stock Lending is permitted	X			
Settlement - Free delivery available	X			
Custody - Omnibus account facilities available to international investors	X	X		
<b>Dealing Landscape</b>				
Brokerage - Sufficient competition to ensure high quality broker services	X	X	X	
Liquidity - Sufficient broad market liquidity to support sizeable global investment	X	X	X	
Transaction costs - implicit and explicit costs to be reasonable and competitive	X	X	X	
Short sales permitted	X			
Off-exchange transactions permitted	X			
Efficient trading mechanism	X			
Transparency - market depth information/visibility and timely trade reporting process	X	X	X	X
<b>Derivatives</b>				
Developed Derivatives Market	X			
<b>Size of Market</b>				
Market Capitalisation \$mn (as at 31 December 2014)				
Total Number of Listed Companies (as at 31 December 2014)				

### Appendix 3. FTSE Country Classifications (as at September 2015)

Developed (25 Markets)	Advanced emerging (10 Markets)	Secondary emerging (11 Markets)	Frontier (26 Markets)
Australia	Brazil	Chile	Bahrain
Austria	Czech Republic (7)	China	Bangladesh
Belgium/Luxembourg	Hungary (3)	Colombia	Botswana
Canada	Malaysia (7)	Egypt	Bulgaria
Denmark	Mexico	India	Côte d'Ivoire
Finland	Poland (3)	Indonesia	Croatia
France	South Africa	Pakistan	Cyprus
Germany	Taiwan	Peru	Estonia
Greece (1) & (11)	Thailand (8)	Philippines	Ghana (9)
Hong Kong	Turkey (7)	Russia	Jordan
Ireland		UAE (5)	Kenya
Israel (2)			Lithuania
Italy			Macedonia
Japan			Malta (6)
Netherlands			Mauritius
New Zealand			Morocco (10)
Norway			Nigeria
Portugal			Oman
Singapore			Qatar (12)
South Korea (4)			Romania
Spain			Serbia
Sweden			Slovakia
Switzerland			Slovenia
UK			Sri Lanka
USA			Tunisia
			Vietnam

## Timeline of FTSE country classification changes

- (1) 02 Jan 2001 – Greece promoted from Advanced Emerging to Developed  
20 June 2003 – Venezuela deleted from All-World Secondary Emerging at zero value
- (2) 22 Sept 2008 – Israel promoted from Advanced Emerging to Developed
- (3) 22 Sept 2008 – Hungary and Poland promoted from Secondary Emerging to Advanced Emerging
- (4) 21 Sept 2009 – South Korea promoted from Advanced Emerging to Developed  
20 Sept 2010 – Argentina demoted from Secondary Emerging to Frontier
- (5) 20 Sept 2010 – UAE added directly to Secondary Emerging from Unclassified (bypassing Frontier)
- (6) 20 Sept 2010 – Malta added to Frontier from being Unclassified
- (7) 20 June 2011 – Czech Republic, Malaysia and Turkey promoted from Secondary Emerging to Advanced Emerging
- (8) 19 March 2012 – Thailand promoted from Secondary Emerging to Advanced Emerging
- (9) 18 June 2012 – Ghana added to Frontier from being Unclassified
- (10) 22 June 2015 – Morocco demoted from Secondary Emerging to Frontier  
22 June 2015 – Argentina demoted from Frontier to Unclassified
- (11) March 2016 – Greece to be demoted from Developed to Advanced Emerging
- (12) September 2016 – Qatar to be promoted from Frontier to Secondary Emerging  
September 2016 – Latvia and Palestine to be added to Frontier from being Unclassified

## **For more information about our indexes, please visit [ftserussell.com](http://ftserussell.com).**

---

© 2015 London Stock Exchange Group companies.

London Stock Exchange Group companies includes FTSE International Limited ("FTSE"), Frank Russell Company ("Russell"), MTS Next Limited ("MTS"), and FTSE TMX Global Debt Capital Markets Inc ("FTSE TMX"). All rights reserved.

"FTSE®", "Russell®", "MTS®", "FTSE TMX®" and "FTSE Russell" and other service marks and trademarks related to the FTSE or Russell indexes are trademarks of the London Stock Exchange Group companies and are used by FTSE, MTS, FTSE TMX and Russell under licence.

All information is provided for information purposes only. Every effort is made to ensure that all information given in this publication is accurate, but no responsibility or liability can be accepted by the London Stock Exchange Group companies nor its licensors for any errors or for any loss from use of this publication.

Neither the London Stock Exchange Group companies nor any of their licensors make any claim, prediction, warranty or representation whatsoever, expressly or impliedly, either as to the results to be obtained from the use of the FTSE Russell Indexes or the fitness or suitability of the Indexes for any particular purpose to which they might be put.

The London Stock Exchange Group companies do not provide investment advice and nothing in this document should be taken as constituting financial or investment advice. The London Stock Exchange Group companies make no representation regarding the advisability of investing in any asset. A decision to invest in any such asset should not be made in reliance on any information herein. Indexes cannot be invested in directly. Inclusion of an asset in an index is not a recommendation to buy, sell or hold that asset. The general information contained in this publication should not be acted upon without obtaining specific legal, tax, and investment advice from a licensed professional.

No part of this information may be reproduced, stored in a retrieval system or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without prior written permission of the London Stock Exchange Group companies. Distribution of the London Stock Exchange Group companies' index values and the use of their indexes to create financial products require a licence with FTSE, FTSE TMX, MTS and/or Russell and/or its licensors.

The Industry Classification Benchmark ("ICB") is owned by FTSE. FTSE does not accept any liability to any person for any loss or damage arising out of any error or omission in the ICB.

Past performance is no guarantee of future results. Charts and graphs are provided for illustrative purposes only. Index returns shown may not represent the results of the actual trading of investable assets. Certain returns shown may reflect back-tested performance. All performance presented prior to the index inception date is back-tested performance. Back-tested performance is not actual performance, but is hypothetical. The back-test calculations are based on the same methodology that was in effect when the index was officially launched. However, back-tested data may reflect the application of the index methodology with the benefit of hindsight, and the historic calculations of an index may change from month to month based on revisions to the underlying economic data used in the calculation of the index.

## About FTSE Russell

FTSE Russell is a leading global provider of benchmarking, analytics and data solutions for investors, giving them a precise view of the market relevant to their investment process. A comprehensive range of reliable and accurate indexes provides investors worldwide with the tools they require to measure and benchmark markets across asset classes, styles or strategies.

FTSE Russell index expertise and products are used extensively by institutional and retail investors globally. For over 30 years, leading asset owners, asset managers, ETF providers and investment banks have chosen FTSE Russell indexes to benchmark their investment performance and create ETFs, structured products and index-based derivatives.

FTSE Russell is focused on applying the highest industry standards in index design and governance, employing transparent rules-based methodology informed by independent committees of leading market participants. FTSE Russell fully embraces the IOSCO Principles and its Statement of Compliance has received independent assurance. Index innovation is driven by client needs and customer partnerships, allowing FTSE Russell to continually enhance the breadth, depth and reach of its offering.

FTSE Russell is wholly owned by London Stock Exchange Group.

For more information, visit [www.ftserussell.com](http://www.ftserussell.com).

To learn more, visit [www.ftserussell.com](http://www.ftserussell.com); email [index@russell.com](mailto:index@russell.com), [info@ftse.com](mailto:info@ftse.com);  
or call your regional Client Service Team office:

### EMEA

+44 (0) 20 7866 1810

### North America

+1 877 503 6437

### Asia-Pacific

Hong Kong +852 2164 3333

Tokyo +81 3 3581 2764

Sydney +61 (0) 2 8823 3521