



**GROUND RULES FOR THE
MANAGEMENT OF THE
FTSE VALUE-STOCKS JAPAN INDEX**

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SECTION 1

1.0 INTRODUCTION

1.1 General

- 1.1.1 This document sets out the ground rules (the "Ground Rules") for the construction and maintenance of the FTSE Value-Stocks Japan Index (the "Index"), a value-based index designed by Value Partners Index Services Limited ("VP") and created, calculated and maintained by FTSE International Limited ("FTSE").
- 1.1.2 The Index will also follow the FTSE Global Equity Index Series ground rules, for instance the free float, the liquidity rules and the corporate event treatment. The FTSE Global Equity Index Series ground rules are available at http://www.ftse.com/Indices/FTSE_Global_Equity_Index_Series/Index_Rules/index.jsp
- 1.1.3 The Index is calculated and published in Japanese Yen, Hong Kong and US dollars.
- 1.1.4 The Index is calculated in real time and published every 15 seconds.

1.2 Index Objective

- 1.2.1 The Index is an investable index comprising 35 Japan companies listed on Tokyo Stock Exchange ("TSE") and Osaka Securities Exchange ("OSE") selected by FTSE and VP according to the following rules.

SECTION 2

2.0 STATUS OF INDEX

2.1 The Index is calculated in real time and may exist in the following states:

(a) **Firm**

The Index is being calculated using trade prices from the TSE and OSE for all constituents during the official opening and closing hours of the Index (the "Official Index Period") (see Appendix B).

The official closing value for the Index is the last Index value calculated at the end of the Firm period.

(b) **Closed**

When the Index has ceased all calculations for the day, the message '**CLOSED**' is displayed against the Index value.

(c) **Held**

During the Firm period, the Index has exceeded pre-set operating parameters and calculation has been suspended pending resolution of the problem. The message '**HELD**' is displayed against the last Index value calculated.

(d) **Indicative**

If there is a system problem or a situation in the market that is judged to be affecting the quality of the constituent prices at any time when the Index is being calculated, the Index will be declared Indicative. The message '**IND**' will be displayed against the Index value.

(e) **Part**

If the Index is being calculated during the Official Index Period, but there are less than 75% of the constituents by capitalisation available with firm prices, then the Index will be displayed with the message '**PART**' to indicate that only a proportion of the securities prices are included. With the exception of the message '**PART**', the Index will continue to be calculated and displayed as if it were Firm.

2.2 The Official Index Period is set out in Appendix B. Variations to the official hours of the Index are published by FTSE as appropriate.

2.3 The Index is calculated on each day which trading takes places either on Tokyo Stock Exchange or Osaka Securities Exchange.

SECTION 3

3.0 MANAGEMENT RESPONSIBILITIES

3.1 VP Responsibilities

- 3.1.1 VP is responsible for undertaking the Index screening review (as set out in Section 5) of the Index. VP will provide FTSE with a list of new constituents at the bi-annual review.

3.2 FTSE Responsibilities

- 3.2.1 FTSE is responsible for the operation, calculation and the maintenance of the Index. FTSE will publicise and keep records of all changes to constituents.
- 3.2.2 FTSE is also responsible for monitoring the performance of the Index throughout the day and will determine whether the status of the Index should be Firm, Held, Indicative or Part (see Rule 2.1).

3.3 Recalculations

- 3.3.1 The Index is recalculated whenever errors or distortions occur that are deemed to be significant. Users of the Index are notified through appropriate media.

3.4 Status of the Ground Rules

- 3.4.1 The Ground Rules are a guide to the policies and procedures applied at the date of publication to the operation and maintenance of the Index. They have been prepared and approved by FTSE and VP. However, these policies and procedures, and their precise application, are subject to variation and periodic review.
- 3.4.2 The purpose of publishing the Ground Rules is to provide information about the general basis on which decisions relating to the calculation and publication of the Index are currently made.
- 3.4.3 In light of the intended purpose of the Ground Rules, and the likely variation and periodic review of the policies and procedures it contains, no liability whether as a result of negligence or otherwise is accepted by FTSE and VP (or any person concerned with the preparation or publication of the Ground Rules) for any loss, damage, claim and expense suffered by any person as a result of:
- a) any reliance on the Ground Rules, and/or
 - b) any errors or inaccuracies in the Ground Rules, and/or
 - c) any non-application or misapplication of the polices or procedures described in the Ground Rules, and/or
 - d) any errors or inaccuracies in the compilation of any constituent data.

SECTION 4

4.0 ELIGIBLE SECURITIES

4.1 Universe Selection Criteria

Each security must be a current constituent of the FTSE Global All Cap Index.

- 4.1.1 The stocks listed on the TSE and OSE will be eligible for Index inclusion and referred to in this document as the Japan Investable Universe.

4.2 Investable Universe

Each company in the defined universe will be subject to three investability screens stated below so as to qualify as candidates in the Japan Investable Universe. These are size, liquidity and free float.

4.2.1 Liquidity

Each security in the defined universe will be tested for liquidity by calculation of its median daily trading per month. The median trade is calculated by ranking each daily trade total and selecting the middle ranking day. Daily totals with zero trades are included in the ranking, therefore a security that fails to trade for more than half of the days in a month will have a zero median trade.

A non-constituent which does not turnover at least 0.05% of the company's total shares in issue (after the application of any investability weightings) based on their median daily trade per month for at least ten out of the twelve months prior to a periodic review will not be eligible for inclusion in the Index.

An existing constituent which does not turnover at least 0.04% of the company's total shares in issue (after the application of any investability weightings) based on their median daily trade per month for at least eight of the twelve months prior to a periodic review will be removed from the Index.

New issues which do not have a twelve month trading record must have a minimum three month trading record when reviewed. They must turnover at least 0.05% of their shares in issue (after the application of any free float weightings) based on their median daily trade per month in each month since their listing to be eligible for inclusion in the Index.

The liquidity of each Index constituent is screened at the FTSE Global All Cap Index regional review for Japan in September of each year.

4.2.2 Free Float

The Index is adjusted for free float and foreign ownership limits. The free float banding rules will follow FTSE Global Equity Index Series methodology.

SECTION 4

4.2.2.1 Free float restrictions include:

- Shares directly owned by State, Regional, Municipal and Local governments (excluding shares held by independently managed pension schemes for governments).
- Shares held by Sovereign Wealth Funds where each holding is 10% or greater. If the holding subsequently decreases below 10%, the shares will remain restricted until the holding falls below 7%.
- Shares held by directors, senior executives and managers of the company, and by their family and direct relations, and by companies that they control.
- Shares held within employee share plans.
- Shares held by public companies or by non-listed subsidiaries of public companies.
- Shares held by founders, promoters, former directors, founding venture capital and private equity firms, private companies and individuals (including employees) where the holding is 10% or greater. If the holding subsequently decreases below 10%, the shares will remain restricted until the holding falls below 7%.
- All shares where the holder is subject to a lock-in clause (for the duration of that clause).
- Shares held for publicly announced strategic reasons, including shares held by several holders acting in concert.

4.2.2.2 The following are not considered as restricted free float:

- Portfolio holdings (such as pension and insurance funds)
- Nominee holdings (unless they represent restricted free float as defined by Rule 4.2.2.1)
- Holdings by investment companies
- ETFs

If in addition to the above restricted holdings, the company's shareholders are subject to legal restrictions, including foreign ownership restrictions, that are more restrictive, the legal restriction will be applied.

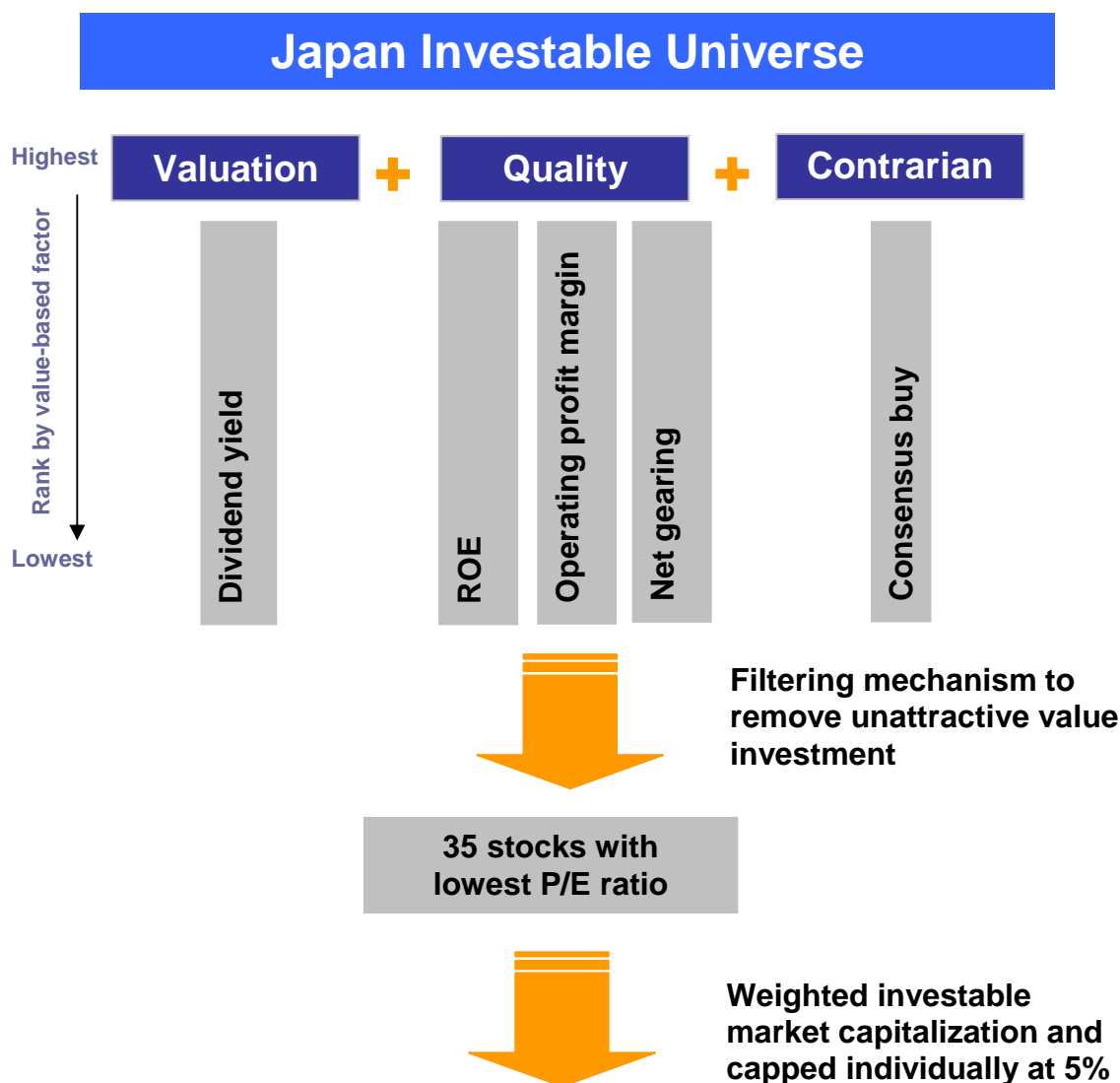
4.2.3 **Size Requirement**

The investable market capitalisation (i.e. after free float adjusted market capitalisation) of a company must be at least 0.1% of the total investable market capitalisation of all the companies which can pass through the Size, Liquidity and Free Float requirements of the FTSE Global Equity Index Series.

SECTION 5

5.0 INDEX SCREENING

VP will screen each security in the Japan Investable Universe and each will be ranked by three sets of value-investing screening criteria, namely Contrarian, Quality and Valuation screenings.



FTSE Value-Stocks Japan Index
35 quality value stocks in Japan

5.1 Contrarian Screening

5.1.1 Contrarian screening aims to avoid following the herd. Companies in the investable universe covered by more than 10 analysts in the forecast recommendation with a buy recommendation from over 80% of analysts will be screened out. The screening criteria will change if the index constituent selection criteria in Rule 5.4.2 is not meet. For further details, please refer to Rule 5.4.2.

SECTION 5

5.2 Quality Screening

5.2.1 Quality screening is applied to avoid value traps, based on the following three fundamental factors:

- a) 3-year Average Return on Equity = $(ROE_{-1} + ROE_{-2} + ROE_{-3}) / 3$ where ROE_{-1} , ROE_{-2} and ROE_{-3} refer to the return on equity for the previous three fiscal years, respectively. $ROE = (\text{Net Income before Preferred Dividends} - \text{Preferred Dividend Requirement}) / \text{Average of Last Year's and Current Year's Common Equity} * 100$
- b) Operating Profit Margin = $\text{Operating Income} / \text{Net Sales or Revenues} * 100$
- c) Net Gearing = $(\text{Total Debt} - \text{Cash}) / (\text{Asset} - \text{Liability})$

5.2.2 Companies in the Japan Investable Universe will be ranked by each of the factors. The worst 5% among the companies in each factor in terms of ordinal ranking will then be screened out.

5.3 Valuation Screening

5.3.1 Valuation screening helps to identify relatively under-valued constituents in the Japan Investable Universe.

- a) Dividend Yield – All companies in the Japan Investable Universe will be ranked by trailing twelve month dividend yield in descending order. Those companies in the bottom 25% in terms of ordinal ranking will then be screened out.
- b) Forecast Price-to-Earnings – All the remaining companies (after all the above screenings) will then be sorted by consensus forecast forward one year price-to-earnings ratio ("PE ratio") in ascending order. Those companies with negative forward PE ratios will be screened out. If forward one fiscal year end date is less than three months after the review date, then forward two year price-to-earnings ratio will be used in calculation instead.

5.4 Index Constituent Selection

5.4.1 From the Japan Investable Universe, the companies passing through all the screenings above are ranked by PE ratio and the 35 companies with the lowest PE ratio are selected to be the constituents of the Index.

5.4.2 If the number of companies passing through all the screenings specified in Rules 5.1 to 5.3 is less than 35 stocks, the following will be applied:

- a) If the number of companies is greater than 28 and less than 35, the Index will comprise less than 35 stocks until the next review.
- b) If the number of companies is less than or equal to 28, the contrarian screening criteria in Rule 5.1 will change such that companies in the Japan Investable Universe covered by more than 10 analysts in the forecast recommendation with a buy recommendation from over 90% of analysts will be screened out. The screening process in Rules 5.2 to 5.3 will continue to apply. Thereafter, if the number of companies passing through the screenings in Rules 5.1 to 5.3 remain less than or equal to 28, companies in the Japan Investable Universe covered by more than 10 analysts in the forecast recommendation with a buy recommendation from all analysts will be screened out.

SECTION 6

6.0 PERIODIC REVIEW OF CONSTITUENT COMPANIES

6.1 Bi-annual Review

6.1.1 Reviews will be conducted on a bi-annual basis in January and July using data as at the last working day in December and June, respectively. For each review, the process of index construction is carried out as stated in Sections 4 and 5.

6.1.2 VP will provide FTSE with the Index review five business days after the month end before the bi-annual review effective date. Any constituent changes will be implemented after the close of the index calculation on the third Friday of January and July.

6.2 Weighting Method

6.2.1 The 35 constituents in the Index are weighted by investable market capitalisation.

6.3 Capping

6.3.1 At the bi-annual review any constituents whose weights are greater than 5% are capped at 5% using prices adjusted for corporate actions as at the close of business on the second Friday in January and July. The weights of all lower ranking constituents are increased correspondingly. The weights of lower ranking constituents are then checked and if they exceed 5% they are also capped at 5%. This process is repeated until no constituent weight exceeds 5%. The capping is implemented after the close of business on the third Friday in January and July based on the constituents, shares in issue and free float on the next trading day following the third Friday of the review month.

6.4 Amendments to the Index Methodology

6.4.1 Any changes and exceptions to this methodology may only be made by FTSE and VP. Any material changes will be announced through appropriate media before implementation.

6.5 Periodic Capping Review

6.5.1 In addition to the bi-annual reviews in January and July, there are capping reviews in March, June, September and December, which will be in accordance with the review of free float and shares in issue undertaken by FTSE Global All Cap index. If any constituent has resulted in a weighting above 10% of the FTSE Value-Stocks Japan Index (based on the close of business on the second Friday of March, June, September and December, taking into account the review undertaken by FTSE Global All Cap Index), a full capping review of the index will be implemented effective after close of business on the third Friday of that month. The capping methodology will be as detailed in Rule 6.3.

SECTION 7

7.0 CHANGES TO CONSTITUENT COMPANIES

Changes to the constituents of the Index will be in line with the treatment of corporate events in the FTSE Global All Cap Index.

7.1 Removal

- 7.1.1 If an existing constituent is acquired for cash, or ineligible paper, or by a non-quoted company, then the existing constituent is removed on the date of the acquisition.
- 7.1.2 Constituents removed from the FTSE Global All Cap Index will be automatically removed from the Index.
- 7.1.3 Constituents which are removed, but which continue to trade will be considered for re-inclusion to the Index at the next review.

7.2 Mergers, Restructuring and Complex Takeovers

- 7.2.1 If the effect of a merger or takeover is that one constituent is absorbed by another constituent in the Index, the resulting company will remain a constituent of the Index.
- 7.2.2 If an existing constituent is acquired for eligible shares (or a combination of eligible shares and cash) by a quoted non-constituent, then the purchasing company will be considered for inclusion in the next review. The vacancy created will not be filled until the next review.
- 7.2.3 If a constituent company splits so as to form two or more companies, and the resulting companies are eligible for inclusion in the FTSE Global All Cap Index, then the resulting companies will be eligible to continue as constituents for the Index. The Index will comprise more than 35 companies until the next review.

7.3 New Issues

- 7.3.1 If a new issue is so large that the effectiveness of the Index as the market indicator would be significantly and adversely affected by its omission, FTSE may decide to include the new issue as a constituent of the Index. To qualify, the company must be a "Fast Entry" into the FTSE Global All Cap Index (please see Appendix D for the definition of Fast Entry). In addition, the investable market capitalisation (i.e. after free float adjusted market capitalisation) of the new issue must be ranked in the top 10 of the existing Japan Investable Universe (see Section 4).
- 7.3.2 FTSE will provide VP data of the new issues. VP will then conduct the index screening process (as set out in Sections 4 and 5) to determine the eligibility of the Fast Entry. VP will inform FTSE two business days* prior to the listing if the Fast Entry has passed the relevant screening criteria to become a constituent of the Index, and an extra index review apart from the periodic bi-annual index review will be conducted (see Rule 7.6).
- 7.3.3 Any changes in the composition of Index constituents triggered by the Fast Entry will be implemented after the close of Index calculation on the fifth business day of official trading and advance notification will be given accordingly.

Note: if the implementation date of the Fast Entry into the Index is less than ten business days prior to the 30 June and 31 December, FTSE and VP may consider delaying the implementation date of the Fast Entry into the Index until the next bi-annual review.

SECTION 7

7.3.4 New issues of companies which do not qualify for Fast Entry under Rule 7.3.1 (but which meet the criteria for eligible securities set out in Section 4) will be eligible for inclusion at the next review, if passing the relevant screening criteria to become a constituent of the Index at that time.

7.3.5 For the purpose of this Section 7, a company which is relisted following suspension or is reorganised or renamed or which arises from a demerger or complex reorganisation of another company which is not an existing constituent, shall not be considered to be a new issue. However, an Initial Public Offering (IPO) which arises from a demerger shall be considered as a new issue.

7.4 Suspension of Dealing

7.4.1 In the event that a constituent of the Index is suspended on its own stock exchange, the constituent may remain in the Index at the price at which it is suspended, for up to 10 business days. FTSE may remove the constituent immediately either at its suspension price, or at zero.

7.4.2 Where a suspension of a constituent lasts beyond noon on the tenth business day (and the option to remove the constituent has not been exercised), the constituent will normally be removed from the Index provided that it has been removed from the FTSE Global All Cap Index on the eleventh trading day at zero or the suspension price.

7.5 Relisting of Suspended Constituents

7.5.1 Securities which on relisting will not re-enter the Index, however the relisted stock will be considered for inclusion at the next review.

7.6 Intra Review Capping

7.6.1 When a new constituent has been added to the Index as the result of a corporate event, and the weight of this new addition is greater than 5% of the Index, the Index will be capped intra review. Any constituents whose weights are greater than 5% are capped at 5%. The weights of all lower ranking constituents are increased correspondingly. The weights of lower ranking constituents are then checked and if they exceed 5% they are also capped at 5%. This process is repeated until no constituent weight exceeds 5%.

SECTION 8

8.0 VERSIONS OF THESE GROUND RULES AND THEIR VALIDITY

- 8.1 The ground rules shall be written in both Chinese and English versions, the English version shall prevail.

APPENDIX A

ELIGIBLE MARKETS, EXCHANGES & EXCHANGE RATES

Markets eligible for the FTSE Value-Stocks Japan Index and sources of trading volume data:

Please note: Thomson Financial, Reuters, TSE, OSE, FTSE and any other source of data cannot accept liability for any incorrect information, including the consequences of relying on this information, as detailed below.

Region	Country	Exchange Location	Market Section
Asia Pacific	Japan	Tokyo	First Section Second Section
		Osaka	First Section

Foreign Exchange Rates

The foreign exchange rates used in the calculation of the Index are Reuter's real-time spot rates.

The Index is calculated in Japanese Yen, Hong Kong and US dollars. Non Japanese Yen denominated constituent prices are converted to Japanese Yen in order to calculate the Index.

The real-time foreign exchange rates are used throughout the period of calculation (see Appendix B). Therefore foreign exchange movements are taken into account in the Index calculation for each constituent even though the underlying market for that constituent may be closed.

The foreign exchange rates received from Reuters at the closing time of the Index (15:20 hrs, local time, see Appendix B) are used to calculate the final Index levels and are termed the "closing FTSE Value-Stocks Japan foreign exchange rates".

APPENDIX B

INDEX & MARKET OPENING AND CLOSING HOURS

	OPEN	CLOSE
Index:		
FTSE Value-Stocks Japan Index	09:00 12:30	11:30 15:20
Stock Market Trading Times:		
Tokyo	09:00 12:30	11:30 15:00
Osaka	09:00 12:30	11:30 15:10

All times are local Japan time.

The Index is calculated on each day which trading takes places on either Tokyo or Osaka stock exchanges.

APPENDIX C

INDEX ALGORITHM AND CALCULATION METHOD

The Index is calculated using the algorithm described below.

$$\frac{\sum_n (P_i * FX_i * S_i * F_i * C_i)}{D}$$

n	=	Number	The number of securities in the Index.
P	=	Price	The latest trade price of the constituent security <i>i</i> (or the price at the close of the Index on the previous day).
FX	=	Exchange Rate	The exchange rate required to convert the home pricing currency of the constituent security <i>i</i> into the Index's base currency i.e. Japanese yen.
S	=	Shares in Issue	The number of shares in issue used by FTSE for security <i>i</i> , as defined in the Ground Rules.
F	=	Free Float Factor	The factor to be applied to each security to allow amendments to its weighting, expressed as a number between 0 and 1, where 1 represents a 100% free float. The free float factor for each security is published by FTSE.
C	=	Capping Factor	The factor applied to each security to allow its weight within the index to be capped, expressed as a number between 0 and 1 where 1 represents 100%, i.e. no cap. The capping factor is calculated by FTSE.
D	=	Divisor	A figure that represents the total issued share capital of the Index at the base date. The divisor can be adjusted to allow changes in the issued share capital of individual securities to be made without distorting the Index.
<i>i</i>	=	Index constituent	Any constituent security in the Index.

APPENDIX D

FAST ENTRY IN THE FTSE GLOBAL ALL CAP INDEX

The terms "Index" and "Ground Rules" in this Appendix D refer to the FTSE Global Equity Index Series and the FTSE Global Equity Index Series Ground Rules respectively.

Definition of Fast Entry Level**For Developed Markets:**

Twice the full market capitalisation of the smallest company that falls wholly within the top 68% of the Index universe by market capitalisation of its home region – when ranked according to Ground Rules.

For Advanced Emerging and Secondary Emerging Markets:

The full market capitalisation of the smallest company that falls wholly within the top 68% of the Index universe by market capitalisation of its home region – when ranked according to Ground Rules.

The Fast Entry level for each region will be set at the time of the review and published by FTSE. Each quarter the Fast Entry levels will be adjusted using the performance of the region in the FTSE Global Equity Index Series as a whole, and an updated figure will be published by FTSE.

A new security becomes eligible for Fast Entry when its full market capitalisation (i.e. before the application of any investability weightings) is greater than the Fast Entry level for the relevant region and qualified under free float requirement stated in the Ground Rules.

APPENDIX E

FURTHER INFORMATION

Further information on the FTSE Value-Stocks Japan Index is available from FTSE or on the website www.ftse.com. FTSE will also welcome any comments on the Ground Rules.

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