FURTHER WEIGHT INCREASE OF CHINA A SHARES IN MSCI INDEXES

February 2019
MSCI announced on February 28, 2019 that it will **increase the weight of China A shares** in the MSCI Indexes using a **3-step inclusion process** beginning with the **May 2019 Semi-Annual Index Review**.

- On completion of this three-step implementation, there will be 253 Large and 168 Mid Cap China A shares, including 27 ChiNext shares, on a pro forma basis in the MSCI Emerging Markets Index, representing a weight of **3.3% in the pro forma index**.

- The decision follows overwhelming support for the weight increase from international institutional investors:
  - The successful implementation of the initial 5% inclusion of China A shares provided investors with positive experience and confidence.
  - Investors also welcomed the continuous commitment by the Chinese regulators to improve market accessibility including the significant reduction in trading suspensions in recent months.

- MSCI performed an extensive global consultation with a large number of international institutional investors, including asset owners, asset managers, broker/dealers and other market participants worldwide.
MSCI will increase the weight of China A in the MSCI Indexes as per the following schedule:

**THREE STEP INCLUSION PROCESS**

**Inclusion Step**

1. Increase the inclusion factor of China A Large Cap shares from 5% to 10% and add ChiNext Large Cap shares with a 10% inclusion factor.
   - **Timing**: May 2019 Semi Annual Index Review

2. Increase the inclusion factor of China A Large Cap shares from 10% to 15%.
   - **Timing**: August 2019 Quarterly Index Review

3. Increase the inclusion factor of China A Large Cap shares from 15% to 20% and include China A Mid Cap shares, including eligible ChiNext shares, with a 20% inclusion factor.
   - **Timing**: November 2019 Semi Annual Index Review
MSCI CHINA A SHARES INCLUSION JOURNEY

2002-2012
QFII and RQFII schemes were launched in 2002 and 2011; both were relaxed and expanded in 2012

2013
QFII repatriation rules relaxed; First RQFII awarded and RQFII expanded to SG/London

2014
Capital gains tax clarified, RQFII expanded to more cities, Shanghai Connect launched

2015
RQFII expanded to more cities

2016
Shenzhen Connect launched; QFII/RQFII quotas linked to fund size, beneficial ownership clarified.

2017
Exchanges loosened pre-approval requirements that can restrict the creation of index-linked vehicles

2018
Connect Daily quota quadrupled; SSE introduced MOC; Suspension rules further tightened

2019
QFII quota doubled; CSRC launched consultation to harmonize and further relax QFII/RQFII schemes

June 2013
MSCI puts China A shares on the 2014 Market Classification Review list

June 2014 – 1st Consultation
No inclusion; issues on QFII/RQFII quota allocation, capital mobility, uncertainties on capital gains tax

June 2015 – 2nd Consultation
No inclusion; new concerns on beneficial ownership

June 2016 – 3rd Consultation
No inclusion; issues on QFII 20% monthly limit, stock suspension, pre-approval of investment instruments

June 2017 – 4th Consultation
MSCI announces inclusion of China A shares at 5% inclusion ratio in May and August of 2018

May 2018 and August 2018
Initial 5% inclusion of Large Cap China A shares was successfully implemented with positive feedbacks

February 2019 – 5th Consultation
MSCI announces a further increase in the weight of China A shares in MSCI Indexes

May 2019, August 2019, November 2019
Implementing further weight increase of China A shares
The pro forma MSCI Emerging Market Index is estimated to have an aggregate turnover of 5.8%* from its current composition upon completion of the 3-step inclusion process.

* Estimated index turnover includes 1.5% turnover due to inclusion of Saudi Arabia and Argentina.
FEEDBACK FROM THE CONSULTATION

• **Overwhelmingly positive support** on further weight increase of China A Shares
  - Over 90% of investors MSCI consulted with* supported the proposal on increasing China A Large Cap inclusion factor to 20%, including China A Mid Cap stocks at 20% inclusion factor, and including ChiNext stocks respectively

• Investors prefer to see China A Large Cap stocks’ weight increase in 3 steps
  - Three step implementation could help alleviate potential execution pressure on the implementation dates vs. originally proposed two-step plan

• A significant proportion of investors suggested a more timely implementation of China A Mid Cap stocks together with the Large Cap stocks’ weight increase

* Note: MSCI conducted an extensive global consultation with a large number of international institutional investors, including asset owners, asset managers, broker/dealers and other market participants worldwide.
International institutional investors also stressed that a future weight increase of China A shares in the MSCI Indexes beyond 20% would require Chinese authorities to address the following accessibility concerns:

- **Access to hedging and derivatives**
  - The lack of listed futures and other derivatives products hamper investors’ ability to implement and risk manage a large scale inclusion.

- **Short settlement cycle of China A shares**
  - The short settlement cycle of China A presents operational risk and tracking challenges. It becomes a larger risk as the A shares weight and number of securities grows.

- **Trading holidays of Stock Connect**
  - The misalignment between onshore China and Stock Connect holidays continues to create investment frictions.

- **Availability of Omnibus trading mechanism in Stock Connect**
  - A functioning omnibus mechanism is critical to facilitate best execution and lower operational risk.
APPENDIX

Update on market liberalization developments in China
Since the announcement of the MSCI China A shares inclusion, more than 5,600 new Stock Connect accounts have been opened to trade China A shares and the total Northbound Connect portfolio value grew by US$84 billion.

### Number of SPSA accounts

<table>
<thead>
<tr>
<th>Period</th>
<th>Number of SPSA accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Before inclusion announcement</td>
<td>1,700</td>
</tr>
<tr>
<td>Feb 2019</td>
<td>7,304</td>
</tr>
</tbody>
</table>

### Northbound Connect AUM

<table>
<thead>
<tr>
<th>Period</th>
<th>Northbound Connect AUM (Rmb billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Before inclusion announcement</td>
<td>347</td>
</tr>
<tr>
<td>Feb 2019</td>
<td>910</td>
</tr>
</tbody>
</table>

Sources: HKEx
SIGNIFICANT ADVANCEMENTS IN ACCESSIBILITY ISSUES HIGHLIGHTED IN PREVIOUS CONSULTATIONS

<table>
<thead>
<tr>
<th>Market Accessibility Issue Highlighted in Previous Consultation</th>
<th>Status of Resolution</th>
</tr>
</thead>
<tbody>
<tr>
<td>QFII and RQFII Quota Allocation (2015)</td>
<td>Harmonization of QFII and RQFII into a single scheme with simplified qualification requirement and Expanded investment scope</td>
</tr>
<tr>
<td>Capital Mobility Restrictions in QFII/RQFII (2015)</td>
<td>The 20% monthly repatriation restriction was removed in 2018</td>
</tr>
<tr>
<td>Beneficial Ownership in Stock Connect (2015)</td>
<td>Resolved after CSRC clarification</td>
</tr>
<tr>
<td>Widespread Trading Suspensions (2016)</td>
<td>Suspensions dropped to historic low levels; SSE/SZSE implemented new suspension rules</td>
</tr>
<tr>
<td>Anti-competitive clauses/pre-approval requirement on investment instruments (2016)</td>
<td>Pre-approval condition was abolished on non-derivatives financial products</td>
</tr>
<tr>
<td>Absence of Market Closing Auction (2017)</td>
<td>Closing auction mechanism was implemented by Shanghai Stock Exchange in 2018</td>
</tr>
<tr>
<td>Daily limit of Stock Connect (2017)</td>
<td>Daily net buy quota quadrupled in 2018</td>
</tr>
</tbody>
</table>
The pace of market opening continued to accelerate during the past few months.

**Latest opening up measures in the China financial sector**

- **May 18**: MSCI successfully implemented the first 2.5% A shares inclusion.
- **June 18**: Shanghai issued consultation on closing auction.
- **June 18**: SAFE removed monthly repatriation cap and principal lock up period, giving QFII/RQFII the ability to access FX hedging instruments and simplifying document filing.
- **July 18**: China opened A shares to eligible foreign individual investors.
- **August 18**: SSE implemented closing auction similar to SZSE on August 20, 2018.
- **November 18**: CSRC issued the “Guiding Opinions on Improving the System of Suspension and Resumption of the Stocks of the Listed Companies”.
- **December 18**: China further relaxed index futures trading rules, reducing margin requirement and cutting trading fees.
- **January 2019**: SAFE doubled the investment quota for qualified foreign institutional investors (QFII) from the current US$150bn to US$300bn.
- **January 2019**: CSRC launched a consultation to combine QFII and RQFII into a single scheme with simplified qualification requirement and expanded investment scope.
APPENDIX

Update on trading suspension
Narrowing down the list of approved reasons for trading suspension: Suspensions arising from restructuring not involving share offering, non-public share offering, outward foreign investment and conclusion of material contracts are forbidden

Shortening the trading suspension term
- Limit the general trading suspension period to a maximum of 2-5 trading days.
- Limit suspensions due to restructuring to 5-10 trading days

Enhancing disclosure requirements
- Companies need to disclose, among other information, the specific reasons for a trading suspension, the progress of the reorganization, and the anticipated trading resumption date

Improving the supporting regulatory mechanism.
- Clarification of trading suspension/resumption principles and mandatory resumption provisions, enhancements to due diligence of relevant parties and establishment of a trading suspension notification system
SIGNIFICANT REDUCTION IN TRADING SUSPENSIONS

Trading Suspension in Since June 2017

Average less than 20 suspensions on a daily basis since end of 2018

Based on the full China A shares universe of over 3,000 securities
APPENDIX

Further weight increase in MSCI ACWI, Asia ex Japan and China Indexes
The pro forma MSCI ACWI Index is estimated to have an aggregate turnover of 0.7%* from its current composition upon completion of the 3-step inclusion process.

* Estimated index turnover includes 0.2% turnover due to inclusion of Saudi Arabia and Argentina.
The pro forma MSCI Asia ex Japan Index is estimated to have an aggregate turnover of 3.3% from its current composition upon completion of the 3-step inclusion process.
The pro forma MSCI China Index is estimated to have an aggregate turnover of 8.5% from its current composition upon completion of the 3-step inclusion process.
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