

ADDING A SHARES INTO EMERGING MARKETS - ARE YOU READY?

June 2017

EXECUTIVE SUMMARY

- MSCI announced on June 20 that it will include **222 China A Large Cap shares** in the MSCI Emerging Markets Index using a **2-step inclusion process** beginning in **June 2018**
 - The MSCI proposal received broad support from international institutional investors
 - improved market accessibility linked to expansion of Stock Connect program
 - loosening by the local Chinese stock exchanges of pre-approval requirements that can restrict the creation of index-linked investment vehicles globally
 - Represents approximately 0.73% of the pro forma MSCI Emerging Markets Index
- MSCI performed an extensive and in-depth cross-regional consultation on the potential partial inclusion of China A shares in the MSCI Emerging Markets Index. This global consultation included a large number of asset owners, asset managers, broker/dealers and other market participants

A RECAP OF THE INCLUSION JOURNEY

- Since MSCI put China A shares on the 2014 Market Classification Review list in 2013, there have been ongoing improvements in China's market accessibility conditions

	<i>1st consultation</i>	<i>2nd consultation</i>	<i>3rd consultation</i>	<i>4th consultation</i>
June 2013 <ul style="list-style-type: none"> • MSCI put China A shares on the 2014 Market Classification Review list 	June 2014 <ul style="list-style-type: none"> • No inclusion • Issues: quota allocation, capital mobility restrictions, uncertainties on Capital Gain Tax • Launched MSCI China A International Index 	June 2015 <ul style="list-style-type: none"> • 2nd consultation: No inclusion • Issues: Quota allocation, capital mobility, beneficiary ownership 	June 2016 <ul style="list-style-type: none"> • 3rd consultation: No inclusion • Issues: QFII 20% monthly limit, stock suspension, pre-approval of financial products 	June 2017 <ul style="list-style-type: none"> • 4th consultation: MSCI announced to partially include A shares in 2018

2002

Launch of QFII scheme
Initial quota at USD20bn

2011

Launch of RQFII scheme
Initial quota at Rmb20bn

2012

QFII, RQFII quota expanded; Eligibility further relaxed for both QFII and RQFII

2013

First foreign investor licensed RQFII
RQFII expanded to LN/SG
QFII repatriation relaxed

2014

Launch of the SH-HK Stock Connect
Clarification of capital gain tax
RQFII expanded to more cities

2015

RQFII expanded to more cities
Shanghai Connect Launched

2016

Link QFII/RQFII quota to fund size,
Relaxed capital mobility
New stock suspension rules
Launch of SZ-HK Connect

2017

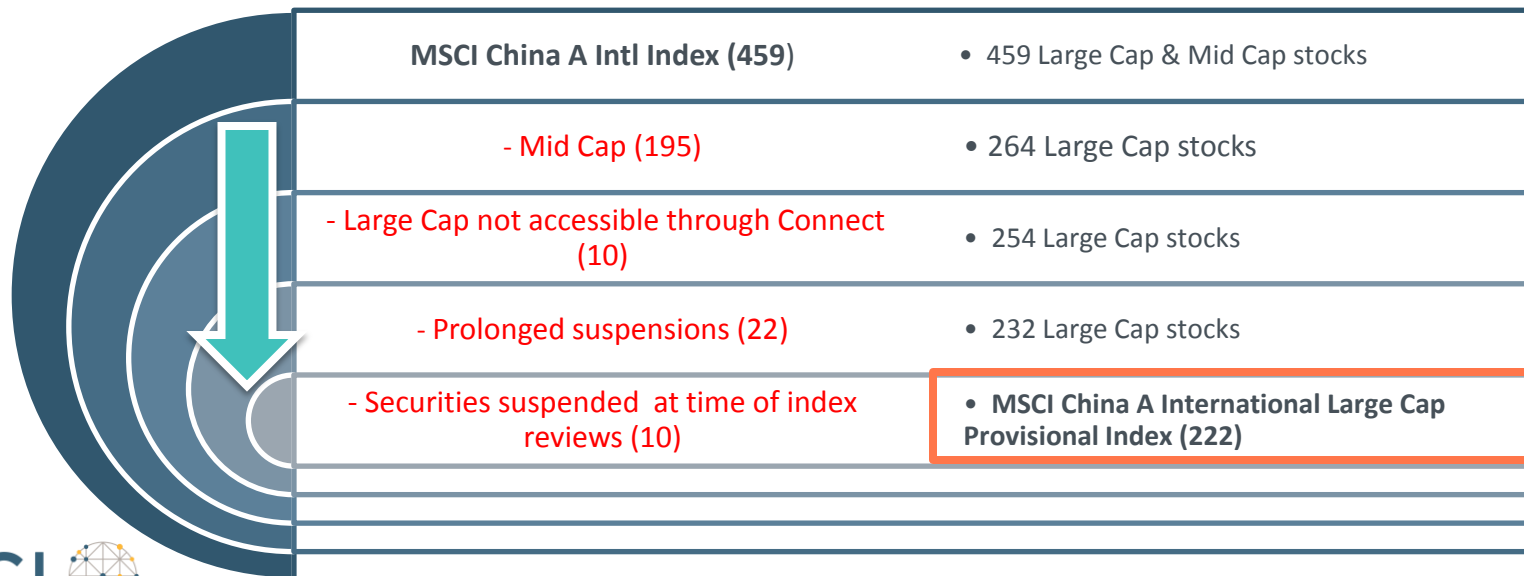
Loosening of pre-approval requirements that can restrict the creation of index-linked investment vehicles globally

FEEDBACK FROM CONSULTATION

- Institutional investors viewed the **Stock Connect as a more flexible access framework** compared to the QFII and RQFII regimes
- They also welcomed the **decrease in the number of suspended China A shares**
 - Institutional Investors continue to view the number of suspensions as an outlier compared to other international markets and have encouraged the Chinese authorities to consider **additional measures** to further reduce the number and duration of trading suspensions
- A large majority of institutional investors agreed with the MSCI proposal to **initially restrict the inclusion to Large Cap shares that are not in trading suspension**
- Additionally, many of them also recommended that MSCI should not exclude **China A Large Cap shares of companies that have H share equivalents** in the MSCI China Index

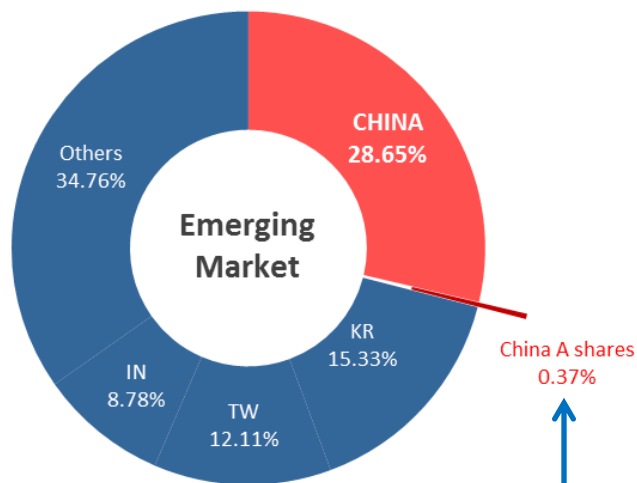
CONSTRUCTION OF THE PRO FORMA A SHARES INDEX

- The pro forma A shares Index is constructed based on the MSCI China International Index, excluding:
 - Mid Cap A shares
 - A shares that are not accessible through the Stock Connect program
 - A shares suspended for more than 50 days in the past 12-months and suspended at time of index reviews

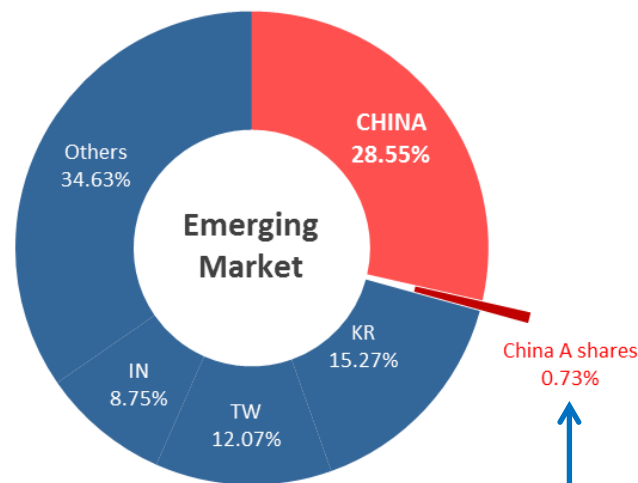


TWO-STEP INCLUSION PROCESS

- MSCI will use a two-step inclusion process to account for the existing daily trading limits on Stock Connect
- An Index Inclusion Factor (IIF) of 2.5% and 5% will be applied to the FIF-adjusted market capitalization of China A shares in the pro forma MSCI China Index at the May 2018 Semi-Annual Index Review (SAIR) and August 2018 Quarterly Index Review (QIR) respectively
- MSCI may revise the planned implementation to a single phase should the daily limit be abolished or significantly expanded before the scheduled inclusion dates



May 2018 SAIR
Inclusion Factor = 2.5%



Aug 2018 QIR
Inclusion Factor = 5%

Data as of June 19, 2017

SIMULATED PRO FORMA MSCI CHINA INDEX

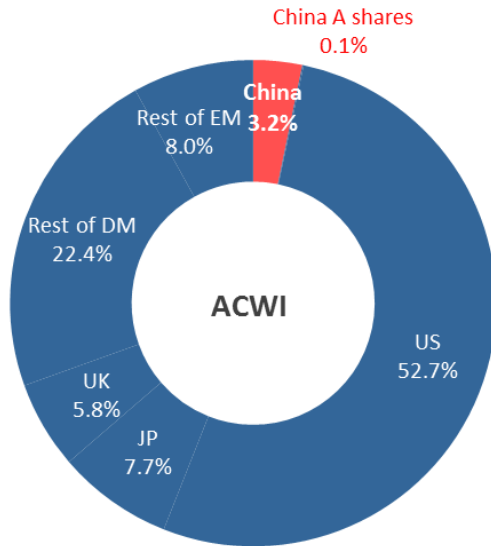
- The number of China A shares in the pro-forma MSCI China Index would be **222**
- The total number of constituents in the pro forma MSCI China Index would increase from 152 to **423**
- The pro forma weight of China A shares in the MSCI Emerging Markets Index following the completion of the second implementation step would be approximately **0.73%**.

	Current Standard		May 2018 SAIR			August 2018 QIR			# Securities	
	Weight	# Sec	Weight	# Sec	1 way Turnover	Weight	# Sec	1 way Turnover	Add	Del
MSCI China										
A Shares	-	-	1.3%	222	1.26%	2.5%	222	2.49%	222	-
B Shares	0.2%	2	0.3%	4	0.12%	0.3%	4	0.12%	2	-
H Shares	35.0%	69	34.7%	89	1.44%	34.2%	89	1.42%	20	-
Red Chip	15.2%	30	15.2%	39	0.73%	15.0%	39	0.72%	9	-
P Chip	24.3%	35	24.5%	52	1.44%	24.2%	52	1.42%	17	-
Overseas	25.3%	16	24.1%	17	0.07%	23.8%	17	0.07%	1	-
Total	100.0%	152	100.0%	423	5.06%	100.0%	423	6.24%	271	-
MSCI EM	-	845	-	1116	1.47%	-	1116	1.83%	271	-
A Shares	-	-	0.4%	222	0.37%	0.7%	222	0.73%	222	-

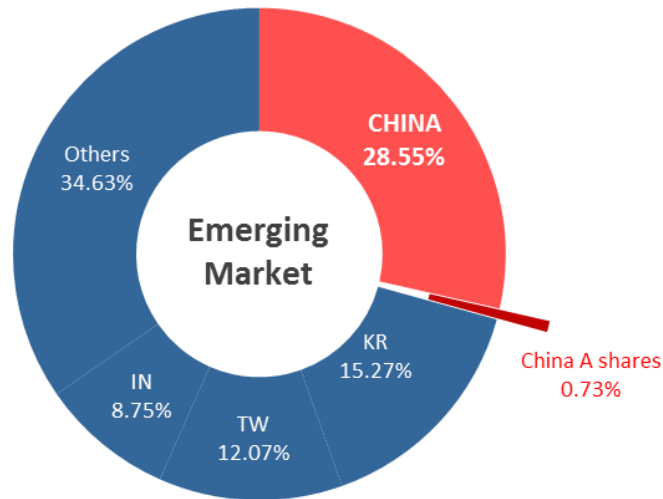
1. The pro-forma constituents are simulated by applying the additional screening criteria of the new proposal to the MSCI China A International Index. Data as of June 19, 2017. The inclusion results in slight increases in other share classes after applying the MSCI GIMI methodology to an enlarged universe.

PRO FORMA WEIGHT OF A SHARES

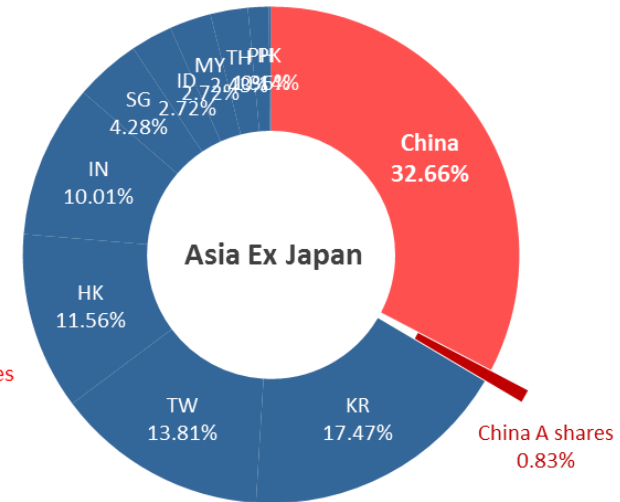
ACWI



Emerging Markets



Asia Ex Japan



Data as of June 19, 2017

ROADMAP OF FUTURE CHINA A SHARES INCLUSION

- During the consultation, many institutional investors requested guidance on the future inclusion road map for China A shares
- Further inclusion of China A shares could potentially include an **increase of the currently announced 5% Inclusion Factor** as well as the **addition of China A Mid Cap shares**, subject to:
 - greater alignment of the China A shares market with international market accessibility standards
 - the resilience of Stock Connect
 - the relaxation of daily trading limits
 - continued progress on trading suspensions
 - further loosening of restrictions on the creation of index-linked investment vehicles.
- MSCI would continue to monitor the situation and launch a **public consultation** to solicit feedback from investors once warranted

LAUNCH OF PROVISIONAL INDEXES

- MSCI will start to calculate the MSCI China A International Large Cap Provisional Index on June 21, 2017
- Additional global and regional provisional indexes including the MSCI China and MSCI Emerging Markets Provisional Indexes, will be launched in August 2017
- These provisional indexes serve to manage the implementation of the inclusion of China A shares in investors' portfolios on the schedule of their choosing

LIST OF PROVISIONAL INDEXES TO BE LAUNCHED

Launched on June 21, 2017

- MSCI China A International Large Cap Provisional Index

To be launched in August 2017:

- MSCI China Provisional Index
- MSCI China IMI Provisional Index
- MSCI Golden Dragon Provisional Index
- MSCI Golden Dragon IMI Provisional Index
- MSCI ZhongHua Provisional Index
- MSCI ZhongHua IMI Provisional Index
- MSCI AC Asia ex Japan Provisional Index
- MSCI AC Asia ex Japan IMI Provisional Index
- MSCI AC Asia Provisional Index
- MSCI AC Asia IMI Provisional Index
- MSCI AC Asia Pacific Provisional Index
- MSCI AC Asia Pacific IMI Provisional Index
- MSCI AC Asia Pacific ex Japan Provisional Index
- MSCI AC Asia Pacific ex Japan IMI Provisional Index
- MSCI EM Provisional Index
- MSCI EM IMI Provisional Index
- MSCI EM Asia Provisional Index
- MSCI EM Asia IMI Provisional Index
- MSCI ACWI Provisional Index
- MSCI ACWI IMI Provisional Index

ADDITIONAL CONSULTATION POINTS

- Following the decision to include China A shares in the MSCI Emerging Markets Index, MSCI will also consult on the following in July 2017:
 1. Implementation of index changes related to corporate events and quarterly index reviews in the event of a market closure due to a “Connect” market holiday or a daily limit breach
 2. Extending the same suspension treatment to the MSCI China A International Indexes
 3. Transition plan of existing China A Indexes

ADDITIONAL CONSULTATION POINTS

	Original Consultation Proposal	Final Decisions/Additional Consultation Points
Eligibility	<ul style="list-style-type: none"> • Include only Large Cap companies which are accessible through the Shanghai and Shenzhen Stock Connect programs • Exclude A shares that have H-shares listings included in the MSCI China Index 	<ul style="list-style-type: none"> ✓ Include only Large Cap companies which are accessible through the Shanghai and Shenzhen Stock Connect programs × Include A shares that have H shares listings included in the MSCI China Index
	<ul style="list-style-type: none"> • Securities suspended for more than 50 days in the past 12 months would not be eligible for index inclusion 	<ul style="list-style-type: none"> ✓ Securities suspended for more than 50 days in the past 12 months would not be eligible for index inclusion ✓ Securities that are suspended during the index review will not be eligible for index inclusion ❖ MSCI will consult on extending this treatment to the MSCI China A International Indexes
ON-GOING TREATMENTS ON SUSPENSION	<ul style="list-style-type: none"> • Remove index constituents that have been suspended for more than 50 days 	<ul style="list-style-type: none"> ✓ Remove index constituents that have been suspended for more than 50 days ❖ MSCI will consult on extending this treatment to the MSCI China A International Indexes
CORPORATE EVENT AND REBALANCING IMPLEMENTATION	<ul style="list-style-type: none"> • No initial inclusion of IPO given Connect investors cannot participate in primary offerings • Postpone implementation to next day for index changes linked to corporate events and quarterly index reviews if the event effective date falls on a “Connect” market holiday or is due to market closure linked to a daily limit breach 	<ul style="list-style-type: none"> ✓ <i>No initial inclusion of IPO given Connect investors cannot participate in primary offerings</i> ❖ MSCI will also further consult on the implementation of index changes related to corporate events and quarterly index review in the event of market closure due to a “Connect” market holiday or a daily limit breach
FX	<ul style="list-style-type: none"> • Offshore exchange rate (CNH) to be used for index calculation 	<ul style="list-style-type: none"> ✓ Offshore exchange rate (CNH) to be used for index calculation

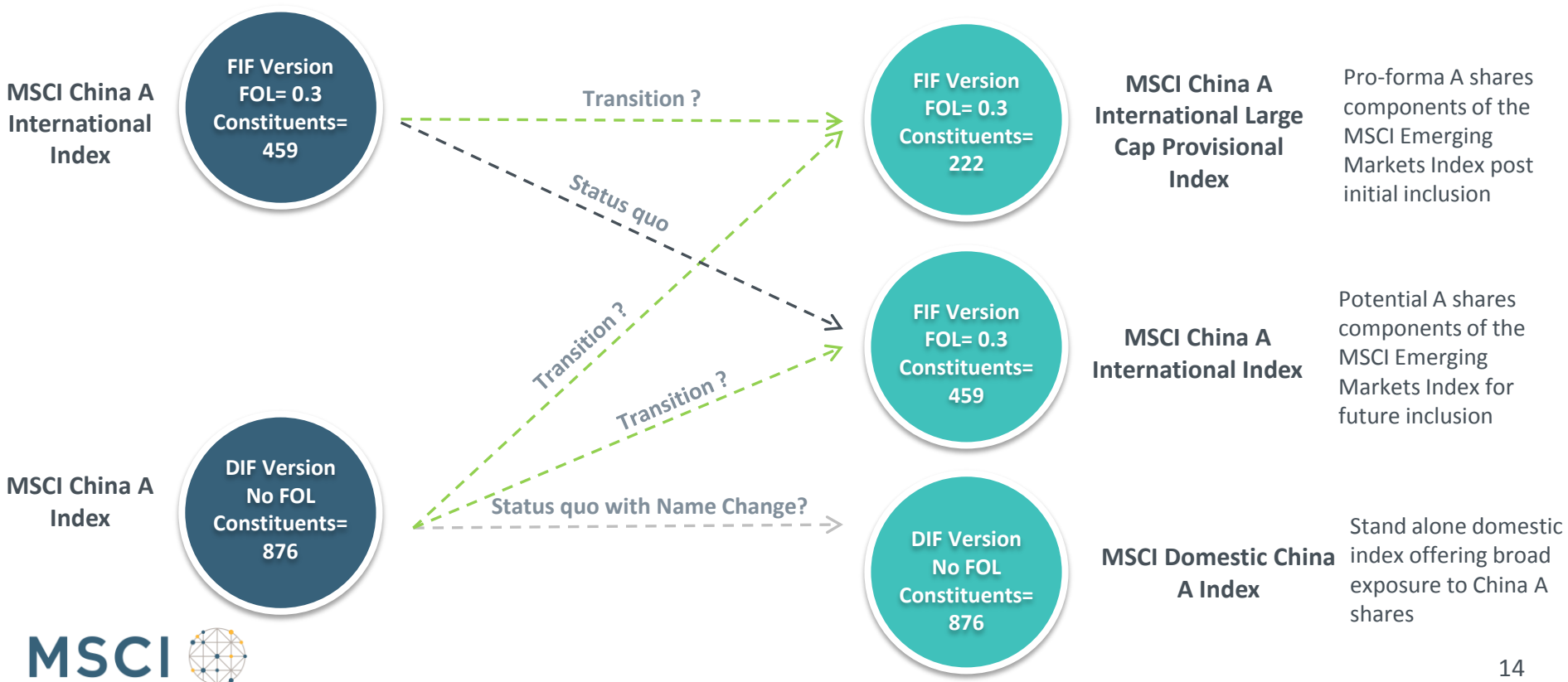
POTENTIAL TREATMENTS OF EXISTING CHINA A INDEXES

- MSCI intends to continue to maintain the existing MSCI China A indexes but will launch a consultation on the transition plan for current users of MSCI China A Index and MSCI China A International Index

Existing MSCI China A Indexes

Future MSCI China A Indexes

Use Case



KEY EVENTS TIMELINE

- June 2017**
- - Announcement of China A shares inclusion in the MSCI Emerging Markets Index
 - - Launch of the MSCI China A International Large Cap Provisional Index

- July 2017**
- - Launch of consultation on transition plan for existing China A Indexes
 - - Launch of consultation on suspensions, index review and CE changes

- August 2017**
- - Launch of global and regional provisional indexes

- September 2017**
- - Announcement of the conclusion of consultations
 - - Detailed Q&A document for the China A shares inclusion

- May 2018 SAIR**
- - Inclusion of A shares in the MSCI Emerging Markets Index with an Inclusion Factor of 2.5%

- August 2018 QIR**
- - Increase in Inclusion Factor to 5%

SAUDI ARABIA, ARGENTINA AND NIGERIA

SAUDI ARABIA

- MSCI announced that **it is launching a consultation on the potential inclusion of the MSCI Saudi Arabia Index in the MSCI Emerging Markets Index**
- In September 2016, the Saudi Arabian Capital Market Authority (CMA) implemented a new version of "Rules for Qualified Foreign Financial Institutions Investment in Listed Securities" which resulted in an increase in the number of Qualified Foreign Investors
 - included the increase of foreign ownership limit levels applicable to listed Saudi Arabian companies
 - the lowering of the minimum assets under management requirements applicable to Qualified Foreign Investors
 - amendments to the list of Qualified Foreign Investors eligible investor types.
- On April 23, 2017, the Saudi Stock Exchange (Tadawul) followed up by implementing a new market operating model.
 - the expansion of the settlement cycle from T+0 to T+2,
 - the introduction of a proper delivery versus payment (DvP) settlement provision
 - proper failed trade management, and
 - the introduction of short selling and securities borrowing and lending facilities

ARGENTINA

- MSCI announced that **it is maintaining the MSCI Argentina Index on the review list** for a potential reclassification to Emerging Markets status as part of the **2018 Annual Market Classification Review**
- Since December 2015, the Argentinian Central Bank has abolished foreign exchange restrictions and the capital controls that had been in place for a number of years. These changes have resulted in, among other things:
 - a floating currency
 - the elimination of cash reserves and monthly repatriation limits affecting the equity market and
 - the abolishment of the capital lock-up period for investments
- Although the Argentinian equity market meets most of the accessibility criteria for Emerging Markets, the irreversibility of the relatively recent changes still remains to be assessed

NIGERIA

- MSCI announced that it is **delaying its decision on a potential reclassification of the MSCI Nigeria Index** to stand-alone market status to the November 2017 Semi-Annual Index Review
 - As a reminder, the Central Bank of Nigeria pegged the local currency to the US dollar in the first half of 2015, resulting in a sharp decline in liquidity on the foreign exchange market, particularly at the beginning 2016
 - Hence, the ability of international institutional investors to repatriate capital has been significantly impaired to a point where the investability of the Nigerian equity market is being questioned
- On April 21, 2017, the Central Bank of Nigeria introduced a new FX trading window for investors and exporters that aimed to facilitate the repatriation of capital. To date, investors seem to be cautiously optimistic on the effectiveness of this new window but still require more time to test it further

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Our line of products and services includes indexes, analytical models, data, real estate benchmarks and ESG research.

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