

Q&A of Consultation on China A-Shares Index Inclusion Roadmap

On March 11, 2014, MSCI announced the launch of a consultation on the proposed index inclusion roadmap for China A-shares in the MSCI Emerging Markets Index. The purpose of this document is to address commonly asked questions regarding the proposal.

Please note that this proposal may or may not lead to any changes to the MSCI Indexes. The results of the 2014 MSCI Market Classification Review will be announced in June 2014.

General Questions

Why is MSCI launching a separate consultation on the potential inclusion of China A shares now?

This is not a new consultation per se. This consultation is part of the broader 2014 Market Classification Review consultation. The objective of this proposal is twofold: i) to provide clarity and transparency in terms of MSCI's current assessment of the China A-share market given the recent market developments and ii) to solicit concrete feedback from the investment community regarding the potential partial inclusion of China A-shares in the MSCI Emerging Markets Index.

Does this consultation suggest that MSCI has come to a conclusion that the China A-shares will be included in the MSCI Emerging Markets Index in May 2015?

No, the decision to include China A-shares in the MSCI Emerging Markets Index has not been made and is subject to the feedback from the investment community on this consultation.

When will the official decision on the potential inclusion of China A-shares be made?

The final decision on the inclusion of the China A-shares will be announced in June 2014 as part of the 2014 Annual Market Classification Review.

What will be the implementation timeline for the potential inclusion of China A-shares if it happens?

As per the consultation document, MSCI proposes to implement the partial inclusion of China A-shares into the MSCI China Index and its corresponding composite indexes coinciding with the May 2015 Semi-Annual Index Review.

How will the partial Inclusion Factor on China A-shares work?

An Inclusion Factor of 5% would be applied to the China A-share constituents of the pro forma MSCI China Index. As an example, an A-share index constituent with a pre-Inclusion Factor index weight of 10% will assume a 0.5% final index weight in the pro forma MSCI China Index. During the initial construction and subsequent regular index reviews, the China A-share securities will be evaluated for index eligibility based on their FIF-adjusted market capitalization before the application of the Inclusion Factor.

Given the current MSCI China A Index is already constructed based on the MSCI GIMI Methodology, why is the simulated pro forma MSCI China Index reflecting a lower number of China A-share constituents?

As per the consultation document, the simulated pro forma MSCI China Index is constructed based on one integrated China equity universe comprising A-shares, B-shares, H-shares, Red-chips and P-chips.

Correspondingly, the derived market size-segment cutoff of this integrated universe differs from the current MSCI China A Index which is constructed based on an universe comprising only A-share securities. Differences in market size-segment cutoff and security universe lead to different index compositions.

In addition, the free float-adjusted market capitalization of China A-shares in the integrated universe reflects a foreign ownership limit (FOL) of 30% while the current MSCI China A Index is constructed based on domestic free float-adjusted market capitalization without the FOL.

How does MSCI treat the multiple listings of A-, H- and B-shares in the pro forma MSCI China Index and what's the methodology rationale?

Consistent with the current MSCI GIMI Methodology, all share classes issued by the same company, as long as they are equity-like and represent different parts of the company's market capitalization, will be eligible for inclusion in the MSCI Global Investable Market Indexes.

In the context of the pro forma MSCI China Index, the A-, B- and H-shares represent different parts of the company market capitalization and are therefore eligible for potential index inclusion. However, the inclusion of different share classes continues to be subject to the same investability requirements of the existing MSCI GIMI methodology.

Why a 5% Inclusion Factor?

While the overall quota of US\$216 billion represents about 17% of the China A share index market capitalization, there are still significant misalignments between the quota allocation and the size of institutional investors especially for the manager segment. In addition, there is a cap of US\$1 billion quota for certain types of QFII investors. Recognizing the potential constraining factors, MSCI is proposing a conservative 5% Inclusion Factor to reflect the maximum allocation to China A-shares based on the implied benchmark weight and the estimated emerging markets allocation of the largest global asset managers.

What are the implications of this potential transition for existing MSCI China A Index clients?

Under the current proposal, at the time of the inclusion of China-A shares, the existing MSCI China A Index will be transitioned to the pro forma (International) MSCI China A Index based on the MSCI Global Investable Market Indexes Methodology.

What is the Pro Forma (International) MSCI China A Index and how does it differ from the current MSCI China A Index?

The pro forma (International) MSCI China A Index represents the A-share components of the pro forma MSCI China index. The security weight of the pro forma (International) MSCI China A Index is determined based on the security FIF adjusted market capitalization (subject to a FOL of 30%). By contrast, the current MSCI China A Index is a standalone index constructed based on the MSCI China A equity universe and the weight is determined by the security DIF adjusted market capitalization (not subject to any FOL).

Will the current form of MSCI China A Index continue to exist after the potential inclusion of China A-shares into the MSCI Emerging Markets Index?

Yes, MSCI will continue to separately maintain the standalone MSCI Domestic China A Index for investors who wish to maintain a broad domestic exposure of the China A-share market.

Where can I find the simulated list of the pro forma MSCI China Index constituents?

The simulated list of pro forma MSCI China Index constituents is available upon request via Client Service.

Would MSCI provide provisional indexes on the new MSCI China Indexes and its corresponding composite indexes?

Yes, MSCI proposes providing a series of provisional indexes on the pro forma MSCI China Indexes, the new pro forma (International) MSCI China A Indexes and other related composite indexes. The list of provisional indexes to be provided would be announced in due course.

Does the potential inclusion of China A-shares suggest that MSCI will potentially upgrade the MSCI Korea Index or MSCI Taiwan Index to Developed Markets?

No, the MSCI Korea Index and MSCI Taiwan Index will be evaluated independently according to the existing MSCI Market Classification Framework. Decisions on the potential inclusion of China A-shares and the potential reclassification of the MSCI Korea Index and MSCI Taiwan Index are unrelated.

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The company's flagship product offerings are: the MSCI indexes with approximately USD 8 trillion estimated to be benchmarked to them on a worldwide basis¹; Barra multi-asset class factor models, portfolio risk and performance analytics; RiskMetrics multi-asset class market and credit risk analytics; IPD real estate information, indexes and analytics; MSCI ESG (environmental, social and governance) Research screening, analysis and ratings; ISS corporate governance research, data and outsourced proxy voting and reporting services; and FEA valuation models and risk management software for the energy and commodities markets. MSCI is headquartered in New York, with research and commercial offices around the world.

¹ As of September 30, 2013, as reported on January 31, 2014 by eVestment, Lipper and Bloomberg

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