

Highly dilutive or large rights issue consultation – Revised proposal – December 2014

Agenda

- Background
- Summary of original proposal & definition of highly dilutive terms or large impact rights issues
- Client feedback and changes to original proposal
- Summary of MSCI current methodology versus original proposal versus revised proposal
- Discussion points: Migration and Valuation of rights
- Appendix:
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 - Appendix II: Indicative list of historical rights issues qualifying to be implemented under revised proposal
 - Appendix III: 2014 Migrations triggered by rights issues

Background

MSCI has launched a consultation on September 18, 2014 on the treatment of highly dilutive or large rights issue. The consultation ended on November 10, 2014.

Following client feedback, MSCI is re-opening the consultation with a revised proposal and 2 discussions points.

MSCI welcomes feedback from the investment community on the amended proposal through December 15, 2014.

This consultation may or may not lead to any changes to the MSCI Indexes.

Original Proposal for Highly Dilutive or Large Rights Issue

- Apply a Price Adjustment Factor (PAF) on Ex-date using the value of Right on Ex-date (market value if Right is trading else intrinsic value).
- Add Right to the Index as of the close of Ex date using market value if the Right is trading else using Intrinsic Value.
- Add Subscription Cash to the Index effective on the last day of subscription period.
- Delete Right and Subscription Cash from the Index as of the close of Pay-date.
- Increase NOS as of the close of Pay-date. Migration upward, if any, will be done simultaneously.

Original Proposal for thresholds to define highly dilutive terms and large impact rights issues

Rights issues with terms 5 per 1 or more as highly dilutive

- Large impact rights issues as those:
 - Triggering an upwards migrations as a result of a size-segment review
 - With impact on free float-adjusted Market Capitalization of more than USD 5 billion for DM and USD 2.5 billion for EM for Standard Indexes
 - With impact on free float-adjusted Market Capitalization of more than USD 3 billion for DM and USD 1.5 billion for EM for Small Cap Indexes

Clients feedback and changes to original proposal

- Based on client feedback, MSCI has revised its original proposal as follows:
 - Subscription cash should be added as of the close of ex date to increase weight of security due to rights issue;
 - Thresholds should be simplified and MSCI to remove float-adjusted market capitalization based thresholds.
- There is no clear consensus for timing of implementation of migrations due to rights issue. Hence, MSCI proposes to postpone migrations to Index Reviews. Migrations, due to rights issue, if any, will be announced with Index Review announcements. However, MSCI still proposes to implement these rights issues as per the revised proposal if they meet the thresholds for highly dilutive and large rights issues.

| Original Proposal | Revised Proposal** |
|--|---|
| Add subscription cash effective open of subscription period | Add subscription cash as of close of ex date |
| Thresholds: <ul style="list-style-type: none"> • 5 per 1 or more • Triggering an upward migrations as a result of a size-segment review • Based on float adjusted USD impact segregated between DM/EM/Standard/Small Cap. | Thresholds*: <ul style="list-style-type: none"> • 5 per 1 or more • Triggering an upward migration as a result of a size-segment review |
| Migration as of close of pay date of new shares | Migration postponed to Index Review as per Index Review Rebalancing rules |



* MSCI intends to cover only IMI securities under the revised proposal.

**Please refer to Appendix I for detailed implementation of revised proposal

MSCI current methodology versus original proposal versus revised proposal

| Implementation date | MSCI current Methodology | Original Proposal for Highly dilutive or large rights issue | Revised Proposal for Highly dilutive or large rights issue* |
|--|--|---|--|
| On Ex-date | Apply a PAF using the terms of the event | Apply a PAF using the Rights (market value or Intrinsic Value) | Apply a PAF using the Rights (market value or Intrinsic Value) |
| As of close of Ex-date | Increase NOS | Add Rights to the Index | Add Rights and Subscription cash to the Index |
| From open of last day of subscription period | N/A | Add Subscription Cash to the Index | N/A |
| As of close of Pay-date | N/A | <ol style="list-style-type: none"> 1) Delete Rights and Subscription Cash from the Index 2) Increase NOS + migration, if any | <ol style="list-style-type: none"> 1) Delete Rights and Subscription Cash from the Index 2) Increase NOS |
| Migration | N/A | As of close of pay-date | At an Index review (based on Index Review Rebalancing rules) |
| Thresholds | N/A | Thresholds: <ul style="list-style-type: none"> • 5 per 1 or more • Triggering an upward migration as a result of a size-segment review • Based on float adjusted USD impact segregated between DM/EM/Standard/Small Cap. | Thresholds: <ul style="list-style-type: none"> • 5 per 1 or more • Triggering an upward migration as a result of a size-segment review |

Discussion point: Migrations

As per the revised proposal, MSCI proposes to implement migrations triggered by highly dilutive or large rights issues at index reviews.

Alternatively, should MSCI consider implementing migrations triggered by highly dilutive or large rights issues at t-1 of the ex date (cum date) to cater for the reverse turnover experienced by Small Cap funds with MSCI current methodology, initial proposal and revised proposal?

Under this alternative, as per analysis of 2014 cases, only for 2 cases out of 4, MSCI would have potentially been able to migrate on cum date, announced with two full business days advance notice to clients, given the late disclosures by companies. Please refer to Appendix III.

- What are the views on this alternative?
- How many days should MSCI consider as sufficient notice to implement migration triggered by highly dilutive or large rights issues at t-1 of the ex date? Should MSCI pre-announce the migration on cum date only if 2 full business days notice is provided to clients?
- If MSCI could not pre-announce and implement the migration on cum date due to late disclosures by companies, should MSCI implement these rights issues as per the revised proposal?

| | Migration as of close of ex-date (current methodology) | Migration as of close of pay date (original proposal) | Migration at Index Review (revised proposal) | Migration as of close of cum date (alternative) |
|-----------|---|---|---|--|
| Small Cap | Potential reverse turnover | Reverse turnover | Reverse turnover | No reverse turnover. |
| Standard | Migration is implemented simultaneously with NOS increase. No reverse turnover. | Migration is delayed to pay date and implemented simultaneously with NOS increase. No reverse turnover. | Migration is delayed to Index Review – time to achieve market price stability. No reverse turnover. | Migration is anticipated. No reverse turnover. In case, the event don't go through, Index will have a Small cap stock in a Standard Index until next Index Review. |
| IMI | Migration is implemented simultaneously with NOS increase. No reverse turnover. | Migration is delayed to pay date and implemented simultaneously with NOS increase. No reverse turnover. | Migration is delayed to an Index Review. No reverse turnover. | Migration is anticipated. No reverse turnover. |

Discussion point: Valuation of rights

- As per proposed implementation, MSCI proposes to use market value of right when rights are trading else to use intrinsic value.*
 - Is the proposed implementation suitable for valuing rights?
 - Should MSCI instead carry forward the last traded market price of right once rights stop trading (from end of rights trading date to pay-date) and delete right using this carry forwarded market price?
 - Alternatively, should MSCI carry forward the last traded market price of right once rights stop trading (from end of rights trading date to one day before pay-date) and switch to intrinsic value for closing on pay-date and delete right using this intrinsic value?

| Valuation of rights | Carry forward last traded value | Market value when trading else Intrinsic value | Carry forward last traded market value and switch to intrinsic value as of close of pay date |
|---------------------|--|--|---|
| PROS | <ul style="list-style-type: none"> • Consistent with MSCI current approach of carrying forward last traded price once security stops trading. | <ul style="list-style-type: none"> • Rights value tracks performance of the stock trading on the market. • No change in Index Divisor as of close of pay date. | <ul style="list-style-type: none"> • Consistent with MSCI current approach of carrying forward last traded price once security stops trading. • No change in Index Divisor as of close of pay date. |
| CONS | <ul style="list-style-type: none"> • Change in Index Divisor as of close of Pay date (when MSCI deletes rights and cash and increase NOS). • Rights value does not track performance of the stock trading on the market. | <ul style="list-style-type: none"> • Index volatile as switch back & forth between market value and intrinsic value. | <ul style="list-style-type: none"> • Index volatile as switch back & forth between market value and intrinsic value. • Rights value does not track performance of the stock trading on the market till pay date -1. |

Appendix:

- I. Detailed implementation for revised treatment
- II. Indicative list of historical rights issues qualifying to be implemented under revised proposal
- III: 2014 Migrations triggered by rights issues

Appendix I: Detailed Implementation for Revised Treatment

▪ Ex Date

○ Apply PAF

- Apply a Price Adjustment Factor (PAF) on ex date using the value of Right on Ex-date.*

$$\text{PAF} = [\text{P}(t) + \text{Right per Share P}(t)] / [\text{P}(t)]$$

○ Add Right

- Right will be valued at market value if it is trading else it will be valued at derived Intrinsic Value if it is not trading.

$$\text{Intrinsic Value of Right} = [(\text{P}(t) * \text{Shares Issued} - \text{Issue P} * \text{Shares Issued})] / [\text{Shares Before}]$$

- Add Right to the Index as of the close of Ex-date (effective next day), **if subscription price is lower than the market price of the security**. Right is added to Index at market value if the right traded on the Ex-date else at intrinsic value if the right did not trade on the Ex-date.
- Right will not be added to Index if the subscription price is equal to or above the market price at the time of confirming the event even though the Rights issue is fully underwritten. The changes in NOS and FIF, if any, will be postponed to the Pay-date.

○ Add Subscription Cash

$$\text{Subscription Cash} = [\text{Shares Issued} / \text{Shares Before}] * [\text{Issue Price}] * [\text{Pre Event Number of Shares}]$$

- Subscription Cash line is added to the Index as of the close of Ex-date (effective next day), if the subscription price is below the market price. The value of subscription cash will be a Fixed value. It will be kept in Index until Pay-date.
- If the subscription price is equal to or above the market price, Subscription Cash will not be added to Index and MSCI will wait for results of Rights issue to implement the increase in NOS and FIF, if any.

Appendix I: Detailed Implementation for Revised Treatment (Continued)

▪ Ex Date + 1

- Price Adjustment Factor (PAF) is removed and no longer a part of Index.
- Right is now a part of Index.
- Subscription cash is now a part of Index

▪ Pay Date

- The Rights will be deleted from the Index as of the close of Pay-date (effective next day). The deletion price will be market value of the Right if it is trading else deletion price will be Intrinsic Value.
- Subscription Cash line will be deleted from the Index as of the close of Pay-date (effective next day).
- New shares resulting from rights issue will be added to the Index as of the close of Pay-date (effective next day).

▪ Pay Date + 1

- Right and Subscription Cash are removed and are no longer part of Index
- New shares are added and are now part of the Index.

▪ Index Reviews

- Migration, if any qualified by the event, will be done as a part of the Index Review as per Index Review Rebalancing rules.

Appendix II: Indicative list of historical rights issues qualifying to be implemented under revised proposal*

| Country Code | Index family | Ex Date | MSCI Security Code | Security Name | Terms | Impact in USD |
|--------------|--------------|-----------|--------------------|--------------------------|----------------------------|----------------|
| IT | Small | 16-Jul-12 | 12562.01 | FONDIARIA - SAI ORD | R 252 : 1 @ EUR 1 | 1,371,320,104 |
| IT | Small | 16-Jul-12 | 13117.03 | UNIPOL GRUPPO FINAN ORD | R 20 : 1 @ EUR 2 | 894,866,780 |
| IT | Small | 16-Jul-12 | 13117.01 | UNIPOL GRUPPO FINAN PRIV | R 20 : 1 @ EUR 0.975 | 421,942,987 |
| GB | Small to Mid | 17-Jul-12 | 32883.01 | MELROSE | R 2 : 1 @ GBP 1.42 | 1,714,133,968 |
| ES | Mid | 30-Apr-13 | 69016.01 | BANKIA | R 397 : 1 @ EUR 1.352663 | 18,678,783,610 |
| GR | Small | 11-Jun-13 | 22868.01 | BANK OF PIRAEUS | R 35.680197 : 1 @ EUR 1.7 | 7,569,882,555 |
| GB | Large | 18-Sep-13 | 10326.01 | BARCLAYS** | R 1 : 4 @ GBP 1.85 | 9,845,550,724 |
| CH | Small | 1-Oct-13 | 29841.01 | SCHMOLZ + BICKENBACH | R 7 : 1 @ CHF 0.53 | 408,452,146 |
| IT | Small to Mid | 31-Mar-14 | 36948.01 | BANCO POPOLARE | R 17 : 18 @ EUR 9 | 3,081,816,312 |
| BR | Small to Mid | 6-Jun-14 | 31001.01 | B2W | R 59.874514 : 100 @ BRL 25 | 736,393,739 |
| DE | Large | 6-Jun-14 | 10862.02 | DEUTSCHE BANK NAMEN** | R 5 : 18 @ EUR 22.5 | 9,418,895,300 |
| IT | Mid | 9-Jun-14 | 23292.01 | BANCA MONTE PASCHI ORD | R 214 : 5 @ EUR 1 | 7,597,150,446 |
| PT | Small to Mid | 1-Jul-14 | 15361.02 | BCP BANCO COMERCIAL | R 7 : 4 @ EUR 0.065 | 3,430,266,719 |

*The list is only indicative and not exhaustive

**These will not be implemented as per new implementation based on revised proposal

Appendix III: 2014 Migrations triggered by rights issues

| Country Code | Index family | Ex Date | MSCI Security Code | Security Name | Terms | Announced with less than 2 business days notice |
|--------------|--------------|-----------|--------------------|---------------------|----------------------------|---|
| IT | Small to Mid | 31-Mar-14 | 36948.01 | BANCO POPOLARE | R 17 : 18 @ EUR 9 | Yes |
| BR | Small to Mid | 6-Jun-14 | 31001.01 | B2W | R 59.874514 : 100 @ BRL 25 | No |
| PT | Small to Mid | 1-Jul-14 | 15361.02 | BCP BANCO COMERCIAL | R 7 : 4 @ EUR 0.065 | Yes |
| FR | Small to Mid | 31-Oct-14 | 73294.01 | NUMERICABLE GROUP | R 15 : 7 @ EUR 17.82 | No |

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