Consultation on a specific methodology enhancement for the MSCI Global Investable Market Indices

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Executive Summary

- MSCI is considering the introduction of specific buffers aimed at reducing the probability of reverse turnover resulting from the re-assessment of the Segment Number of Companies at the time of the Semi-Annual Index Reviews (SAIRs) of the MSCI Global Investable Market Indices (GIMI).
- The proposed enhancement could potentially affect only the markets where the market coverage target is not attained.
- Specifically, the proposed size buffers intend to limit the increase in the Segment Number of Companies triggered by insufficient market coverage when this would result in the addition of companies with full market capitalization only marginally above the lower boundary of the Size Target Range set at 0.5 times the Global Minimum Size Range (GMSR). Similarly, the proposed enhancement intends to limit the decrease in the Segment Number of Companies triggered by excessive market coverage when this would result in the deletion of companies with full market capitalization only marginally below the upper boundary of the Size Target Range (1.15 time the GMSR).

Reminder on Size & Coverage Integrity

- In order to create size segments that can be meaningfully aggregated into composites, the individual Market Size Segments need to balance the following two objectives:
  - *Achieving Global Size Integrity* by ensuring that, within a given size segment of a composite index, only companies of comparable and relevant sizes are included across all markets. This can be measured by looking at a size segment cutoff relative to a free float-adjusted market capitalization coverage target based on the Global Investable Equity Universe.
  - *Achieving Consistent Market Coverage by* ensuring that each market's size segment is represented in its proportional weight in the composite universe. This can be measured by looking at a size segment cutoff relative to a consistent and comparable target size segment coverage within each market.

Reminder on Size & Coverage Integrity

- It is not possible to achieve both of these objectives consistently and simultaneously across all markets. Therefore, to balance these objectives, the methodology sets a minimum size cutoff for each size segment in each market using:
  - A size range for all markets derived from a free float-adjusted target market capitalization of the Global Investable Equity Universe, together with
  - A target free float-adjusted coverage range set within each individual Market Investable Equity Universe.

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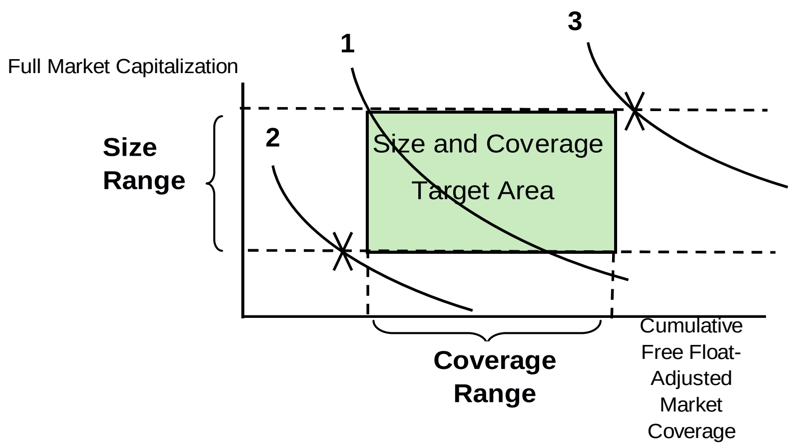
Reminder on Size & Coverage Integrity

- The intersection of these ranges specifies a Size and Coverage Target Area as depicted below. This is done for each of the three size segment indices, namely the Investable Market Index, the Standard Index, and the Large Cap Indices.
- Due to differences in the market structure each country would have a different size-coverage relationship. As shown below, the country size-coverage curve may or may not cross the Size and Coverage Target area.
  - If a country size-coverage relationship curve does not cross the Size and Coverage Target Area (curves 2 and 3 below), simultaneous size and coverage integrity is not possible for a given country
  - In the cases when simultaneous size and coverage integrity are not possible Size Integrity is treated with a higher priority. Consequently, countries lying on the curve which is on the left from the Size and Coverage Target Area would be under represented, while countries lying on the right from the Area would be over-represented.



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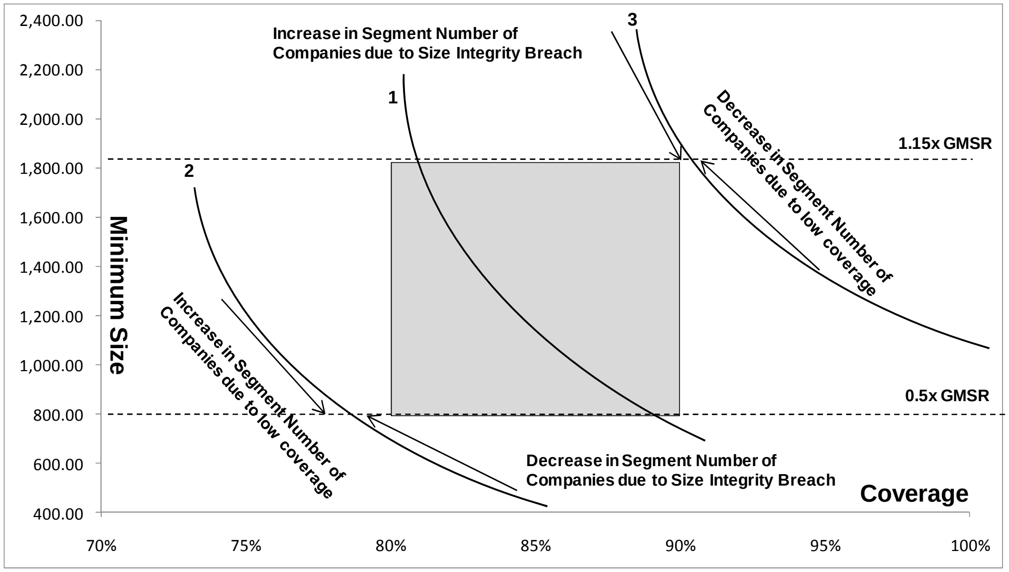
Possibility of Reverse Turnover

- In some instances when a country size-coverage curve does not cross the Size-Coverage Target Area there is a possibility of increased fluctuations in the Segment Number of Companies
- This may occur due to the fact that at the time of the Semi-Annual Index Reviews (SAIRs) low coverage results in additions to the Segment until the lower limit of the Global Minimum Size Range is reached. If at the subsequent SAIRs the Global Minimum Size Reference moves up relative to the country Size-Segment Cutoff, deletions in the Segment Number of Companies may be required. The symmetrically opposite may occur for the countries with a high coverage.



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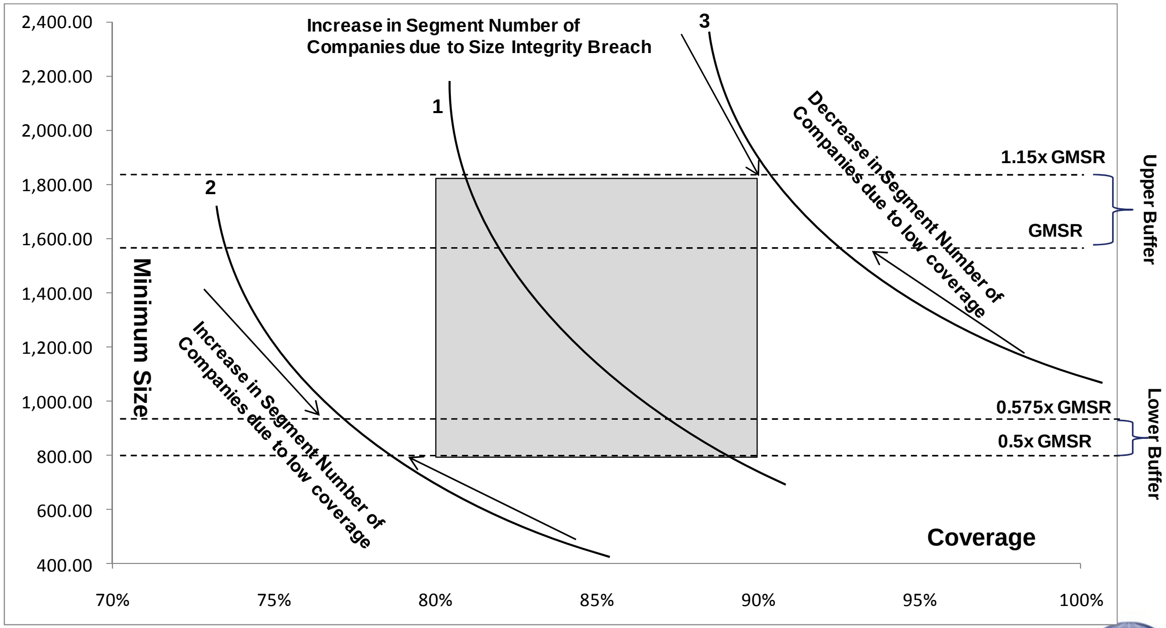
Proposal

- MSCI considers enhancing the current methodology by introducing a buffer at the upper and the lower bound of the Global Minimum Size Range (GMSR). These buffers would result in adding less companies in the under-represented countries and removing less companies in the over-represented countries, when adjustments to the Segment Number of Companies are required at the time of the SAIR due to low or high coverage.
- Such buffers would reduce the likelihood of reverse change in the Segment Number of Companies at the subsequent SAIRs due to fluctuation of the Country Size-Segment Cutoff relative to the Size & Coverage Target Area.



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Potential Impact

- There will be no impact from the proposed enhancement to the countries for which simultaneous size and coverage integrity can be found.
- At the time of the SAIRs countries located in the proposed buffer zones would not experience increase or decrease in the segment number of companies even if they do not comply with the coverage integrity.
- Countries located outside the coverage range and outside the proposed buffer zones are likely to experience smaller changes in the segment number of companies in comparison to the potentially required adjustments under the existing methodology.
- The proposed enhancement to the GIMI methodology would result in reduced fluctuation in the segment number of companies, however countries impacted by the enhancement may remain further from the target coverage range than under the existing methodology.

Discussion Points

- Is it acceptable to keep some countries more over or under represented for the benefit of lower fluctuation of the segment number of companies?
- Is the proposed buffer size appropriate?

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