



Consultation - Current Treatment of Spin-Offs where the Spun-Off Security Does Not Trade on the ex-date

OBJECTIVE

MSCI is consulting on the current treatment of spin-offs where the spun-off security does not trade on the ex-date, and where an indicative price is available.

BACKGROUND

Currently, in the cases of spin-offs, MSCI applies a Price Adjustment Factor (“PAF”) based on the terms of the spin-off event to the parent security on the ex-date when the ex-date coincides with the first trading day of the spun-off security. The spun-off security may or may not be added to the index on the close of its first trading day, depending on whether it meets the criteria for addition.

However, there have been several cases whereby the spun-off security is not traded on the ex-date. In such cases, the following describes MSCI’s current treatment:

- MSCI applies a PAF to the parent security based on $PAF = P(t-1) / P(t)$, *effectively freezing the performance of the security on the ex-date.*
- As of the close of the ex-date, a dummy security termed as the detached security is added to the same index family as the parent security, with the same number of shares, FIF/DIF, VIF and GICS. The price of the detached security will be the difference between the closing price of the parent on the cum-date and on the ex-date. This cum-ex price will be maintained until the spun-off security commences trading. *The market capitalization of the detached security therefore represents the market cap decrease of the parent security on the ex-date, and is a proxy for the market cap of the spun-off security.*
- At the open of the first trading day of the spun-off security, a PAF is applied to the detached security based on the terms of the spin-off event and the price of the spun-off security will be used for the detached security. *The detached security will show a performance on that day reflecting the difference between the cum-ex price and the actual price of the spun-off entity. The frozen performance on the ex-day is recovered on that day.*
- As of the close of the first trading day of the spun-off security, the detached security will be deleted from the indices and the spun-off security will be added (if applicable).

PROPOSAL FOR DISCUSSION

This consultation seeks feedback on whether to use an indicative price (when available) rather than the cum-ex price when a spun-off entity does not trade on the ex-date.

AN ILLUSTRATION - TELEFONICA SPINS OFF ANTENA 3

In the below illustration, the indicative price for the spun-off security was available in the company prospectus and a comparison is now made in terms of the treatment of the spin-off event.

Telefonica from Spain spun-off Antena 3. An indicative price of EUR25.2 was given for Antena 3.

The ex-date of the spin-off event was 22 Oct, 2003 and the first listing day of the spun-off security, Antena 3, was 29 Oct, 2003.

Terms of Spin-off : 1 Telefonica share: 0.0034 Antena 3 share
 Price of Telefonica 21 Oct, 2003 : EUR 10.62
 Price of Telefonica 22 Oct, 2003 : EUR 10.42
 Listing Price of Antena 3 share 29 Oct, 2003 : EUR 27.25

Comparison of Implementation between using Cum-Ex Price and Indicative Price

Implementation	Based on MSCI's Current Treatment (Using Cum-Ex Price)	Based on Alternative Treatment (Using Indicative Price)
PAF applied on Parent Security Telefonica on 22 Oct, 2003	$PAF = [P(t-1)] / [P(t)] = 1.0192$	$PAF = [P(t) + \text{Official Indicative Price} * \text{Spun Off Shares Issued} / \text{Shares Before}] / [P(t)]$ $= 10.42 + 25.2 * 0.0034 / 10.42$ $= 1.0082$
Price used for Detached Security Added on 23 Oct, 2003	Cum-Ex Price = EUR 0.2	Adjusted Indicative Price (based on spin-off terms) $= \text{EUR } 25.2 * 0.0034$ $= \text{EUR } 0.0857$
PAF applied on Detached Security on 30 Oct, 2003	PAF = 0.0034	PAF = 0.0034
Price of Antena 3 Added on 30 Oct 2003	EUR 28.75	EUR 28.75
Impact of Price used for Detached Security (Detached Security Market Cap/Index Market Cap as of 22 Oct, 2003)	0.42%	0.02%

Comparison of Spain Index Performance during period between 22 to 29 October, 2003

Date	Cum-Ex Price	Indicative Price
22-Oct-03	0.20%	0.48%
23-Oct-03	0.45%	0.45%
24-Oct-03	-0.15%	-0.15%
27-Oct-03	-0.92%	-0.92%
28-Oct-03	-0.26%	-0.27%
29-Oct-03	0.16%	-0.11%
30-Oct-03	-1.32%	-1.32%
Total	-1.83%	-1.84%

QUESTIONNAIRE

- 1) Based on the current MSCI treatment for a spun-off security that does not trade on the ex-date, do you have any feedback on the current implementation of the spin-off event with regards to the PAF applied on the parent entity?
- 2) If an official indicative price - defined as the expected market price of the spun-off entity on the first listing day given by the company or by the stock exchange - is available, how would you respond to using the official indicative price to determine the PAF applied on the parent entity and as the price of the detached security?
- 3) Presently, what do managers consider as a fair value of the spun-off entity not yet quoted? Do you use the cum-ex price as defined by MSCI or do you use other forms of an official indicative price (if available)?
- 4) Apart from the official indicative price given by the company or stock exchange, what other estimated prices (e.g., brokers' estimates, net asset values, net tangible asset, book values, etc.) would be acceptable to determine the PAF applied on the parent entity and as the price of the detached security?

Please note that this consultation is intended solely to obtain information from market participants and may or may not lead to any changes in MSCI's current index methodologies. If MSCI determines to make any change, MSCI will make a public announcement in advance of the change.

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