

**MSCI**

# Consultation

## **MSCI Consultation Paper on a Proposal to Remove the Limited Investability Factor (LIF) Currently Applied to the MSCI Taiwan Index**

**April 21, 2004.** MSCI is soliciting feedback on a proposal to remove in two phases the Limited Investability Factor (LIF) currently applied to the MSCI Taiwan Index. This paper provides details of the proposal and sets forth a series of questions for investors to provide MSCI with additional information and feedback. MSCI will announce its final decision regarding this proposal on or before June 18, 2004. Importantly, this decision may or may not result in any changes to the LIF currently applied to the MSCI Taiwan Index.

### **BACKGROUND**

On July 23, 2003, MSCI announced that it had opened a formal review of the impact on foreign investors of the set of changes in regulations announced by the Securities and Futures Commission of Taiwan, as well as to assess the extent of the remaining investment constraints on foreign investors.

Many market participants have highlighted to MSCI positive developments in recent years regarding foreign investment restrictions in Taiwan, including the recent elimination of the QFII system and its replacement by the new foreign investment registration system. Some concerns over the transparency of the new system remain due to the absence of publicly disclosed guidelines used by the authorities to accept or reject applicants that have indicated they engage in hedging strategies. However, generally under this new registration system, in place since October 2003, the speed and ease of applying for foreign investment status in Taiwan appear to have improved significantly.

At the same time, foreign institutional investors have indicated to MSCI that they are concerned by the persistence of some constraints that still encumber the investment process. These include, among others, pre-funding requirements, lack of mechanisms for the transfer of assets between sub-accounts, the 7% daily stock trading limit, as well as limitations on securities borrowing and lending activities. However, investors have indicated that these constraints (although some are unique to Taiwan) are not fundamentally different from difficulties encountered in other emerging market countries.

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# **MSCI** Taiwan LIF Consultation (continued)

## **MSCI'S PROPOSAL ON THE LIMITED INVESTABILITY FACTOR (LIF) FOR THE MSCI TAIWAN INDEX**

The following table summarizes MSCI's proposed changes to the LIF currently applied to the MSCI Taiwan Index, as well as an alternative proposal.

<b>Proposals</b>	<b>Description</b>	<b>Timeframe and Implementation of Changes</b>
<b>MSCI's Proposal</b>	<b>Complete Removal of LIF</b>	Phase 1: Increase the LIF from 0.55 to 0.75 in November 2004 Phase 2: Increase the LIF from 0.75 to 1 in May 2005
<b>Alternative Proposal</b>	<b>Partial Removal of LIF</b>	Phase 1: Increase the LIF from 0.55 to 0.75 in November 2004. Conduct further review after Phase 1 to assess whether a further increase in LIF is warranted

### **RATIONALE FOR MSCI'S PROPOSAL**

MSCI's proposal reflects the view that significant developments have taken place to relax foreign investment restrictions in Taiwan over the past few years. In particular, the cumbersome QFII registration and quota approval processes have been progressively softened, simplified and ultimately replaced with a much simpler registration system for Foreign Institutional Investors (FINIs). Market participants have not identified to us particular problems with this new FINI system during the six months it has been in existence. While other investment constraints continue to exist, their implications are not significantly different from those existing in other emerging markets and as such may not justify the maintenance of a LIF applied to the MSCI Taiwan Index.

### **RATIONALE FOR ALTERNATIVE PROPOSAL**

An alternative proposal would be to acknowledge by a first increase of the LIF to 0.75 that the liberalization efforts of the Taiwanese authorities have been material. However, a further increase or removal of the LIF would be conditional upon the outcome of a review of market participants' further experiences under the new framework and further improvements in the investment framework for foreign investors. This alternative proposal would provide additional time for market participants to continue to evaluate the new foreign investor framework. Under this alternative proposal, MSCI would increase the LIF from 0.55 to 0.75 in November 2004 and would continue to monitor market participants' feedback and developments in Taiwan to determine whether a further increase or removal of the LIF is warranted.

### **TO PROVIDE FEEDBACK:**

Comments should be submitted by June 1, 2004 using the attached questionnaire. Please return the questionnaire via e-mail to [consultation@msci.com](mailto:consultation@msci.com) or fax to (+65) 6834-6623.

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# **MSCI** Taiwan LIF Consultation (continued)

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## **Questionnaire on the Limited Investability Factor (LIF) Currently Applied to the MSCI Taiwan Index**

Please submit your response via either e-mail to [consultation@msci.com](mailto:consultation@msci.com) or fax to (+65) 6834-6623

### **Contact Details**

Name: \_\_\_\_\_ Title: \_\_\_\_\_

Organization: \_\_\_\_\_

Email: \_\_\_\_\_ Telephone: \_\_\_\_\_

### **Questions**

1. Do you think a removal of the LIF of 0.55 currently applied to the MSCI Taiwan Index is warranted?  
 Yes, fully (proceed to Q3)  
 Yes, but only partially (proceed to Q2)  
 No (proceed to Q2)
2. If you do not think a removal of the LIF is warranted or only a partial removal is warranted, please explain why and what additional areas in your opinion need to be addressed.
3. What in your view is the best way to implement any changes to the LIF currently applied to the MSCI Taiwan Index and what would be the most appropriate timing?
4. Are there any other comments you would like to share with MSCI regarding this topic?

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# MSCI Taiwan LIF Consultation (continued)

## APPENDIX

### Potential impact of increasing the weight of the MSCI Taiwan Index on the MSCI EM and MSCI Far East Ex Japan Indices

Tables 1 and 2 are provided for illustrative purposes only and show the pro-forma weights of various countries and regions in the MSCI EM and MSCI Far East ex Japan Indices, as of February 27, 2004, based on MSCI's proposed two-phase change to the LIF.

In addition, the two tables show the potential transition turnover in the MSCI EM and MSCI Far East ex Japan Indices that could result from the implementation of MSCI's proposed two-phase change to the LIF and the distribution of this turnover across the different constituent countries and regions.

Finally, note that the turnover data shown is specific to the current MSCI EM and MSCI Far East ex Japan Indices and is not indicative of the turnover in any other MSCI index.

As shown in Table 1, applying the proposed changes to the MSCI EM Index constituents would produce an estimated aggregate one-way index transition turnover of approximately 7.82% -- 3.72% in the first phase followed by 4.10% in the second phase (using data as of February 27, 2004).

TABLE 1: TAIWAN LIF IMPLEMENTATION IMPACT ANALYSIS ON MSCI EM INDEX IN 2 PHASES

	LIF = 0.55		LIF = 0.75			LIF = 1.00		
	Index Mcap USD mm	Index Weight	Index Mcap USD mm	Index Weight	One-way Index Turnover	Index Mcap USD mm	Index Weight	One-way Index Turnover
KOREA	170,244	18.87%	170,244	18.07%	0.40%	170,244	17.18%	0.44%
SOUTH AFRICA	118,618	13.15%	118,618	12.59%	0.28%	118,618	11.97%	0.31%
<b>TAIWAN</b>	<b>113,963</b>	<b>12.63%</b>	<b>154,090</b>	<b>16.35%</b>	<b>1.86%</b>	<b>202,604</b>	<b>20.45%</b>	<b>2.05%</b>
CHINA	74,632	8.27%	74,632	7.92%	0.18%	74,632	7.53%	0.19%
BRAZIL	75,383	8.35%	75,383	8.00%	0.18%	75,383	7.61%	0.20%
MEXICO	61,167	6.78%	61,167	6.49%	0.14%	61,167	6.17%	0.16%
INDIA	44,748	4.96%	44,748	4.75%	0.11%	44,748	4.52%	0.12%
RUSSIA	45,431	5.04%	45,431	4.82%	0.11%	45,431	4.58%	0.12%
MALAYSIA	42,608	4.72%	42,608	4.52%	0.10%	42,608	4.30%	0.11%
ISRAEL	34,743	3.85%	34,743	3.69%	0.08%	34,743	3.51%	0.09%
THAILAND	24,830	2.75%	24,830	2.63%	0.06%	24,830	2.51%	0.06%
CHILE	18,006	2.00%	18,006	1.91%	0.04%	18,006	1.82%	0.05%
INDONESIA	14,275	1.58%	14,275	1.51%	0.03%	14,275	1.44%	0.04%
TURKEY	14,568	1.61%	14,568	1.55%	0.03%	14,568	1.47%	0.04%
POLAND	11,216	1.24%	11,216	1.19%	0.03%	11,216	1.13%	0.03%
HUNGARY	9,322	1.03%	9,322	0.99%	0.02%	9,322	0.94%	0.02%
ARGENTINA	5,308	0.59%	5,308	0.56%	0.01%	5,308	0.54%	0.01%
CZECH REPUBLIC	4,964	0.55%	4,964	0.53%	0.01%	4,964	0.50%	0.01%
PERU	4,226	0.47%	4,226	0.45%	0.01%	4,226	0.43%	0.01%
PHILIPPINES	4,188	0.46%	4,188	0.44%	0.01%	4,188	0.42%	0.01%
EGYPT	2,351	0.26%	2,351	0.25%	0.01%	2,351	0.24%	0.01%
MOROCCO	2,075	0.23%	2,075	0.22%	0.00%	2,075	0.21%	0.01%
PAKISTAN	1,534	0.17%	1,534	0.16%	0.00%	1,534	0.15%	0.00%
JORDAN	1,495	0.17%	1,495	0.16%	0.00%	1,495	0.15%	0.00%
VENEZUELA	1,227	0.14%	1,227	0.13%	0.00%	1,227	0.12%	0.00%
COLOMBIA	1,137	0.13%	1,137	0.12%	0.00%	1,137	0.11%	0.00%
<b>EM</b>	<b>902,259</b>		<b>942,386</b>		<b>3.72%</b>	<b>990,900</b>		<b>4.10%</b>

Note: Data as of the close of February 27, 2004

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# MSCI Taiwan LIF Consultation (continued)

As shown in Table 2, applying the proposed changes to the MSCI Far East ex Japan Index constituents would produce an estimated aggregate one-way index transition turnover of approximately 9.96% -- 4.83% in the first phase followed by 5.13% in the second phase (using data as of February 27, 2004).

**TABLE 2: TAIWAN LIF IMPLEMENTATION IMPACT ANALYSIS ON AC FAR EAST ex JAPAN IN 2 PHASES**

	LIF = 0.55		LIF = 0.75			LIF = 1.00		
	Index Mcap USD mm	Index Weight	Index Mcap USD mm	Index Weight	One-way Index Turnover	Index Mcap USD mm	Index Weight	One-way Index Turnover
KOREA	170,244	26.47%	170,244	24.92%	0.78%	170,244	23.27%	0.83%
HONG KONG	134,269	20.88%	134,269	19.65%	0.61%	134,269	18.35%	0.65%
<b>TAIWAN</b>	113,963	17.72%	154,090	22.55%	2.42%	202,604	27.69%	2.57%
CHINA	74,632	11.60%	74,632	10.92%	0.34%	74,632	10.20%	0.36%
SINGAPORE	64,095	9.97%	64,095	9.38%	0.29%	64,095	8.76%	0.31%
MALAYSIA	42,608	6.63%	42,608	6.24%	0.19%	42,608	5.82%	0.21%
THAILAND	24,830	3.86%	24,830	3.63%	0.11%	24,830	3.39%	0.12%
INDONESIA	14,275	2.22%	14,275	2.09%	0.07%	14,275	1.95%	0.07%
PHILIPPINES	4,188	0.65%	4,188	0.61%	0.02%	4,188	0.57%	0.02%
<b>AC FAR EAST ex JAPAN</b>	<b>643,104</b>		<b>683,231</b>		<b>4.83%</b>	<b>731,745</b>		<b>5.13%</b>

Note: Data as of the close of February 27, 2004

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# **MSCI** Taiwan LIF Consultation (continued)

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