MSCI'S FEEDBACK ON ESMA CONSULTATION PAPER RELATED TO REGULATION (EU) 2016/1646

MSCI

July 2019

INTRODUCTION

MSCI appreciates the opportunity to comment on the consultation paper related to the Regulation (EU) 2016/1646, which specifies the main indices and recognized exchanges pursuant to paragraph 8 of Article 197 of the Capital Requirements Regulation (EU) 575/2013 (CRR).

ABOUT MSCI

MSCI is a leading provider of investment decision support tools to institutional investors globally, including asset managers, banks, hedge funds and pension funds. MSCI products and services include indexes, ESG research and tools, and portfolio risk and performance analytics. MSCI is headquartered in New York, with research and commercial offices around the world.

DRAFTNG NOTE

MSCI's flagship equity indexes include the MSCI Global Equity Indexes and MSCI has been calculating indexes for more than 50 years. MSCI Global Equity Index families include country and regional indexes, size indexes (large cap, small cap, and micro-cap), sector indexes, style (value/growth) indexes, strategy indexes, thematic indexes and ESG indexes. MSCI also calculates custom indexes at the request of clients, by applying client screens and constraints to MSCI Global Equity Indexes.

MSCI Global Equity Indexes are used worldwide by:

- assets owners to help them with their mandate decisions and with reviewing their managers' performance;
- active asset managers so that they can actively manage their funds against an index and report performance;
- passive fund managers to issue passive funds and ETFs based on the indexes;
- broker dealers for providing trading execution services, creating OTC and non-OTC derivative financial products and writing research more generally;
- stock exchanges to create equity index linked futures and options contracts; and
- CCPs to calculate the risks of its positions for index linked futures and options contracts.

During 2013 and 2014, MSCI implemented the IOSCO Principles, was externally audited during each of 2014, 2015 and 2016 for the MSCI equity indexes and select MSCI private real estate indexes and posted the adherence statements and audit reports on the Index Regulation page of www.msci.com. During 2017 and 2018, MSCI devoted those resources to implementing the BMR, and MSCI posted the IOSCO adherence statements on the Index Regulation page of www.msci.com.

On 5 March 2018, MSCI Limited, which is a UK subsidiary of MSCI Inc., was granted authorization by the UK FCA as a UK administrator under the EU benchmark regulation ("BMR") for all of the MSCI equity indexes. MSCI was the first major global equity index provider to become authorized under the BMR.

MSCI'S FEEDBACK

Question Number	Question	MSCI response
Q1	Do you agree with the calibration of the parameters specified in new methodology proposed by ESMA to select the main indices for the purpose of the ITS? Please provide a detailed feedback	MSCI welcomes the introduction of reduced size requirements under test "b" of Option B. Such change would allow broader indexes to become eligible for classification as "main indices". While MSCI agrees that it is critical to maintain relevant liquidity requirements, which are also part of MSCI Global Investable Market Index construction methodology and serves as a basis of construction the MSCI Country and Composite Indexes, MSCI suggests a different approach for the liquidity screening. The test "b" in the proposal aims at "capturing those indices that are composed predominantly of small cap stocks which have a minimum level of liquidity measured by the ADT". The proposed size requirements would positively enhance coverage of securities available for a potential use as collateral. However, the proposed liquidity requirements may to a large extent undermine this objective. Smaller securities often naturally have lower ADT due to their size. However, absolute holding amounts in less sizeable companies are generally smaller, thus requiring lower absolute volumes to trade efficiently.

		Therefore, for the purpose of index construction, MSCI prefers assessing liquidity relative to the size of a security. Under the MSCI Global Investable Market Indexes (GIMI) methodology, this is expressed as a ratio of a trading value over a security's free float-adjusted market capitalization (further details could be found in Section 2.2.5 of the MSCI GIMI methodology, available at https://www.msci.com/index-methodology). While the test "b" partially recognizes this effect by splitting securities into two size categories, MSCI believes this may not be sufficient and either: • more granular size/liquidity tiers may be appropriate, or • a relative measure of liquidity may be applied For example, the least liquid constituents of the MSCI USA Investable Market Index (IMI), covering both larger and smaller companies in the U.S., have an ADT of approximately EUR 150,000. Based on MSCI's relative liquidity criteria, that had been validated through consultations with market participants, small securities with ADT as low as EUR 45,000 may be considered as sufficiently liquid. While the proposed ADT threshold of EUR 500,000 may be appropriate for most securities with free float-adjusted market capitalization of approximately EUR 1,000,000,000 and above, this requirement may be too stringent for smaller securities, potentially significantly reducing the set of eligible securities and thus indexes.
Q2	Do you agree with the list of indices analyzed (please refer to the list provided in Table 6 in Annex V? If you believe that there should be additional indices to be	MSCI would like to seek clarification on how the list of indexes in Table 2 – List of indices, Table 5, and Table 6 and Table 7 in Annex V was populated. More specifically: - (1) How were the indexes selected for inclusion in the tables, and hence the

	considered, please provide details and also specify which test (and related methodology) they meet in order to qualify as main indices.	analysis? i.e. why the same set of criteria was not applied across all country and key composite indexes for all index providers? - (2) Why did some MSCI Equity Indexes not pass specific criteria (some examples are mentioned below)? - (3) Why were some of the MSCI Equity Indexes not selected as "main indices" among other indexes, while being broader? The MSCI All Country World Index (ACWI) covers all markets classified by MSCI as Developed or Emerging Markets. The index construction follows a "building block" approach, i.e. all constituents of the underlying MSCI Country Indexes are included in the relevant MSCI Composite Indexes which the countries are part of. Section 3.2.3 of the consultation document mentions that "ESMA could not retrieve the composition of the MSCI AC Europe & Middle East Index which as a consequence could not be assessed". MSCI would like to clarify that this index is a subset of the MSCI ACWI Index, already analyzed by ESMA. MSCI understands that the MSCI ACWI Index is considered as a "main index" under the both current and proposed methodologies. What is unclear is why most of the individual country components of this index were not included in the assessment. Only indexes such as the MSCI India Index, the MSCI Indonesia Index, MSCI Philippines Index, the MSCI South Africa Index as well as the MSCI Taiwan Index were included in Table 2. Based on MSCI's analysis, most, if not all MSCI Country Indexes included in the MSCI ACWI Index would pass the tests, particularly under test "a" of Option B. For example, it is unclear why the MSCI Taiwan Index fails test "a" under Option B, while based on MSCI's assessment as of July 1, 2019, the

		smallest security in the index by free float-adjusted market capitalization was above EUR 500,000,000. Similarly, based on MSCI's assessment, the MSCI Emerging Markets Index would meet the proposed tests, at the same time the MSCI EM 50 Index was selected instead, which is a narrow subset of the MSCI Emerging Markets Index, as well as the MSCI ACWI Index. Table 5 shows selected indexes, deemed broadest across regions/markets under the different options. It is unclear why the S&P 500 Index was selected, while the MSCI USA Index is broader (with 641 constituents as of July 1, 2019). Also, MSCI would like to clarify why IBOVESPA with 65 constituents was considered the most appropriate index for South America, while for example the MSCI EM Latam Index covering 118 names is broader. Similarly, FTSE RAFI Emerging Index has 357 constituents, while a potentially eligible MSCI Emerging Markets Index had 1,202 securities. Table 7 highlights that a number of MSCI Country Indexes which we believe would pass all the tests, such as the MSCI Emerging Markets Index, the MSCI Indonesia Index, the MSCI India Index, the MSCI Philippines Index and the MSCI South Africa Index. At the same time, they were not selected as they are "already included in the index", presumably because they are part of the already selected MSCI ACWI Index. However, it is unclear why the MSCI Russia Index considered as eligible, while also being a component of the MSCI ACWI Index. The MSCI Country IMI Indexes are broader as they include Small Cap securities. The MSCI ACWI IMI Index, for example, is a broader version of the MSCI ACWI Index. As per MSCI's assessment of the proposed methodology, most of the MSCI Country IMI Indexes would be ineligible, usually due to failing the liquidity tests. However, if the liquidity tests become less stringent in line with the suggestions made by MSCI for Question 1, some of the MSCI

		Country IMI indexes, such as the MSCI USA IMI Index, containing 2,463 constituents, could become eligible.

CONTACT US

clientservice@msci.com

AMERICAS

Americas	1 888 588 4567 *
Atlanta	+ 1 404 551 3212
Boston	+ 1 617 532 0920
Chicago	+ 1 312 675 0545
Monterrey	+ 52 81 1253 4020
New York	+ 1 212 804 3901
San Francisco	+ 1 415 836 8800
Sao Paulo	+ 55 11 3706 1360
Toronto	+ 1 416 628 1007

EUROPE, MIDDLE EAST & AFRICA

Cape Town	+ 27 21 673 0100
Frankfurt	+ 49 69 133 859 00
Geneva	+ 41 22 817 9777
London	+ 44 20 7618 2222
Milan	+ 39 02 5849 0415
Paris	0800 91 59 17 *

ASIA PACIFIC

China North	10800 852 1032 *
China South	10800 152 1032 *
Hong Kong	+ 852 2844 9333
Mumbai	+ 91 22 6784 9160
Seoul	00798 8521 3392 *
Singapore	800 852 3749 *
Sydney	+ 61 2 9033 9333
Taipei	008 0112 7513 *
Thailand	0018 0015 6207 7181 *
Tokyo	+ 81 3 5290 1555

* = toll free

ABOUT MSCI

For more than 40 years, MSCI's research-based indexes and analytics have helped the world's leading investors build and manage better portfolios. Clients rely on our offerings for deeper insights into the drivers of performance and risk in their portfolios, broad asset class coverage and innovative research.

Our line of products and services includes indexes, analytical models, data, real estate benchmarks and ESG research.

MSCI serves 99 of the top 100 largest money managers, according to the most recent P&I ranking.

For more information, visit us at www.msci.com.