

CONSULTATION ON ENHANCEMENTS TO THE MSCI ISLAMIC INDEX SERIES

February 2015

TABLE OF CONTENTS

- 03. Proposed Changes for Consultation
- 05. Proposal #1. Background
- 06. Proposal #1. Proposed Change
- 07. Proposal # 1. Potential Impact
- 08. Proposal #1. Timeline for Implementation
- 09. Proposal #1. Consultation Questions
- 11. Proposal #2. Background
- 12. Proposal #2. Proposed Change
- 13. Proposal # 2. Potential Impact
- 14. Proposal #2. Timeline for Implementation
- 15. Proposal #2. Consultation Questions

PROPOSED CHANGES FOR CONSULTATION

- Proposal #1: Clarification of Prohibited Activities in the Business Activity Screening to Include Interest Income.
 - Currently, the Business Activity Screening takes into account Sharia Investment Principles in that investments in companies that are directly active in or derive more than 5% of their cumulative revenue from non-Sharia compliant activities are considered non-compliant.
 - The proposal aims to include all Interest Income (i.e., operating and non-operating) in the calculation of the 5% prohibited income threshold.
- Proposal #2: Clarification of Total Earnings in the computation of the dividend adjustment factor.
 - The current methodology uses total earnings in the calculation of the dividend adjustment factor. In terms of implementation, the denominator used is based on gross operating income.
 - The proposal aims to align the calculation of the dividend adjustment factor to the Business Activity Screening (i.e., use total earnings as defined in proposal #1 for the denominator).
- This consultation may or may not lead to any changes to the MSCI Indexes or methodologies.

PROPOSAL #1: CLARIFICATION OF PROHIBITED ACTIVITIES TO INCLUDE INTEREST INCOME

BACKGROUND

- The MSCI Islamic Index Series Methodology currently applies Islamic Index Screens that follow Sharia investment principles, particularly business activity and financial ratios.
- On the Business Activity Screening, consistent with the Sharia Scrutiny Report, Sharia investment principles do not allow investment in companies that are directly active in, or derive more than 5% of their revenue (cumulatively) from non-Sharia compliant activities.
- Interest Income is currently not included in the list of non-Sharia compliant activities as part of the Business Activity Screening.
- While the Financial Screening already takes into account interest-bearing assets, including Interest Income in the Business Activity Screening would be aligned with treatment of excluding non-Sharia compliant activities.

PROPOSED CHANGE

- Clarification in the MSCI Islamic Index Series Methodology book, particularly under provision 2.1 Business Activity Screening.
- The proposal is to clarify the calculation of the percentage of prohibited income relative to total earnings as follows:
 - Revenue from prohibited activities including interest income all over total earnings. Total earnings include sales and interest income.
 - Interest income includes both operating and non-operating income.
 - Operating interest income will not be included if it is already reflected as part of revenue/ sales to avoid double counting.

POTENTIAL IMPACT

- The proposed treatment is **aligned** with Sharia investment principles.
- Upon implementation, this treatment will lead to the removal of current constituents that have income from prohibited activities (prohibited income, including interest income) greater than 5% of total earnings.
- In terms of impact, the following **Islamic** regional indexes may be affected: World, Emerging Market IMI, Frontier Markets, Pacific Small Cap, GCC Domestic IMI and GCC International ex Saudi Arabia IMI.
- MSCI's simulations based on information on Business Activity and Interest Income data as of the May 2014 Index Review showed an **incremental** one way turnover of less than 2% for the current World Islamic and EM Islamic IMI **resulting from this treatment**. The simulated results for the other regions also did not demonstrate a significant impact.*
- However, note that the ultimate turnover impact will depend on the updated Business Activity data as part of the May 2015 Index Review. It will likely vary from the simulated results.

*Please see disclaimers at the end of this presentation regarding simulated and back tested data.

TIMELINE FOR IMPLEMENTATION

- The consultation period is scheduled to end on March 13, 2015.
- If the proposed changes are adopted, implementation will start from the May 2015 Index Review.
 - Changes will coincide with the May 2015 Semi-Annual Index Review.
 - As a reminder, MSCI fully reviews the composition of the Islamic Indexes by applying the Business Activity Screening and the Financial Screening on an annual basis at the May Semi-Annual Index Review.

CONSULTATION QUESTIONS

- Do you agree with the proposed change?
- Are the changes in the calculation of prohibited income as a percentage of total earnings clear to you?
- Is the definition of total income (i.e., total earnings including sales and interest income) sufficiently defined?

PROPOSAL #2: CLARIFICATION OF TOTAL EARNINGS IN THE COMPUTATION OF THE DIVIDEND PURIFICATION FACTOR

BACKGROUND

- The MSCI Islamic Index Series incorporates Dividend Purification which is designed to reflect Sharia investment principles that state that income from prohibited activities must be deducted from a company's dividend and given to charity.
- This is done through the application of a dividend adjustment factor defined as follows:
[total earnings – (income from prohibited activities + interest income)] / total earnings.
- Total earnings are defined as gross income and interest income is defined as operating and non-operating interest income.
- In terms of implementation, MSCI uses prohibited income (including interest income) as the numerator versus operating income as the denominator.
- The enhancement is proposed in order to align the treatment on prohibited income wherein the denominator will be based on total earnings as proposed in Proposal #1 and further explained in succeeding slides.

PROPOSED CHANGE

- Clarification in the MSCI Islamic Index Series Methodology book, particularly under provision 2.3 Dividend Purification.
- MSCI will apply a “dividend adjustment factor” to all reinvested dividends.
 - The “dividend adjustment factor” is currently defined as: $(\text{total earnings} - (\text{income from prohibited activities} + \text{interest income})) / \text{total earnings}$.
 - Total earnings is defined as total revenues (including interest income) and interest income is defined as operating and non-operating interest.
 - MSCI will continue to review the “dividend adjustment factor” on an annual basis at the May Semi-Annual Index Review.

POTENTIAL IMPACT

- The proposed treatment on the “dividend adjustment factor” will be aligned with the framework for Business Activity Screening. That is, this treatment will enhance the comparability of the “dividend adjustment factor” to the Business Activity Screening results.
- Relative to the current implementation, this approach will generally have a tendency to generate higher adjustment factors.

TIMELINE FOR IMPLEMENTATION

- The consultation period is scheduled to end on March 13, 2015.
- If the proposed changes are adopted, implementation will start from the May 2015 Index Review.
 - Changes will coincide with the May 2015 Semi-Annual Index Review.
 - As a reminder, MSCI reviews the “dividend adjustment factor” on an annual basis at the May Semi-Annual Index Review.

CONSULTATION QUESTIONS

- Do you agree with the proposed change?
- Are the changes in the calculation of the “dividend adjustment factor” sufficiently explained?

CONTACT US

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

* = toll free

msci.com

clientservice@msci.com

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 *
Tokyo	81 3 5290 1555

NOTICE AND DISCLAIMER

This document and all of the information contained in it, including without limitation all text, data, graphs, charts (collectively, the "Information") is the property of MSCI Inc. or its subsidiaries (collectively, "MSCI"), or MSCI's licensors, direct or indirect suppliers or any third party involved in making or compiling any Information (collectively, with MSCI, the "Information Providers") and is provided for informational purposes only. The Information may not be modified, reverse-engineered, reproduced or disseminated in whole or in part without prior written permission from MSCI.

The Information may not be used to create derivative works or to verify or correct other data or information. For example (but without limitation), the Information may not be used to create indexes, databases, risk models, analytics, software, or in connection with the issuing, offering, sponsoring, managing or marketing of any securities, portfolios, financial products or other investment vehicles utilizing or based on, linked to, tracking or otherwise derived from the Information or any other MSCI data, information, products or services.

The user of the Information assumes the entire risk of any use it may make or permit to be made of the Information. NONE OF THE INFORMATION PROVIDERS MAKES ANY EXPRESS OR IMPLIED WARRANTIES OR REPRESENTATIONS WITH RESPECT TO THE INFORMATION (OR THE RESULTS TO BE OBTAINED BY THE USE THEREOF), AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, EACH INFORMATION PROVIDER EXPRESSLY DISCLAIMS ALL IMPLIED WARRANTIES (INCLUDING, WITHOUT LIMITATION, ANY IMPLIED WARRANTIES OF ORIGINALITY, ACCURACY, TIMELINESS, NON-INFRINGEMENT, COMPLETENESS, MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE) WITH RESPECT TO ANY OF THE INFORMATION.

Without limiting any of the foregoing and to the maximum extent permitted by applicable law, in no event shall any Information Provider have any liability regarding any of the Information for any direct, indirect, special, punitive, consequential (including lost profits) or any other damages even if notified of the possibility of such damages. The foregoing shall not exclude or limit any liability that may not be applicable law be excluded or limited, including without limitation (as applicable), any liability for death or personal injury to the extent that such injury results from the negligence or willful default of itself, its servants, agents or sub-contractors.

Information containing any historical information, data or analysis should not be taken as an indication or guarantee of any future performance, analysis, forecast or prediction. Past performance does not guarantee future results.

The Information should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. All Information is impersonal and not tailored to the needs of any person, entity or group of persons.

None of the Information constitutes an offer to sell (or a solicitation of an offer to buy), any security, financial product or other investment vehicle or any trading strategy.

It is not possible to invest directly in an index. Exposure to an asset class or trading strategy or other category represented by an index is only available through third party investable instruments (if any) based on that index. MSCI does not issue, sponsor, endorse, market, offer, review or otherwise express any opinion regarding any fund, ETF, derivative or other security, investment, financial product or trading strategy that is based on, linked to or seeks to provide an investment return related to the performance of any MSCI index (collectively, "Index Linked Investments"). MSCI makes no assurance that any Index Linked Investments will accurately track index performance or provide positive investment returns. MSCI Inc. is not an investment adviser or fiduciary and MSCI makes no representation regarding the advisability of investing in any Index Linked Investments.

Index returns do not represent the results of actual trading of investible assets/securities. MSCI maintains and calculates indexes, but does not manage actual assets. Index returns do not reflect payment of any sales charges or fees an investor may pay to purchase the securities underlying the index or Index Linked Investments. The imposition of these fees and charges would cause the performance of an Index Linked Investment to be different than the MSCI index performance.

The Information may contain back tested data. Back-tested performance is not actual performance, but is hypothetical. There are frequently material differences between back tested performance results and actual results subsequently achieved by any investment strategy.

Constituents of MSCI equity indexes are listed companies, which are included in or excluded from the indexes according to the application of the relevant index methodologies. Accordingly, constituents in MSCI equity indexes may include MSCI Inc., clients of MSCI or suppliers to MSCI. Inclusion of a security within an MSCI index is not a recommendation by MSCI to buy, sell, or hold such security, nor is it considered to be investment advice.

Data and information produced by various affiliates of MSCI Inc., including MSCI ESG Research Inc. and Barra LLC, may be used in calculating certain MSCI indexes. More information can be found in the relevant index methodologies on www.msci.com.

MSCI receives compensation in connection with licensing its indexes to third parties. MSCI Inc.'s revenue includes fees based on assets in Index Linked Investments. Information can be found in MSCI Inc.'s company filings on the Investor Relations section of www.msci.com.

MSCI ESG Research Inc. is a Registered Investment Adviser under the Investment Advisers Act of 1940 and a subsidiary of MSCI Inc. Except with respect to any applicable products or services from MSCI ESG Research, neither MSCI nor any of its products or services recommends, endorses, approves or otherwise expresses any opinion regarding any issuer, securities, financial products or instruments or trading strategies and MSCI's products or services are not intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Issuers mentioned or included in any MSCI ESG Research materials may include MSCI Inc., clients of MSCI or suppliers to MSCI, and may also purchase research or other products or services from MSCI ESG Research. MSCI ESG Research materials, including materials utilized in any MSCI ESG Indexes or other products, have not been submitted to, nor received approval from, the United States Securities and Exchange Commission or any other regulatory body.

Any use of or access to products, services or information of MSCI requires a license from MSCI. MSCI, Barra, RiskMetrics, IPD, FEA, InvestorForce, and other MSCI brands and product names are the trademarks, service marks, or registered trademarks of MSCI or its subsidiaries in the United States and other jurisdictions. The Global Industry Classification Standard (GICS) was developed by and is the exclusive property of MSCI and Standard & Poor's. "Global Industry Classification Standard (GICS)" is a service mark of MSCI and Standard & Poor's.