

# The Index Review Must Go On

Featuring: **Craig Feldman**, Global Head of Index Management Research

**Adam:** This is MSCI Perspectives. Your source for weekly research insights as investors respond to the COVID-19 pandemic. I'm your host Adam Bass. And today is May 14th, 2020. This week index reviews. It's what allows index providers to make adjustments to their indexes to make sure they still precisely reflect the investment universe. Given recent volatility, some investors were asking whether too much had changed too quickly for reviews to proceed. For answers about why MSCI went forward with their scheduled review and the methodology behind it, we spoke with Craig Feldman global head of index management research. Thanks for joining us, Craig.

**Craig:** Thanks for having me.

**Adam:** We're talking today about a routine event, but this pandemic has upended most routines. How's it been for you?

**Craig:** For my family, it's been nice because I obviously have my daughter home. Who's not, I'm not usually afforded the opportunity to be with every day. We eat together as a family, more consistently, which in normal workflow we never had the opportunity to do. And so it's been a really nice re-engagement in the family unit.

**Adam:** Some silver linings, for sure. But let's turn to the main topic MSCI semi-annual index review.

**Craig:** Yeah, sure. Maybe just to take a step back on an overall perspective of the maintenance of our global investible market indexes. We look to maintain them with a central objective of always trying to reflect the evolution of the underlying equity markets and the segments within those equity markets on a very, very timely basis. We're always looking to have continuity of our indexes while maintaining continuous investability of our constituents, the replicability of those indexes, and maintaining a stable index with low index turnover.

**Adam:** How did these reviews work?

**Craig:** Our general index review cycles on a quarterly basis. The semi-annual index reviews that occur in May and November, usually more impactful and more in depth across our global index offering, and that occurs when we update the indexes on the basis of a fully refreshed and reviewed investible equity universe as a whole. But we also look to take formulate buffer rules into consideration so that we mitigate migration of securities across size segments. And again, try to limit turnover. And again, ultimately it's to have this timely reconstitution of securities within our indexes to reflect the evolution of equity markets.

**Adam:** And the buffers exist to?

**Craig:** To control index turnover. We have multiple buffers that we put in place to try to restrict appropriately inclusion, exclusion, a migration of securities between size segments.

**Adam:** And restricting turnover can help keep transaction costs down for portfolios linked to a given index.

**Craig:** That's right.

**Adam:** What did turnover look like compared to past reviews?

**Craig:** The use of these buffers just to stay on that topic, within the most recent semi-annual index review in May, 2020 led turnover to be really in line with past semi-annual index reviews and relative market volatility, that was clearly increased, really had no significant impact on overall turnover, relative to other crisis and May semi-annual review period. So I think again, that points to, really the consistency and robustness of our methodologies in terms of managing these types of situations.

**Adam:** Given all the volatility we've seen the last few months, did you and your team ever consider postponing?

**Craig:** Postponing or the cancellation of any index review as really an exceptional and extreme type of scenario, and certainly not the rule. One of the things that have been continuous and robust throughout this process, and certainly through these more volatile and extreme times, has been the dimensions by which we view market conditions. One of them centrally functions on or focused on market functioning. The second facet focused on market liquidity, and the third on what we call data availability, which looks at both data quality and availability.

And as we made those assessments on those three dimensions, outside of a few markets that stayed closed, we really didn't see that the current impact of any market closures or anything idiosyncratic to a given market was enough to warrant, not proceeding with the index review, and the same went through for our assessment of overall market liquidity and the quality, consistency, and availability of the data that fuels the index review.

**Adam:** But there were some markets where you felt postponement made sense.

**Craig:** Yeah, sure. So we, in our announcement that we made, there were a few markets where we decided not to put forth any specific changes or restricted any changes from going through in the May SAR because these markets had prolonged stock closures. Those markets were Bangladesh, Jordan, and Sri Lanka. And the other market for which we noted exceptional treatment of not putting through changes that resulted from the May semi-annual review was in Nigeria. That in fact though, was due to deterioration of liquidity in its FX market.

**Adam:** For markets that did go through the process. What can you tell us about the results?

**Craig:** I think overall, the consistency of the methodology and what came through in terms of the index review, both in terms of turnover and results, wasn't necessarily overly exceptional. I think one thing maybe to note, without getting too specific at the company level was, clearly given the COVID-19 pandemic, you did see certain sectors, industries and sub-industries have a noted impact. In terms of either, performance upward or under performance, based on the industry and how it came through this, these initial months of the pandemic.

**Craig:** So certainly as companies rallied in certain sectors, whether it be healthcare or certain subsets of communications, and they met the investability and liquidity standards to be included, they were part of our additions. As other companies, whether it be in the airline sectors or others, that might've been more impacted on the downside, that was reflected as well in terms of some deletions from migrations between size segments.

**Craig:** So I think again, overall I think the consistency of what we expected in the review held, and I think one of the things that was, again, more event driven was with some of the results and how they correlated to some of the industries that were more impacted or not from the pandemic.

**Adam:** And as you mentioned earlier, the turnover was nothing unusual.

**Craig:** Correct.

**Adam:** Looking ahead to next month, MSCI will release the results of its annual market classification review. How does that one differ?

**Craig:** The market classification review and the accessibility review are both done on an annual cycle. The classification review something very, very central and visible for MSCI. And it really has to do with our market classification framework, in terms of how we classify markets into developed markets, emerging markets, or frontier markets, and below that, our standalone classification.

The review that we do in accessibility transcends into that classification review as well because, while we do look at the depth and breadth of the respective universes across the developed market, emerging market, and frontier market classifications, a lot of the focus review and due diligence has to do with market accessibility on a number of different fronts. To make sure that investors can obviously go in set up accounts, execute that there's not consistent intervention by government authorities, that there's no restrictive measures in the effects market or capital controls. And so as we review markets for potential, either a reclassification as an upgrade or downgrade, obviously we take those factors into account as per their methodology, and then make our announcement each successive June.

This June we'll be announcing, and we continue to consult right now with market participants on a potential reclassification of the MSCI Iceland index from standalone to frontier markets. And we also are consulting around the replicability and market classification of the MSCI Argentina indexes.

**Adam:** Consulting with market participants, how much has that changed?

**Craig:** Yeah, I think it's a great question. I mean, consultation and reach out to market participants is really a cornerstone of our philosophy here. It's the preface for any methodological directive change that we put forth. And certainly in market classification, it's one of the real high times for which we, research that is, go out on the road, speak to clients directly, get their feedback. And honestly it goes into our ultimate decisions on what we announce. in terms of the market classification review.

Obviously this year that'll be a little bit different given we won't go on the road necessarily and travel extensively, cross regionally to see our clients in person around some of these, but certainly, the continuity of the communication we maintained to them, the reach out we've done, gives us a lot of confidence that we'll be able to get the appropriate feedback from the appropriate clients, and give everyone a voice as they always have.

Anecdotally, it might be a better thing to not see them in person given the very prolific beard I have grown over the last two months, but all kidding aside, we feel competent we'll get the appropriate level and depth of feedback we always do.

**Adam:** So all in all, it sounds like despite all the upset routines of late, this index review was pretty much business as usual.

**Craig:** No, I mean, I think again, through managing through this index review has been exceptional, and in some circumstances, given the backdrop for which we did it. But I think ultimately again, the consistency and the robustness of our methodologies, the continuity for which they're applied, and our consistency as well of communication to be transparent with our client base through the entire process has really yielded a lot of positive benefits that we can take throughout this crisis and beyond.

**Adam:** That's all for this week. Thanks to Craig and to all of you for joining us. If you have a moment, be sure to leave a comment and subscribe so you can stay up to date on our latest episodes and insights. For more from MSCI check out our ESG Now Podcast with new episodes each Friday, and as always, you can follow us on the MSCI LinkedIn page, and please bookmark [www.msci.com/coronavirus](http://www.msci.com/coronavirus) for all our crisis related content. Until next week, I'm your host, Adam Bass. And this is MSCI Perspectives. Stay safe, everyone.

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