CONSULTATION ON CHINA A-SHARES INDEX INCLUSION ROADMAP

June 2016
EXECUTIVE SUMMARY

• In June 2016, MSCI announced that it will delay including China A-shares in the MSCI Emerging Markets Index and China A-shares will remain on the 2017 review list for potential inclusion into Emerging Markets.

• While the overall market accessibility of A shares has continued to improve over the past 12 months, the 2016 consultation feedback identified three remaining obstacles that need to be addressed:
  – Effective implementation of the QFII policy changes and removal of the 20% monthly repatriation limit
  – Effective implementation of new trading suspension treatment
  – Resolution of pre-approval requirements by the local exchanges on launching financial products

• MSCI does not rule out a potential off-cycle announcement should significant positive developments occur ahead of June 2017.
KEY HIGHLIGHTS OF 2017 PROPOSAL

MSCI is maintaining the proposal for a 5% partial inclusion of China A-shares into the MSCI Emerging Markets Index effective in June 2018 in one single phase.

The 5% partial inclusion approximates 1.1% weight of China A shares in the MSCI Emerging Markets Index.

• The Chinese authorities have demonstrated a clear commitment to bring the accessibility of the China A-shares market closer to international standards.

• Recent improvements in the accessibility of the China A-shares market include:
  – Resolution of the issues regarding beneficial ownership
  – Linking QFII Quota allocation to size of investors
  – Relaxation of capital mobility restrictions under the QFII scheme
  – Enhanced regulations on trading suspensions

• In addition, the Chinese regulators have also recently announced the expansion of RMB 250 billion RQFII quota to USA. The potential launch of the Shenzhen-Hong Kong Stock Connect is also expected to further improve the overall accessibility of China A-shares.
2016 CONSULTATION FEEDBACK

- Of the various issues highlighted, only the beneficial ownership issue is considered to have been satisfactorily resolved

<table>
<thead>
<tr>
<th>Highlighted Issues by MSCI</th>
<th>Status and Developments</th>
<th>Feedbacks from Market Participants</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beneficial Ownership</td>
<td>✓ Clarification on the beneficial ownership status of securities in QFII and RQFII (including separate accounts).</td>
<td>✓ International investors are generally satisfied with the clarification by the CSRC</td>
</tr>
</tbody>
</table>
| Quota Allocation Process, Capital Mobility Restrictions | ✓ Base quota is now linked to AUM ranging from US$20mn to US$5bn.  
  ✓ Base quota automatically obtained based on AUM through filing with SAFE  
  ✓ Repatriation for QFIIs (including separate accounts) shortened to daily | ❖ Feedback were generally positive however investors need more time to assess the effectiveness of the implemented changes  
  ❖ However, most investors viewed 20% monthly repatriation limit as problematic |
| Widespread voluntary suspension | ✓ Clarification of trading suspension policies from both Shanghai and Shenzhen Stock Exchanges.  
  ✓ Company can only apply for suspension after providing proper reasons and submitting necessary documents to the exchanges  
  ✓ Trading suspension ranges from 10 days to 5 months | ❖ Investors generally welcome greater clarity of the trading suspension rules  
  ❖ More time is needed to assess the effectiveness of the recently announced policy |
| Pre-approval requirements imposed by stock exchanges | ❖ Remain unaddressed | ❖ Institutional investors expressed strong concern over the pre-approval requirements and agreed that the issue needs to be satisfactorily resolved before the inclusion happens |
1. Effective implementation of the QFII policy changes and removal of the 20% monthly repatriation limit
   • Progress has been made on the QFII quota allocation and capital mobility issues but a period of observation on the effectiveness of implemented changes is still required
   • Positive experiences on quota applications by international investors, as well as seamless execution of daily capital repatriation
   • A complete removal or substantially increase the 20% monthly repatriation limit with a shorter repatriation horizon

2. Effective implementation of new trading suspension treatment
   • MSCI welcomes the implementation of the new trading suspension policies but a period of observation on the effectiveness of implemented changes is still required
   • Significant reduction of the number of suspended stocks on the Shanghai and Shenzhen exchanges

3. Resolution of pre-approval requirements by the local exchanges on launching financial products
   • Ability to launch financial products by any financial institution on any stock exchange internationally if these products are linked to indexes that include China A-shares
INDEX INCLUSION ROADMAP OF CHINA A-SHARES

Current Status

- China 26.0%
- Emerging Market
  - Others 16.8%
  - RU 3.8%
  - MX 4.1%
  - BR 6.5%
  - SA 7.2%
  - IN 8.4%
  - TW 12.3%
  - CHINA Overseas 5.0%

Partial Inclusion (5%)

- China 27.6%
- Emerging Market
  - Others 16.4%
  - RU 3.7%
  - MX 4.0%
  - BR 6.4%
  - SA 7.0%
  - IN 8.2%
  - TW 12.1%
  - CHINA A-Shares 1.1%
  - CHINA Overseas 5.0%

Full Inclusion (100%)

- China 40.0%
- Emerging Market
  - Others 13.6%
  - RU 3.1%
  - MX 3.3%
  - BR 5.3%
  - SA 5.8%
  - IN 6.8%
  - TW 10.0%
  - KR 12.0%
  - CHINA Overseas 4.2%

Data as of June 10, 2016

Timeline of Recent Developments

- Feb 2016
  - Linking QFII Quota allocation to size of investors
  - Relaxation of capital mobility restrictions under the QFII scheme

- May 2016
  - MSCI resumes consultation on China A-shares inclusion roadmap

- Jun 2016

  Remaining Obstacles:
  - Effective implementation of the QFII policy changes and removal of the 20% monthly repatriation limit
  - Effective implementation of new trading suspension treatment
  - Resolution of pre-approval requirements by the local exchanges on launching financial products
TRANSITION ANALYSIS

• If the partial inclusion proposal is accepted, the number of constituents in the MSCI China Index would increase from 150 to 620 with a majority of new constituents coming from A shares.  

• The estimated one way index turnover will be 7.7%, comparable to the first-phase transition of overseas listed China ADRs in November 2015.

<table>
<thead>
<tr>
<th>Current Standard</th>
<th>Pro forma (IF* = 5%)</th>
<th># Securities</th>
</tr>
</thead>
<tbody>
<tr>
<td>MSCI China A</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Weight</td>
<td># Sec</td>
<td>Weight</td>
</tr>
<tr>
<td>Large Cap</td>
<td>100%</td>
<td>66.7%</td>
</tr>
<tr>
<td>Mid Cap</td>
<td>33.3%</td>
<td>512</td>
</tr>
<tr>
<td>MSCI China A IMI</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Weight</td>
<td># Sec</td>
<td>Weight</td>
</tr>
<tr>
<td>Large Cap</td>
<td>100%</td>
<td>50.3%</td>
</tr>
<tr>
<td>Mid Cap</td>
<td>25.1%</td>
<td>512</td>
</tr>
<tr>
<td>Small Cap</td>
<td>24.5%</td>
<td>1167</td>
</tr>
<tr>
<td>MSCI China</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Weight</td>
<td># Sec</td>
<td>Weight</td>
</tr>
<tr>
<td>A Shares</td>
<td>0.0%</td>
<td>0</td>
</tr>
<tr>
<td>B Shares</td>
<td>0.3%</td>
<td>2</td>
</tr>
<tr>
<td>H Shares</td>
<td>39.9%</td>
<td>72</td>
</tr>
<tr>
<td>Red Chip</td>
<td>19.4%</td>
<td>30</td>
</tr>
<tr>
<td>P Chip</td>
<td>21.0%</td>
<td>33</td>
</tr>
<tr>
<td>Overseas#</td>
<td>19.4%</td>
<td>13</td>
</tr>
<tr>
<td>MSCI EM</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Weight</td>
<td># Sec</td>
<td>Weight</td>
</tr>
<tr>
<td>A Shares</td>
<td>835</td>
<td>-</td>
</tr>
<tr>
<td>MSCI EM (include LC only)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Weight</td>
<td># Sec</td>
<td>Weight</td>
</tr>
<tr>
<td>A Shares (include LC only)</td>
<td>835</td>
<td>-</td>
</tr>
</tbody>
</table>

Data as of June 10, 2016
1. The pro forma index constituents are based on the MSCI China A International Index.
1. What has been your experience with regards to:
   - The QFII policy relaxations with regards to quota allocation and capital mobility?
   - The change in regulation governing trading suspensions on the A shares market?

2. Do you see the 20% monthly repatriation limit as a road block to the inclusion?
   - Would the launch of the Shenzhen Stock Connect alleviate the 20% monthly repatriation issue?

3. Given the QFII quota is now linked to the asset size of investors and potentially sufficient to cater for a larger allocation, does a 5% initial inclusion still represent a reasonable proposal? Should MSCI consider a higher percentage for the initial inclusion?

4. Would you agree with the proposed one-phase transition plan and implementation timeline?
• MSCI is maintaining its proposal to include China A-shares in the MSCI China Index in steps starting with a partial Inclusion Factor of 5%
  – The inclusion in the MSCI China Index would be reflected in its corresponding composite indexes, including the MSCI Emerging Markets Index, simultaneously
  – The pro forma MSCI China Index would be constructed based on one integrated China equity universe comprising A-shares, B-shares, H-shares, Red-chips, P-chips and Overseas listed China companies
  – A 5% Inclusion Factor would be applied to the FIF-adjusted market capitalization of China A-shares in the pro forma MSCI China Index
  – The free float-adjusted market capitalization of China A-shares would be evaluated based on the Foreign Inclusion Factor (FIF) subject to a 30% Foreign Ownership Limit (FOL)
  – The implementation of this proposal would coincide with the May 2018 Semi-Annual Index Review
  – Any subsequent increase in the Inclusion Factor of China A-shares in the MSCI Emerging Markets would be subject to positive market liberalization developments and public consultation with market participants
• Please note that this proposal may or may not lead to any changes to the MSCI Indexes
FOR EXISTING MSCI CHINA A INDEX CLIENTS

- Existing clients who benchmarked to the MSCI China A Index can consider transitioning to the MSCI China A International Index. The index is available since 2015.
- In addition, MSCI proposes to maintain the MSCI China A Index as a domestic index for clients who wish to gain a deeper and broader access to the China A-share opportunity set.

  - Question: Does it make sense to disconnect the minimum size threshold with the MSCI Global Investable Market Indexes?

Data as of June 10, 2016
## KEY ACCESS CHANNELS TO CHINA A-SHARES

<table>
<thead>
<tr>
<th>Eligible Investors</th>
<th>RQFII</th>
<th>QFII</th>
<th>Stock Connect</th>
</tr>
</thead>
<tbody>
<tr>
<td>Institutional investors based in selected eligible locations</td>
<td>Institutional investors that meet certain operation and AUM requirements</td>
<td>All investors</td>
<td></td>
</tr>
<tr>
<td>Individual Quota: None</td>
<td>Base quota ranging from US$20 million to US$ 5 billion</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Application Process</th>
<th>RQFII</th>
<th>QFII</th>
<th>Stock Connect</th>
</tr>
</thead>
<tbody>
<tr>
<td>Need license (CSRC) and quota (SAFE) The process can range from weeks to months</td>
<td>• Applications for base quota will be filed with SAFE via onshore custodians • Applications for quota exceeding US$5 billion will be required to apply to SAFE directly for approval</td>
<td>N.A.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Capital Mobility</th>
<th>RQFII</th>
<th>QFII</th>
<th>Stock Connect</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Open-Ended Funds:</strong></td>
<td><strong>Others:</strong></td>
<td><strong>Open-Ended Funds:</strong></td>
<td><strong>Others:</strong></td>
</tr>
<tr>
<td>Lock-up: None</td>
<td>Lock-up: 1 year</td>
<td>Lock-up: 1 year</td>
<td>Lock-up: 1 year</td>
</tr>
<tr>
<td>Remit Period: None</td>
<td>Remit Period: 6 months</td>
<td>Remit Period: N.A.</td>
<td>Remit Period: 6 months</td>
</tr>
<tr>
<td>Others: Quota required to be used within 1 year upon approval</td>
<td>Others: Monthly repatriation cannot exceed 20% of NAV of previous year</td>
<td>Others: Monthly repatriation cannot exceed 20% of NAV of previous year</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Equity Coverage Universe</th>
<th></th>
<th></th>
<th>570+ stocks listed on Shanghai Stock Exchange</th>
</tr>
</thead>
<tbody>
<tr>
<td>All securities listed on Shanghai and Shenzhen Stock Exchanges</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
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