

# CONSULTATION ON A MARKET RECLASSIFICATION PROPOSAL FOR THE MSCI PAKISTAN INDEX

Potential Reclassification from Frontier to  
Emerging Markets

April 2016

# RECLASSIFICATION PROPOSAL

- MSCI proposes to reclassify the MSCI Pakistan Index from Frontier Markets to Emerging Markets
  - The proposed reclassification would be reflected in all relevant global and regional composite indexes
  - The proposal is to implement the potential reclassification in one step coinciding with the May 2017 Semi-Annual Index Review
- MSCI will consult with market participants on this reclassification proposal as part of the 2016 Annual Market Classification Review
  - MSCI will announce its decision in June 2016
- Please note that this proposal may or may not lead to any changes to the MSCI Indexes

# HISTORICAL BACKGROUND

- MSCI Pakistan Index was removed from MSCI Emerging Markets Index at the end of December 2008 following the deteriorated investability conditions prevailing in the Pakistani equity market. The index was classified as stand-alone
- As announced in February 2009
  - *Proposal to be included in the MSCI Frontier Markets Index*
- MSCI Pakistan was included in the MSCI Frontier Markets coinciding with the 2009 May Semi Annual Index Review
- As announced in June 2009
  - *The Pakistani equity market will need to function without any trading disruptions for some time as a condition to being considered for reclassification in Emerging Markets.*
- As announced in June 2010, not added to Review List for reclassification to EM
  - *Pakistani Market has returned to normal functioning since the removal of the “floor rule” in late 2008. However, the Pakistani Market was still characterized by a very limited number of sizeable securities and some holdover concerns on the institutional framework*
- As announced in June 2011
  - *MSCI Pakistan Index will not be added to the review list primarily due to the limited number of sizeable securities*

## RATIONALE FOR PROPOSAL

- The Pakistani equity market underwent a number of positive developments over the course of the past 12 to 18 months
- The Pakistani equity market has grown significantly and its liquidity has greatly improved over the past years
  - As a result, the concerns about the potential for failing to meet size and liquidity criteria should there be a negative market event have receded

# RECENT DEVELOPMENTS

- Launch of Pakistan Unified Corporate Action Reporting System (PUCARS) at Karachi Stock Exchange (KSE) – March 2014
  - PUCARS to provide an automated web-based announcement interface for listed issuers for sharing price sensitive information with market participants
- Restrictions on Negotiated Deal Market (NDM) transactions – April 2014
  - NDMs between a broker's proprietary account and a client sub-account as well as transactions between sub-accounts of different clients with the same broker will be blocked
  - These restrictions are aimed to prevent unauthorized movement of client securities via NDM transactions
- FII's to be taxed independently and are no longer exempted from withholding taxes (July 2014)
- Approval SME Regulations for Karachi Stock Exchange – January 2015
  - Draft regulatory framework for Private Equity is also in place
- Development of an Online Complaint Management System – March 2015

# MARKET ACCESSIBILITY

	Pakistan
<b>Openness to foreign ownership</b>	
Investor qualification requirement	++
Foreign ownership limit (FOL) level	++
Foreign room level	++
Equal rights to foreign investors	++
<b>Ease of capital inflows / outflows</b>	
Capital flow restriction level	++
Foreign exchange market liberalization level	+
<b>Efficiency of the operational framework</b>	
<b>Market entry</b>	
Investor registration & account set up	+
<b>Market organization</b>	
Market regulations	+
Competitive landscape	
Information flow	++
<b>Market infrastructure</b>	
Clearing and Settlement	+
Custody	++
Registry / Depository	++
Trading	++
Transferability	++
Stock lending	-/?
Short selling	-/?
<b>Stability of institutional framework</b>	-/?

- **Foreign Exchange Market Liberalization Level:** No offshore currency market and minor constraints on onshore currency market (e.g., buying and selling done through a Special Convertible Rupee Account)
- **Investor Registration & Account Setup:** Foreign investors are required to open a Special Convertible Rupee Account (SCRA) and obtain a UIN (Unique Identification Number). The registration of UIN takes around 3-4 days to complete
- **Market Regulations:** Regulations have frequently changed over the past few years. In particular, trading on the Pakistani equity market was practically suspended for five months following the implementation of a price floor rule in August 2008
- **Clearing and Settlement:** Nominee status and omnibus structures are available. Overdraft facilities remain prohibited
- **Stock Lending & Short Selling:** Foreign investors are not allowed to undertake short selling or stock lending and borrowing
- **Stability of Institutional Framework:** There have been instances of interventions that challenged the stability of the “free-market” economy as illustrated by frequently changing market regulations

# SIMULATED CONSTITUENTS CHANGE

## Number of Constituents

	Large Cap	Mid Cap	Standard	Small Cap	IMI
Frontier Markets	6	10	16	20	36
Emerging Markets	3	6	9	19	28

Data as of January 20, 2016

The simulation reflects the application of the Semi-Annual Index Review methodology, using either the Frontier Markets or Emerging Markets requirements

## Free Float Adjusted Market Capitalization (USD billion)

	Large Cap	Mid Cap	Standard	Small Cap	IMI
Frontier Markets	3.4	3.6	7.0	2.2	9.2
Emerging Markets	2.6	3.2	5.9	2.7	8.6

Data as of January 20, 2016

The simulation reflects the application of the Semi-Annual Index Review methodology, using either the Frontier Markets or Emerging Markets requirements

- The MSCI Pakistan Index would have 9 constituents under Emerging Markets, compared to 16 under Frontier Markets
  - The free float-adjusted market capitalization would be 16% lower under Emerging Markets

# SIMULATED INDEX CONSTITUENT LIST

Company	Full Mcap*	FIF Mcap*	FIF**	Size Segment
Oil & Gas Development	4.0	0.6	0.15	Large Cap
Habib Bank	2.5	1.0	0.4	Large Cap
MCB Bank	2.1	1.0	0.5	Large Cap
United Bank	1.7	0.5	0.3	Mid Cap
Lucky Cement	1.5	0.7	0.5	Mid Cap
Fauji Fertilizer	1.3	0.6	0.45	Mid Cap
Engro Corporation	1.3	0.6	0.45	Mid Cap
Hub-Power Co	1.1	0.4	0.35	Mid Cap
Pakistan State Oil Co	0.8	0.4	0.5	Mid Cap

Data as of January 20, 2016

The simulation reflects the application of the Semi-Annual Index Review methodology, using either the Frontier Markets or Emerging Markets requirements

\* USD billion

\*\* Foreign Inclusion Factor



# SIMULATED EMERGING MARKETS WEIGHTS

	Pro forma Standard Index		
	FIF Mkt Cap	Weight	# Sec.
<b>EM</b>	<b>3,016,197</b>	<b>100.00%</b>	<b>846</b>
<b>EM Asia</b>	<b>2,203,204</b>	<b>73.05%</b>	<b>562</b>
China	766,340	25.41%	155
Korea	486,659	16.13%	107
Taiwan	372,102	12.34%	88
India	272,498	9.03%	74
Malaysia	105,464	3.50%	44
Indonesia	84,534	2.80%	31
Thailand	66,270	2.20%	32
Philippines	43,473	1.44%	22
Pakistan	5,864	0.19%	9
<b>EM EMEA</b>	<b>461,336</b>	<b>15.30%</b>	<b>166</b>
South Africa	194,632	6.45%	55
Russia	96,382	3.20%	20
Poland	43,195	1.43%	25
Turkey	38,370	1.27%	23
Qatar	29,201	0.97%	13
United Arab Emirates	26,604	0.88%	11
Greece	12,841	0.43%	10
Hungary	8,911	0.30%	3
Egypt	5,905	0.20%	3
Czech Republic	5,293	0.18%	3
<b>EM Latin America</b>	<b>351,658</b>	<b>11.66%</b>	<b>118</b>
Brazil	157,903	5.24%	60
Mexico	133,970	4.44%	27
Chile	37,050	1.23%	19
Colombia	12,544	0.42%	9
Peru	10,192	0.34%	3

- The simulated MSCI Pakistan Index would have a potential weight of 0.19% in Emerging Markets

## KEY QUESTIONS

- Is it too early to consider the MSCI Pakistan for reclassification to Emerging Markets given the market's specific accessibility history?
- Are the potential decreases in number of constituents and index market capitalization problematic?
  - If yes, should it be a show stopper?
- Is the potential small weight of the MSCI Pakistan Index in Emerging Markets problematic?
  - If yes, what should be the minimum weight in global indexes that would warrant a reclassification?
- Are there any other market accessibility concerns that should prevent the reclassification?

# APPENDIX

# SIMULATED CONSTITUENT LIST

Company Name	Full Mcap	FIF Mcap	FIF	FM	EM
Oil & Gas Development	4,038	606	0.15	Large	Large
Habib Bank	2,480	992	0.40	Large	Large
MCB BANK	2,056	1,028	0.50	Large	Large
Pakistan Petroleum	1,974	197	0.10	Large	
K-Electric	1,848	92	0.05	Large	
United Bank	1,718	515	0.30	Large	Mid
Lucky Cement	1,494	747	0.50	Mid	Mid
Fauji Fertilizer Co	1,332	599	0.45	Mid	Mid
Engro Corporation	1,315	592	0.45	Mid	Mid
Hub-Power Co	1,096	384	0.35	Mid	Mid
National Bank Pakistan	1,074	269	0.25	Mid	Small
Pakistan State Oil Co	802	401	0.50	Mid	Mid
Indus Motor Company	779	156	0.20	Mid	Small
Fatima Fertilizer	761	152	0.20	Mid	Small
Pakistan Telecom	729	65	0.12	Mid	
Kot Addu Power Company	654	196	0.30	Mid	Small
Fauji Cement Co	487	211	0.45	Small	Small
Dawood Hercules Corp	486	97	0.20	Small	Small
Packages	481	144	0.30	Small	Small
Pakistan Oilfields	429	129	0.30	Small	Small
Fauji Fertilizer Bin Qas	428	107	0.25	Small	Small
Searle Pakistan	420	189	0.45	Small	Small
Maple Leaf Cement	414	145	0.35	Small	Small
Bank Alfalah	410	164	0.40	Small	Small
Pak Suzuki Motor Co	399	100	0.25	Small	Small
Kohat Cement	353	106	0.30	Small	Small
Attock Petroleum	344	69	0.20	Small	
Nishat Mills	322	113	0.35	Small	Small
Ferozesons Laboratories	317	158	0.50	Small	Small
Sui Southern Gas Co	274	55	0.20	Small	
Igi Insurance	273	95	0.35	Small	Small
Askari Bank	246	61	0.25	Small	
Shell Pakistan	239	48	0.20	Small	
Pak Elektron	236	83	0.35	Small	Small
Millat Tractors	208	93	0.45	Small	Small
National Refinery	172	43	0.25	Small	

- Only 1 company has a free float adjusted market capitalization of more than USD 1 billion
- Large Cap companies are in general exhibiting low free float
- 4 Mid Cap companies would be migrating to the MSCI Pakistan Small Cap Index

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