CONSULTATION ON SPECIFIC TOPICS RELATED TO CHINA A RECLASSIFICATION

August 8, 2017
INTRODUCTION

- MSCI announced on June 20 that it will include China A Large Cap shares* in the MSCI Emerging Markets Index using a 2-step inclusion process beginning in June 2018.

- MSCI is now launching a consultation on the following specific topics:

  1. Transition plan for existing China A Indexes
  2. Implementation of index changes in the event of a “Connect” market closure or a daily limit breach and IPO treatment
  3. Enhancing the treatment of suspensions in all indexes including China A shares
  4. Treatment of MSCI Factor, Thematic, ESG or Capped Indexes ("Derived Indexes") in the context of China A shares inclusion

- MSCI welcomes feedback from the investment community on the proposal. MSCI welcomes feedback from the investment community until September 29, 2017. This consultation may or may not result in the changes in the MSCI Global Investable Market Indexes.

* 222 A shares as of July 31, 2017. The number may change due to regular index reviews and corporate events maintenance.
TRANSITION OF EXISTING CHINA A INDEXES
ENHANCING CHINA A INDEX OFFERING

• MSCI proposes to enhance the China A index offering by:
  – Launching new indexes covering only stocks accessible through “Stock Connect”, which would be named “MSCI China A Indexes”
  – Launching the “MSCI China A Inclusion Index”, designed to track progressive inclusion of A shares in Emerging Markets over time
  – Rename the current “MSCI China A Indexes”, which are providing China A exposure from domestic perspective, to “MSCI China A Domestic Indexes”

• The MSCI China A International Indexes would continue to represent the A share component of the MSCI Emerging Markets benchmark based on an unlimited access to the onshore Chinese domestic equity market
POTENTIAL TRANSITION OF EXISTING CHINA A INDEXES

Current

- China A
- China A International
- China A Intl LC Prov.

Proposed

- China A Domestic
- China A International
- China A LC Prov.
- China A Inclusion

June 2018

- Discontinued

Description

**MSCI China A Domestic Indexes**
- Stand alone domestic index offering broad exposure to China A shares

**MSCI China A International Indexes**
- Potential A shares components of the MSCI Emerging Markets based on unlimited market access to A shares

**MSCI China A Large Cap Provisional Index**
- Index reflecting A shares to be added to Emerging Markets in June 2018

**MSCI China A Inclusion Index**
- Pro-forma A shares components of the MSCI EM Index post initial inclusion
- Further inclusion of A shares will be reflected at the time of the implementation

**MSCI China A Indexes**
- Full suite of indexes built on the basis of the MSCI China A International Indexes, reflecting the Stock Connect constraints

Launch of the new indexes

- Connect compatible
- Reflect the A shares in MSCI EM overtime

Launch of the new indexes

- Connect compatible
- Full Suite (L,M,S), Sectors, Factors

*The China A Large Cap Index will have the same index composition as the China A Inclusion Index before further A shares inclusion to EM.*
CHINA A OFFERING ROADMAP

June 2018
(addition of Large Caps on Connect)

20XX
(addition of Mid Caps on Connect)

20XX
(Full Inclusion)

China A International

China A International

China A

China A

China A Inclusion

China A Inclusion

MSCI
**KEY DATES**

- **August 2017**
  - Launch of global and regional provisional indexes

- **Q4 2017**
  - Announcement of the final corporate events and suspensions methodology as well as the final transition plan
  - Implementation of the methodology changes and the transition plan*

- **June 2018**
  - Inclusion of A shares in the MSCI Emerging Markets Index with an inclusion factor of 2.5%

- **September 2018**
  - Increase in the inclusion factor to 5%

* The final date and scope of the changes will be confirmed after the consultation is closed.
CORPORATE EVENTS AND INDEX REVIEW MAINTENANCE OF STOCK CONNECT SECURITIES
• In order to reflect accessibility of securities trading on Stock Connect and keep MSCI Indexes replicable, methodologies need to be enhanced in order to accurately reflect the investment process of Stock Connect investors.

• MSCI will generally implement corporate events as per the current Corporate Events Methodology for all types of events except for cases when Stock Connect is closed but the onshore Chinese domestic market* is trading.

• MSCI will enhance the current prolonged suspension treatment applied to Chinese securities by transitioning from monthly to daily evaluation and immediate deletion from MSCI Indexes.

* Onshore markets pertains to Shanghai and Shenzhen Stock Exchanges where domestic China A shares are listed.
REFLECTING MARKET CLOSURE OF STOCK CONNECT

Onshore market and Stock Connect is open/closed concurrently

Market Neutral & Non Market Neutral Events

NO CHANGE
(Implementation as per current CE Methodology)

Onshore market -> Trading Stock Connect -> Closed

Market Neutral Events

NO CHANGE
(Implementation as per current CE Methodology)

Non Market Neutral Events

CHANGE
(Postpone/Prepone Implementation)

Note:
CE – Corporate Events
Market neutral events – Do not trigger a change in index weight of the impacted security
Non-Market neutral events – Typically result in changes in index weight / index membership. Portfolio adjustment is required to replicate the index change.

More details on the next slide
## PROPOSAL FOR NEUTRAL & NON-NEUTRAL EVENTS

<table>
<thead>
<tr>
<th>Type of events</th>
<th>Market Neutral Events</th>
<th>Non-Market Neutral Events*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Events covered</td>
<td>✓ Stock Dividend ✓ Split ✓ Consolidation ✓ Redemption ✓ PAF due to Buyback ✓ PAF due to Partial Acquisition ✓ Rights Issue of non-trading asset (PAF of 1) ✓ Special dividend and capital repayment**</td>
<td>✓ Rights Issue of common shares ✓ Spinoff ✓ Merger ✓ Conversion</td>
</tr>
<tr>
<td>Proposed Implementation</td>
<td>Implement events on their “ex” date irrespective of Stock Connect Closure</td>
<td>When Stock connect is closed -&gt; Ex date is postponed to the next trading day of Stock connect. Previous day's price is carried forward for the security.</td>
</tr>
<tr>
<td>Ex/Effective date of events</td>
<td>Ex-date for both Onshore and Stock connect securities will be same</td>
<td>In this case, Ex date will be different for Onshore and Stock connect securities</td>
</tr>
</tbody>
</table>

### Discussion:
- Should MSCI postpone the implementation of market neutral events too?
- Do you foresee any issues with the proposal for Market neutral and Non-Market neutral?

* PAF events require the application of price adjustment factors while Non-PAF events do not
** Similar to the proposed treatment for cash dividends as explained in the next slide
PROPOSAL FOR CASH DIVIDENDS

Reinvestment – Same (above) treatment for cash dividend, special dividend and capital repayment
Exchange Rate for Reinvestment – Stock Connect securities dividend reinvestment will happen using Offshore exchange rate (CNH) instead of onshore exchange rate (CNY)

Discussion:
- Is such treatment for reinvestment on ex-date replicable?
IPO: Defer addition to the regular index reviews

- “Stock Connect” investors cannot participate in primary offerings
- Eligibility (Inclusion) to “Stock Connect” may not coincide with Onshore exchange
- All IPO securities will be reviewed for addition at subsequent Index Review according to methodology
- Discussion: Should MSCI consider early inclusion for Stock Connect securities?

Other Early Inclusion Events: Addition at the time of the event

- Events such as spinoff, merger, acquisition, etc. except IPO, would lead to addition to the index at the time of event if:
  1. Security satisfies the inclusion criteria as defined in MSCI methodology, and
  2. The eligibility (inclusion) to "Stock Connect" is announced on or before the day of sending “Confirmed” corporate event announcement for the relevant event
Stock Connect daily limit breached on the effective implementation date:

- Daily limit breach of Stock Connect can happen anytime during the trading session

- Given the uncertainty of the timing, MSCI proposes **NOT** to postpone the implementation of corporate events and Index Review changes for Stock Connect A shares when the Stock Connect daily limit is breached on the effective implementation date

- **Discussion:**
  - Do you agree with not postponing the implementation of index review changes and corporate events?
Closure of Stock Connect on an Index Review implementation date:

- Postpone the implementation of Index Review changes for Stock Connect A shares when the Stock Connect is closed on the effective implementation date of the Index Review.
- The postponed Index Review changes will be implemented two days after the next Stock Connect trading day.
- **Discussion:** Should MSCI postpone or prepone the implementation of index review changes?
SUSPENSION TREATMENT
PROPOSAL: PROLONGED SUSPENSION

- MSCI proposes to monitor Chinese securities (including A shares, B shares, H shares, P Chips, Red Chips and foreign listings) under prolonged suspension on a daily basis and delete them by giving 2 business days’ notice as soon as suspension reached 50 business days even if the security has pending corporate event
  - This proposal is different compared to the current process wherein all suspended securities are evaluated once a month and deleted at month-end

- Contrary to the current methodology*, MSCI also proposes to delete these securities irrespective of reason for suspension, e.g., even securities with pending corporate event will be deleted

- Discussion:
  - Should MSCI consider putting an exception and not delete the securities for the following instances?
    - If the security is suspended pending regulatory approval or other reasons to complete the event (For example – in acquisition, company waiting to get the delisting approval) and/or
    - If the event for the security is already announced and/or partially implemented by MSCI

* In general, MSCI deletes securities that exceed the prolonged suspension thresholds (50 business days) on the last business day of each month regardless of the reasons for suspension, except for securities pending corporate events, which are kept in the indexes. Currently, MSCI considers “restructuring” as a corporate event for A-shares.
### SIMULATED IMPACT FOR THE EXISTING INDEXES

<table>
<thead>
<tr>
<th>Index</th>
<th>Current Index Market Cap</th>
<th>Current Index # Sec.</th>
<th>Pro forma Index Market Cap</th>
<th>Pro forma Index # Sec.</th>
<th># Securities</th>
<th>One Way Index Turnover*</th>
</tr>
</thead>
<tbody>
<tr>
<td>MSCI China A Index</td>
<td>1,772,225</td>
<td>875</td>
<td>1,723,021</td>
<td>843</td>
<td>0</td>
<td>32</td>
</tr>
<tr>
<td>MSCI China A International Index</td>
<td>966,770</td>
<td>459</td>
<td>940,625</td>
<td>441</td>
<td>0</td>
<td>18</td>
</tr>
</tbody>
</table>

Note: All market caps are in USD millions. Data as of the close of July 18, 2017

### MSCI China A Small Cap Index

<table>
<thead>
<tr>
<th>Index</th>
<th>Current Index Market Cap</th>
<th>Current Index # Sec.</th>
<th>Pro forma Index Market Cap</th>
<th>Pro forma Index # Sec.</th>
<th># Securities</th>
<th>One Way Index Turnover*</th>
</tr>
</thead>
<tbody>
<tr>
<td>MSCI China A Small Cap Index</td>
<td>505,170</td>
<td>1,262</td>
<td>480,435</td>
<td>1,216</td>
<td>0</td>
<td>46</td>
</tr>
<tr>
<td>MSCI China A International Small Cap Index</td>
<td>429,975</td>
<td>1,561</td>
<td>409,680</td>
<td>1,504</td>
<td>0</td>
<td>57</td>
</tr>
</tbody>
</table>

Note: All market caps are in USD millions. Data as of the close of July 18, 2017
MSCI proposes to implement the following suspension treatment for the MSCI China A Indexes, the MSCI China All Shares Indexes and the MSCI China Indexes (starting from the inclusion of A shares in May 2018 SAIR):

**Exclude non-constituent A shares suspended for more than 50 business days in the past 12 months from the investable equity universe:**

- A share securities that are currently not constituents of the Investable Market Indexes and had suspended for more than 50 days in the past 12 months would be excluded from the investable equity universe at the time of an Index Review
  - The 50 business days threshold is consistent with the current prolonged suspension treatment
  - The 12 months seasoning period is in-line with existing treatment for securities deleted due to Foreign Room issue and Ineligible Alert Board

- **Discussion:** Should MSCI further tighten the threshold for suspension, i.e., increasing the 12 months seasoning period and / or decreasing number of days for suspension? *

**Not implement index inclusion changes for Chinese securities suspended on the Index Review Price Cutoff date:**

- MSCI propose not to implement any additions or migrations between size-segment for companies that are suspended on the Index Review Price Cutoff date
  - Status of such companies in the MSCI Indexes prior to the index review would be maintained

*Simulations on the next slide*
FURTHER TIGHTENING OF SUSPENSION THRESHOLDS?

• Given a relatively high number of suspensions in China A compared to other markets, should even further tightening of the suspension thresholds be considered?

• Further tightening of the thresholds might improve investability of index and minimize potential liquidity risk resulting from prolonged suspension, but at the expense of index representation
  – Reducing the acceptable number of suspension days for index constituents may result in exclusion of securities with pending corporate events, which are otherwise not suspended
  – Increasing the seasoning period may delay the inclusion of certain securities when the suspension situation has been improved

<table>
<thead>
<tr>
<th>No. of Constituents</th>
<th>No. of suspension days</th>
<th>50</th>
<th>40</th>
<th>30</th>
<th>20</th>
<th>10</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>12-month seasoning period</td>
<td>222</td>
<td>221</td>
<td>219</td>
<td>211</td>
<td>196</td>
<td>175</td>
<td></td>
</tr>
<tr>
<td>Index weight in EM</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>12-month seasoning period</td>
<td>0.73%</td>
<td>0.73%</td>
<td>0.72%</td>
<td>0.70%</td>
<td>0.66%</td>
<td>0.60%</td>
<td></td>
</tr>
<tr>
<td>24-month seasoning period</td>
<td>0.60%</td>
<td>0.65%</td>
<td>0.64%</td>
<td>0.57%</td>
<td>0.49%</td>
<td>0.39%</td>
<td></td>
</tr>
</tbody>
</table>

Simulated impact on the A shares inclusion in EM under various suspensions thresholds

Data as of June 19, 2017
TREATMENT OF THE DERIVED INDEXES
PROPOSAL FOR IMPLEMENTATION IN MSCI FACTOR, THEMATIC, ESG & CAPPED INDEXES (DERIVED INDEXES)

• China A securities in the MSCI GIMI Indexes will be weighted based on the partial inclusion factor applied on their free-float adjusted market capitalization

• The MSCI Factor, Thematic, ESG and Capped Indexes (derived Indexes) will use the above adjusted Parent Index weights (post application of the partial inclusion factor) while applying all aspects of their specific rebalancing methodology
  – Indexes that include the application of optimization constraints based on Parent Index Weights (for example – in MSCI Minimum Volatility Indexes, the constituent weight is limited to 20x the Parent Index Weight) will use the adjusted Parent Index Weights for applying the constraints
  – Indexes that use the Parent Index Constituent weight for sorting (for example – in the MSCI ESG Leaders Indexes, for constituents with same ESG rating and score, the Parent Index weight is used to determine the rank) will use the adjusted Parent Index Weights for ranking securities

• The weights resulting from the rebalancing of the derived indexes will not be adjusted further to account for the partial inclusion criteria for China A securities

• This treatment may result in active weights for China A securities in some indexes where the constituent weight is not linked to the Parent Index Weight (for example: MSCI Equal Weighted Indexes), however, it ensures the consistent application of the corresponding methodology in all indexes*

• All valuation ratios used in the derived indexes methodologies (e.g. dividend yield, P/E, etc.) will be based on the offshore CNH rate

*For example: The overall weight of China after partial inclusion of China A shares will be 12.5% (including 8% China A shares) compared to the current weight of China at 6.03% in the MSCI ACWI Equal Weighted Index. Data as of June 19, 2017.
APPENDIX
**Index Features**

- Domestic benchmark
- Broad exposure
- Domestic Inclusion Factor
- Onshore CNY rate

- A Shares full inclusion scenario
- Foreign Inclusion Factor
- Onshore CNY rate

**Current**

- China A

**Proposed**

- China A Domestic

- China A International

- China A

**Index Features**

- Domestic benchmark
- Broad exposure
- Domestic Inclusion Factor
- Onshore CNY rate
- New Suspension Treatment

- A shares full inclusion scenario
- Foreign Inclusion Factor
- Onshore CNY rate
- New suspension treatment

- China A International Indexes reflecting Connect constraints
  - Foreign Inclusion Factor
  - Stock Connect compatible
  - New suspension treatment
  - Offshore CNH rate

- A shares components in EM
  - Foreign Inclusion Factor
  - Stock Connect compatible
  - New suspension treatment
  - Offshore CNH rate

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*Note for the MSCI China A Inclusion Index:

- Index history would be created based on the MSCI China A International Large Cap Index with the enhanced suspension treatment applied*
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