

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

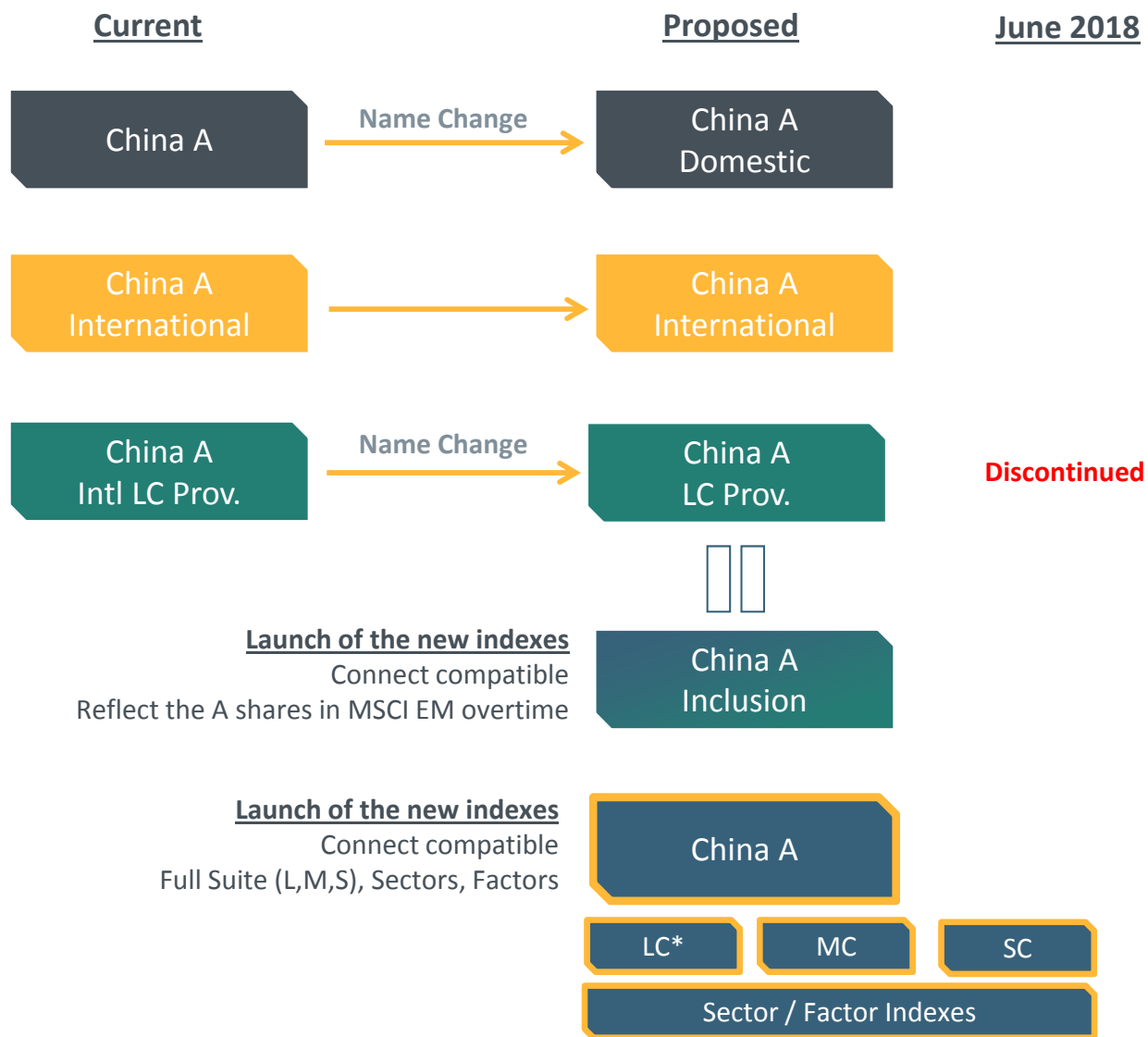
* 222 A shares as of July 31, 2017. The number may change due to regular index reviews and corporate events maintenance

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



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

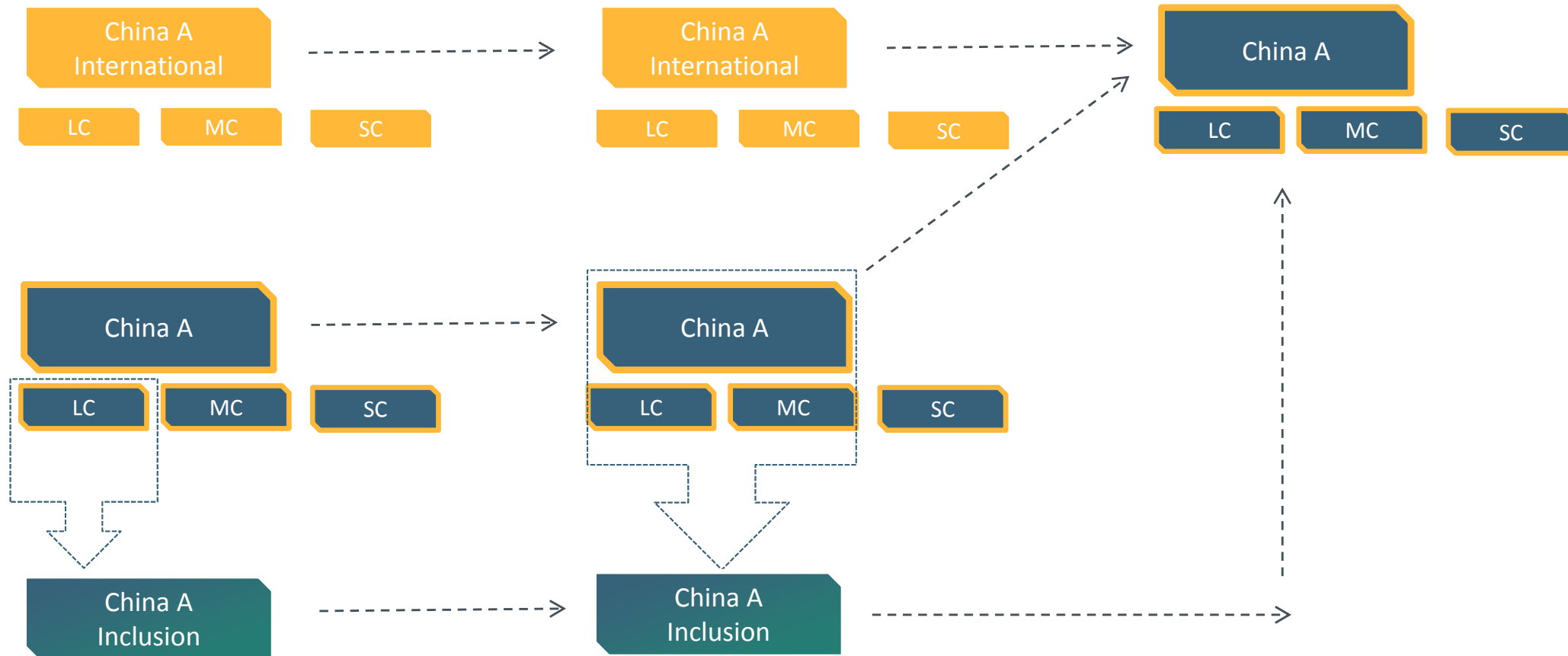
* The China A Large Cap Index will have the same index composition as the China A Inclusion Index before further A shares inclusion to EM

CHINA A OFFERING ROADMAP

June 2018
(addition of Large Caps on Connect)

20XX
(addition of Mid Caps on Connect)

20XX
(Full Inclusion)



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%

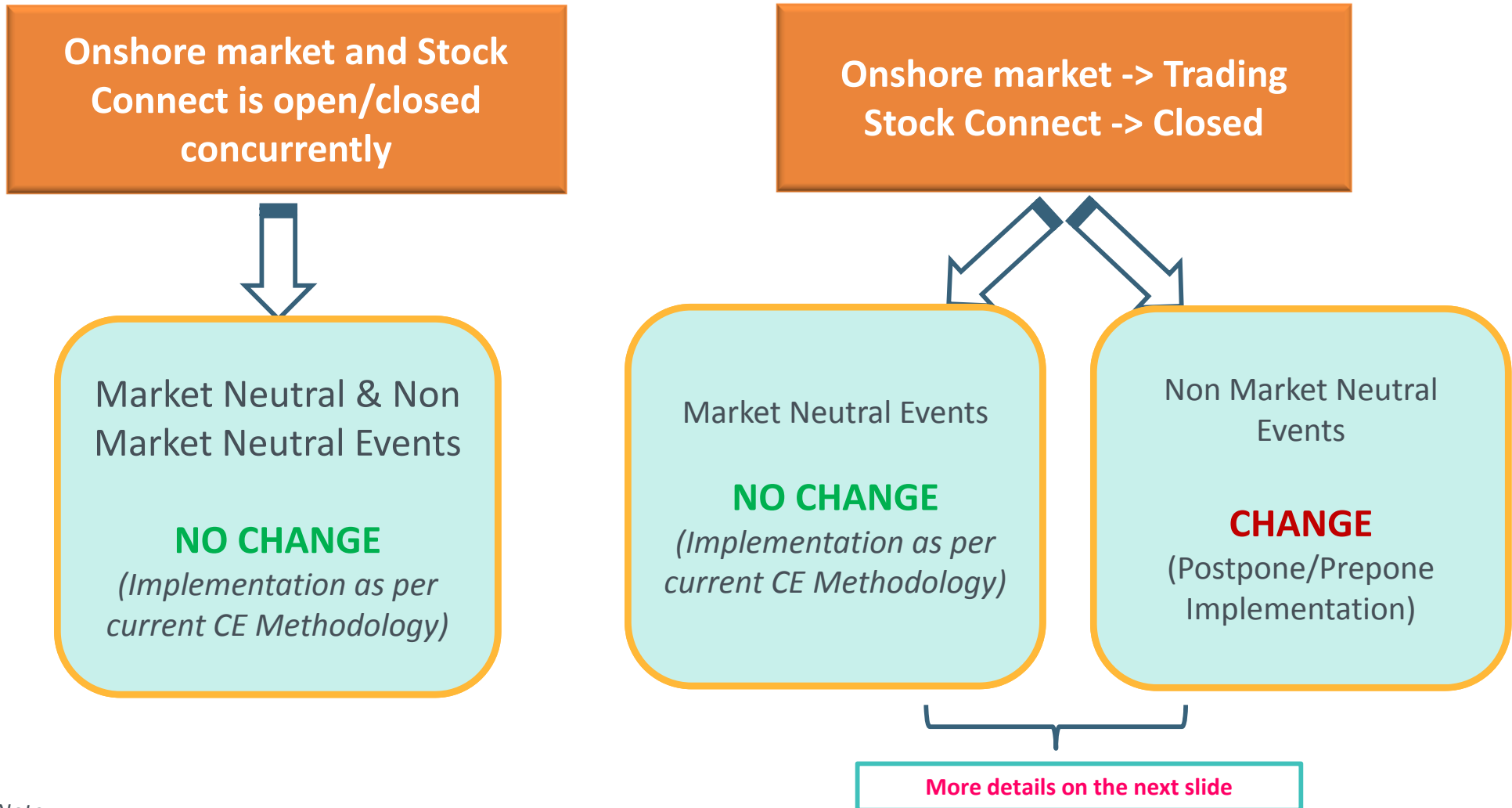
CORPORATE EVENTS AND INDEX REVIEW MAINTENANCE OF STOCK CONNECT SECURITIES

OVERVIEW

- 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



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

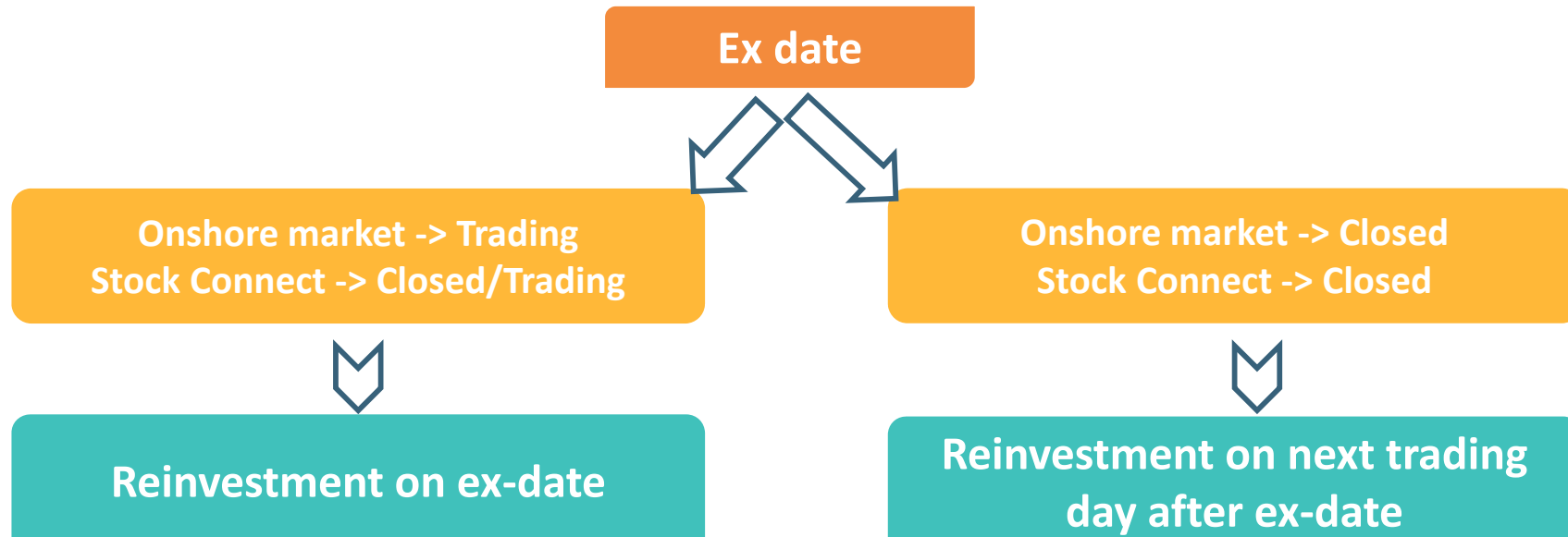
PROPOSAL FOR NEUTRAL & NON-NEUTRAL EVENTS

	Market Neutral Events	Non-Market Neutral Events*	
Type of events	PAF events	PAF events	Non PAF events
Events covered	<ul style="list-style-type: none"> ✓ 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** 	<ul style="list-style-type: none"> ✓ Rights Issue of common shares ✓ Spinoff ✓ Merger ✓ Conversion 	All Non PAF events (Excluding suspension, IPO and other early inclusion)
Proposed Implementation	Implement events on their “ex” date irrespective of Stock Connect Closure	When Stock connect is closed -> Ex date is postponed to the next trading day of Stock connect. Previous day's price is carried forward for the security.	Postpone the implementation effective date for both Onshore and Stock Connect securities. However, in some cases such as Delisting, MSCI may prepone the implementation for both onshore and “Stock Connect” securities.
Ex/Effective date of events	Ex-date for both Onshore and Stock connect securities will be same	In this case, Ex date will be different for Onshore and Stock connect securities	In case of Stock connect closure, the effective date will be postponed/preponed for both Onshore and Stock connect securities and will have the same effective date.

- **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?

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?

PROPOSAL: INTRA QUARTER ADDITIONS

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

PROPOSAL: DAILY LIMIT BREACH

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?

PROPOSAL: INDEX REVIEW IMPLEMENTATION

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

	Current Index		Pro forma Index		# Securities Add	Del	One Way Index Turnover*
	Index Market Cap	# Sec.	Index Market Cap	# Sec.			
MSCI China A Index	1,772,225	875	1,723,021	843	0	32	2.8%
MSCI China A International Index	966,770	459	940,625	441	0	18	2.7%

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

	Current Index		Pro forma Index		# Securities Add	Del	One Way Index Turnover*
	Index Market Cap	# Sec.	Index Market Cap	# Sec.			
MSCI China A Small Cap Index	505,170	1,262	480,435	1,216	0	46	4.9%
MSCI China A International Small Cap Index	429,975	1,561	409,680	1,504	0	57	4.7%

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

PROPOSAL: SUSPENSIONS AT INDEX REVIEWS

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

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

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

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

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

APPENDIX

INDEX FEATURES AND INDEX HISTORY LINKING

Index Features

Current

Proposed

Index Features

China A

China A
Domestic

China A
International

China A
International

China A

China A
Inclusion*



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

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

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

- **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

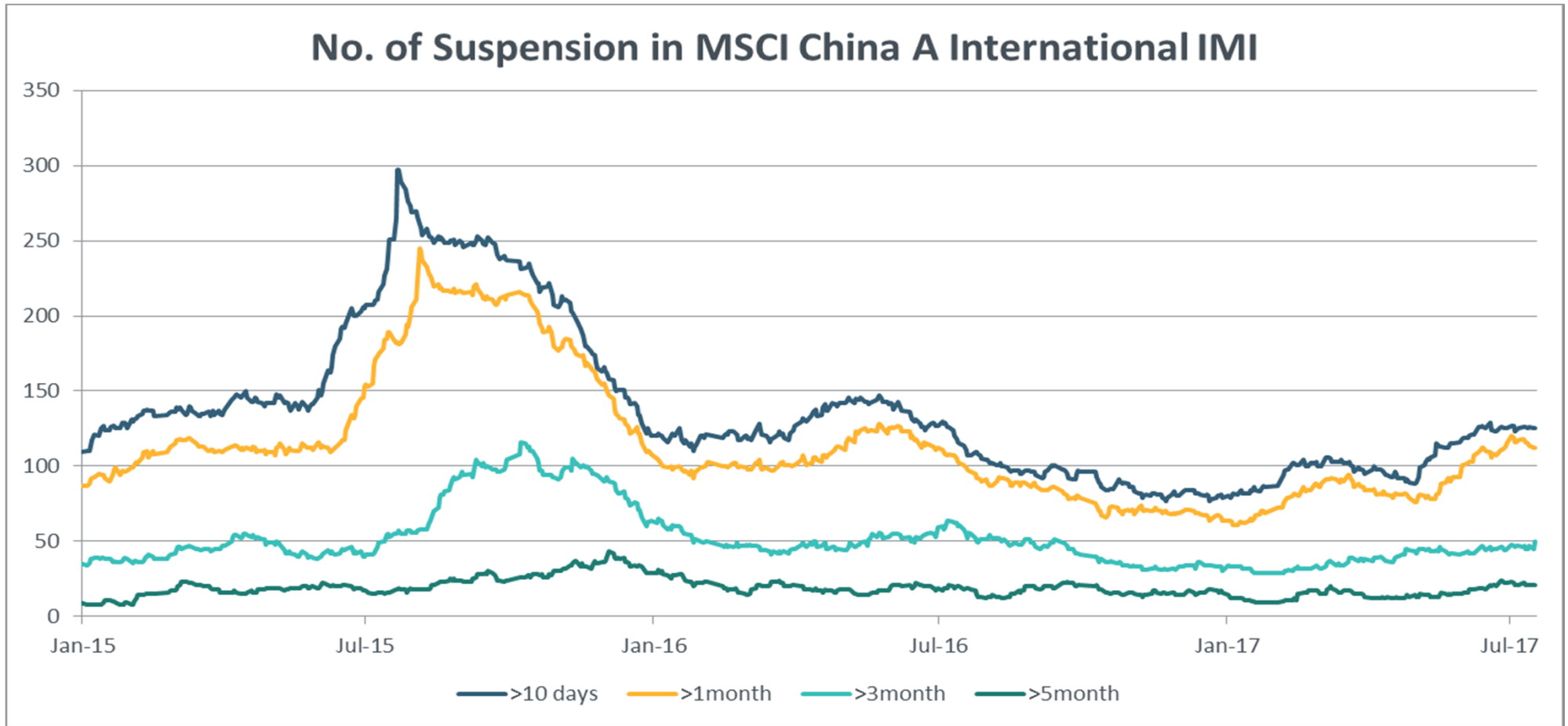
---> Index history linkage

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

*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

TRADING SUSPENSION



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For more than 40 years, MSCI's research-based indexes and analytics have helped the world's leading investors build and manage better portfolios. Clients rely on our offerings for deeper insights into the drivers of performance and risk in their portfolios, broad asset class coverage and innovative research.

Our line of products and services includes indexes, analytical models, data, real estate benchmarks and ESG research.

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