CONSULTATION TO ADDRESS CONTINUOUS LISTING STANDARDS FOR US LISTED EXCHANGE TRADED PRODUCTS

July 2017

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SUMMARY AND BACKGROUND

Until now, US-listed exchange traded products (ETPs) have only been required to comply with listing standards ***at the time of initial listing***.

- A rule change, driven by the Securities and Exchange Commission, has now stated that "…for exchange listing standards to effectively achieve their goals, including to effectively address the potential for manipulation of a listed ETP, their application cannot be linked to only a single point in time (i.e., the time of initial listing)."
- As a result, effective October 1, 2017, US exchanges (which include NYSE/ARCA, CBOE/BATS and NASDAQ) will introduce rules that require ETP portfolios to meet the same initial listing standards on a continual and ongoing basis as well.
- MSCI opens a consultation on a proposal to address compliance with the continuous listing standards for US ETPs through a new index methodology.
- The methodology can be implemented as an 'overlay' to a pre-existing parent or capped index underlying an ETP, and would aim to remediate any non-compliance of the underlying index on a daily basis.
- MSCI welcomes feedback on the consultation and will announce the results of the consultation on or before August 4, 2017.
- This consultation may or may not lead to the adoption of any or all proposals contained in this presentation.

OVERVIEW OF CONTINUOUS LISTING STANDARDS

Listing Standard	International/Global **	Domestic *
Minimum market cap of component stocks that account for at least 90% of index weight	$100M	$75M
Minimum liquidity of component stocks that account for at least 70% of index weight	Minimum monthly trading volume of 250,000 shares or minimum notional volume traded per month of $25,000,000 averaged over the last six months	
Maximum weight of top component stock	25%	30%
Maximum aggregate weight of top 5 component stocks	60%	65%
Minimum number of component stocks	20	13

*A domestic ETF is an ETF that includes only “U.S. Component Stocks”, which are equity securities that are registered under Sections 12(b) or 12(g) of the 1934 Act or American Depositary Receipts, the underlying equity security of which is registered under Sections 12(b) or 12(g) of the 1934 Act.

**A global or international ETF is an ETF that consists of either (a) only Non-U.S. Component Stocks or (b) both U.S. Component Stocks and Non-U.S. Component Stocks. A "Non-U.S. Component Stock" is an equity security that is not registered under Sections 12(b) or 12(g) of the 1934 Act and that is issued by an entity that (a) is not organized, domiciled or incorporated in the United States, and (b) is an operating company (including REITS and income trusts, but excluding investment trusts, unit trusts, mutual funds, and derivatives).

ENFORCEMENT OF LISTING STANDARDS

- While the SEC was the impetus to suggest, and then later approve the changes in listing standard enforcement, the implementation and oversight of the standards will be owned and defined at the respective US exchange level.

- The exchanges are generally aligned on how they will enforce compliance with the standards and have stated explicitly that the onus is on the ETP issuer to comply. In addition to reliance on issuer notification, the exchanges will employ a system of monitoring for potential non-compliance.

- If a product is deemed to be non-compliant post October 1, 2017, the product will be given a 'BC' (Below Compliance) designation within a few days after notification to the issuer. This timing may vary across exchanges and the designation, once given, will be made public.

- After a time period allowed for the issuer to submit a proposal to address the non-compliance (45 days), remediation of the non-compliance can be executed during a respective 'cure' period (usually 180 days), before a delisting process would commence.

- There is a slight differentiation between the continuous listing standards present for global/international ETFs and for domestic ETFs.

US CONTINUOUS LISTING STANDARDS: MSCI INDEX METHODOLOGY PROPOSAL

Underlying Indexes	Any MSCI Index and/or MSCI Capped Index Methodology
Index Construction Method	Optimization (constraints are listing standards)
Rebalance Frequency	Daily/EOD check for non-compliance
Index Compliance Priority (QIR)	Prioritization given to regulation driven ('Listing Standards'; Capped (i.e. 25/50)) index methodologies
Index Compliance Priority (non-QIR)	Prioritization given to 'Listing Standards' Methodology
Tracking Error (QIR/non-QIR)	At QIR, TE minimized to underlying index At non-QIR, TE minimized to index itself
Turnover Budget	10%
Minimum Constituent Weight	Smallest constituent weight in underlying index post optimization equal to smallest weight pre optimization.
Constraint Rebalance Buffers	10% relative to constraints (listing standards)
Constraint non-compliance remediation	Weighting Adjustments or ad-hoc rebalance to parent index if constituents fall below minimum number. If an additional constituent is needed for index compliance during a non-QIR rebalance, that security will only be added to the 'overlay' version of the index; not the underlying MSCI capped or parent index.

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INDEX SIMULATIONS

An historical month-end (July 2015-April 2017) stress test was run on the indexes noted below to gauge the frequency of compliance breaches and to test the efficacy of the methodological framework for ongoing remediation of any index non-compliance.

- MSCI Taiwan 25/50 Index
- MSCI US Investable Market Telecom Services 25/50 Index
- MSCI USA IMI Telecom Services 25/50 Index
- MSCI South Africa Index
- MSCI Korea 25/50 Index

Summary of Findings

- ❑ Over the time period examined for all indexes, the number of non-compliance incidents was relatively small (11). The Korea and Taiwan Indexes had no occurrences of non-compliance during the time period that was reviewed.
- ❑ The breaches occurred within the concentration related listing standards. The market cap, liquidity related, and minimum constituency standards were never breached.
- ❑ Ex-ante Turnover and Tracking error varied depending on the extent of the breach, but never exceeded 3.0% and 0.33% respectively during the re-optimization to bring the index back into compliance with the listing standards.

NOTE: The stress tests were executed with some exceptions to the proposed methodology. Most notably monthly data was used for liquidity rather than trailing 6 month averages, and global/international standards were used universally across all indexes.

INDEX SIMULATION-MSCI SOUTH AFRICA INDEX

Listing Standard	# of breach occurrences (Jul 2015-Apr2017)	Date (s) of breach occurrence(s)	Index Turnover (%) to regain full compliance	Tracking Error (to non-compliant portfolio)
Minimum market cap	0			
Max weight-top stock	5	June 2016 Sept 2016 Oct 2016 Nov 2016 April 2017	.89% .88% .99% .39% .97%	.22% .22% .25% .09% .21%
Max weight- top 5 stocks	0			
Min number of stocks	0			
Min Liquidity	0			

INDEX SIMULATION-MSCI US INVESTABLE MARKET TELECOM SERVICES 25/50 INDEX

Listing Standard	# of breach occurrences (Jul 2015-Apr2017)	Date (s) of breach occurrence(s)	Index Turnover (%) to regain full compliance	Tracking Error (to non-compliant portfolio)
Minimum market cap	0			
Max weight-top stock	1	August 2015	1.36%	.19%
Max weight- top 5 stocks	3	August 2015 January 2016 February 2016	1.36% .72% 3.01%	.19% .08% .33%
Min number of stocks	0			
Min Liquidity	0			

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INDEX SIMULATION-MSCI USA IMI TELECOM SERVICES 25/50 INDEX

Listing Standard	# of breach occurrences (Jul 2015-Apr2017)	Date (s) of breach occurrence(s)	Index Turnover (%) to regain full compliance	Tracking Error (to non-compliant portfolio)
Minimum market cap	0			
Max weight-top stock	1	August 2015	1.01%	.14%
Max weight- top 5 stocks	1	February 2016	1.62%	.18%
Min number of stocks	0			
Min Liquidity	0			

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DISCUSSION POINTS

- Does the proposed index methodology present a sufficient solution to facilitate compliance to the continuous listing standards?

- Would you consider the methodology 'overlay' a material change in the underlying index for the ETP? What level of change constitutes materiality?

- Would you look to employ the index methodology selectively as an ETP approached non-compliance of one or more of the listing standards?

-or-

- Would this be proactively implemented across all indexes underlying ETPs prior to the effective date (October 1, 2017) of continuous listing standard enforcement?

- Would you look to have the methodology as a part of any indexes that were the basis of US listed ETPs at launch?

ABOUT MSCI

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.

MSCI serves 98 of the top 100 largest money managers, according to the most recent P&I ranking.

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