

# Consultation on Enhancements to the Free Float Adjustment Factor Methodology

## MSCI GLOBAL INVESTABLE MARKET INDEXES

This consultation may or may not lead to the implementation of any or all of the proposed changes in MSCI's indexes. Consultation feedback will remain confidential unless a participant requests that its feedback be disclosed. In that case, the relevant feedback would be published at the same time as the final results of the consultation.

July 2024

# Executive Summary

- MSCI Global Investable Market Indexes (GIMI) are based on free float-adjusted security market capitalization. MSCI assigns a Foreign Inclusion Factor (FIF) as the free float-adjustment factor to each security\*
- Starting with the May 2023 Index Review, MSCI migrated to a Quarterly Comprehensive Index Review (QCIR) and moved to a full quarterly review of the free float for all securities from an annual review
- MSCI aims to further improve the free float methodology for the MSCI GIMI with the objective of increasing precision of free float and enhancing index stability
- Specifically, MSCI proposes the following enhancements to the free float adjustment factor methodology
  - **Increase precision** by assigning free float factors in intervals of 2.5%, 0.5% and 0.1%, depending on the free float level and by rounding the FIF up to three decimals (one decimal when expressed in %)
  - **Enhance Index stability** by introducing buffers of +/- 2.5%, +/- 0.5% and +/-0.1% depending on the free float level
- As a reminder, the FIF is currently calculated by rounding up the free float to the nearest 5% for free float greater than 15% and to the nearest 1% for free float less than 15%.

MSCI welcomes feedback from the investment community until October 31, 2024. MSCI will announce the results of this consultation on or before January 17, 2025.



\*For Domestic Indexes, MSCI adjusts the market capitalization of each security using a free float adjustment factor referred to as the Domestic Inclusion Factor (DIF). The DIF is not subject to Foreign Ownership Limits (FOL).

# Background

- The MSCI GIMI are weighted based on free float-adjusted security market capitalization
- To reflect this, MSCI assigns a FIF as the free float-adjustment factor to each security, which is reviewed on a quarterly basis. For Domestic Indexes, MSCI adjusts the market capitalization of each security by using an adjustment factor referred to as the DIF which is not subject to the FOL
- Currently, MSCI calculates free float adjustment factor on the following basis:
  - For securities with free float greater than 15%, the FIF/DIF is equal to the estimated free float, rounded up to the closest 5%
  - For securities with free float less than 15%, the FIF/DIF is equal to the estimated free float, rounded to the closest 1%
  - FIF/DIF changes are implemented provided the change in free float is more than 1%
  - For securities subject to FOL, the FIF is capped by this limit
- Rounding up free float to the nearest 5% may result in potential overstatement of free float, which would be particularly pronounced for companies with lower free float. This could also lead to sizeable incremental FIF changes, which when combined with the narrow FIF/DIF change buffer of 1% across all free float levels, may lead to higher index turnover
- To further improve the free float adjustment factor methodology with the objective of **increasing precision of the free float factor** and **enhancing index stability**, MSCI is proposing **to reduce incremental float changes** (2.5%, 0.5%, 0.1% depending on security free float level), **to calculate FIF/DIF up to three decimals**, as well as **to introduce new FIF/DIF change buffers**

# Details of the Proposal

- MSCI proposes to **increase precision and index stability** by assigning free float factors in the following way:
  - for securities with free float greater than 25%
    - Assign free float factors in increments of 2.5% (for e.g., FIF/DIF would be 0.25, 0.275, 0.3 etc.)
    - Apply a buffer of +/- 2.5% by
      - Triggering a FIF/DIF change only if the absolute change in free float compared to the current index FIF/DIF is at least 2.5%
      - **Rounding up** to the closest 2.5% for **decrease** in free float and **rounding down** to the closest 2.5% for **increase** in free float
  - for securities with free float between 5% and 25%
    - Assign free float factors in increments of 0.5% (for e.g., FIF/DIF would be 0.15, 0.155, 0.16 etc.)
    - Apply a buffer of +/- 0.5% by
      - Triggering a FIF/DIF change only if the absolute change in free float compared to the current index FIF/DIF is at least 0.5%
      - **Rounding up** to the closest 0.5% for **decrease** in free float and **rounding down** to the closest 0.5% for **increase** in free float
  - for securities with free float less than 5%
    - Assign free float factors in increments of 0.1% (for e.g., FIF/DIF would be 0.011, 0.012, 0.013 etc.)
    - Apply a buffer of +/- 0.1% by
      - Triggering a FIF/DIF change only if the absolute change in free float compared to the current index FIF/DIF is at least 0.1%
      - **Rounding up** to the closest 0.1% for **decrease** in free float and **rounding down** to the closest 0.1% for **increase** in free float
- Under this proposal, for new listings in the MSCI investable universe, the FIF for securities not subject to FOLs and DIF would be equal to the estimated free float, rounded down **2.5%** (free float greater than 25%), **0.5%** (free float less than 25% and greater than 5%), **0.1%** (free float less than 5% )

For securities subject to FOL, the FIF will be continued to be capped at lower of DIF and FOL

In cases where MSCI applies a Limited Investability Factor (LIF), the free float adjusted for limited investability is defined as the product of the available free float for foreign investors and the LIF



# Illustration of the Proposal

The following examples illustrate the FIF calculations as per the current and proposed free float adjustment factor methodology

## Example 1 (High Free Float) :

- Company A is a constituent of MSCI Indexes and as per MSCI Free float methodology free float estimation is 88% at the time of listing
- Below table depicts the FIF calculations as part of the Index Reviews

Company A	Quarter 1	Quarter 2	Quarter 3
Free Float	88.00%	91.00%	89.00%
FIF as per current methodology	0.9	0.95	0.9
FIF as per proposed methodology	0.875	0.9	0.9
Benefits of the proposed methodology	Conservative and more precise FIF	Reduced turnover due to lower incremental FIF change	Reduced reverse turnover due to FIF change

## Example 2 (Low Free Float):

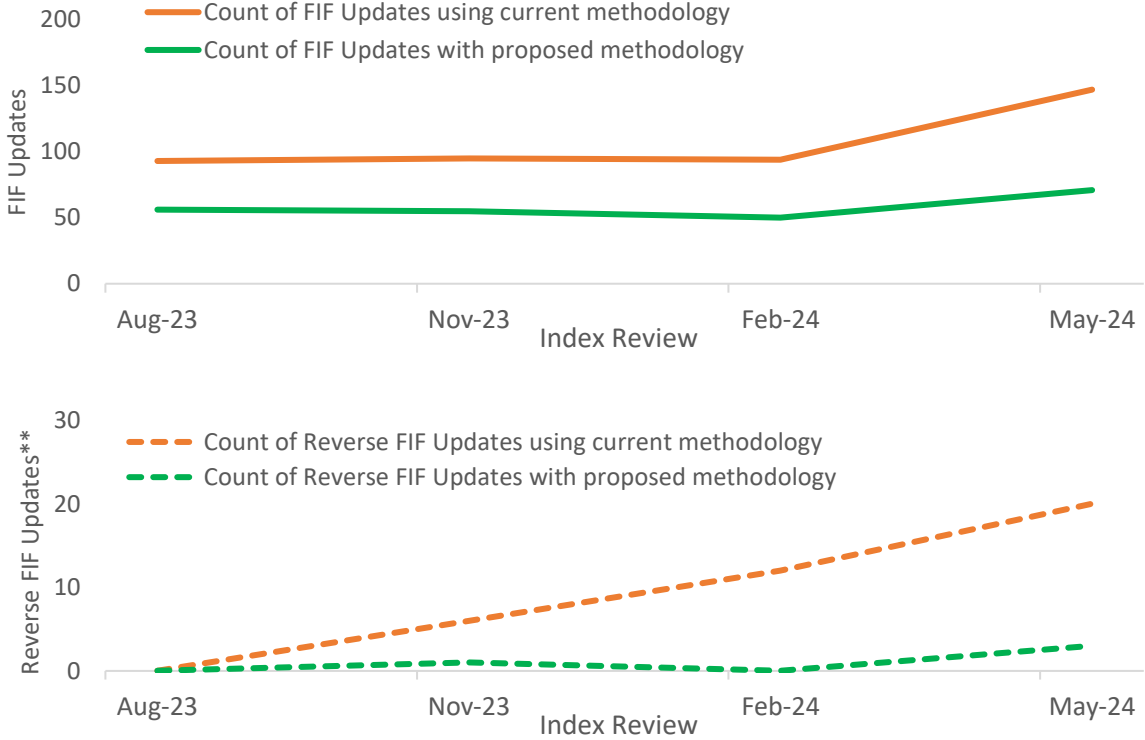
- Company B as per MSCI Free float methodology free float estimation is 14.6% at the time of listing
- Below table depicts the FIF calculations as part of the Index Reviews

Company B	Quarter 1	Quarter 2	Quarter 3
Free Float	14.60%	15.70%	14.55%
FIF using current methodology	0.15	0.2	0.15
FIF as per proposed methodology	0.145	0.155	0.15
Benefits of the proposed methodology	Conservative and more precise FIF	Reduced turnover due to lower incremental FIF change	Reduced reverse turnover due to FIF change

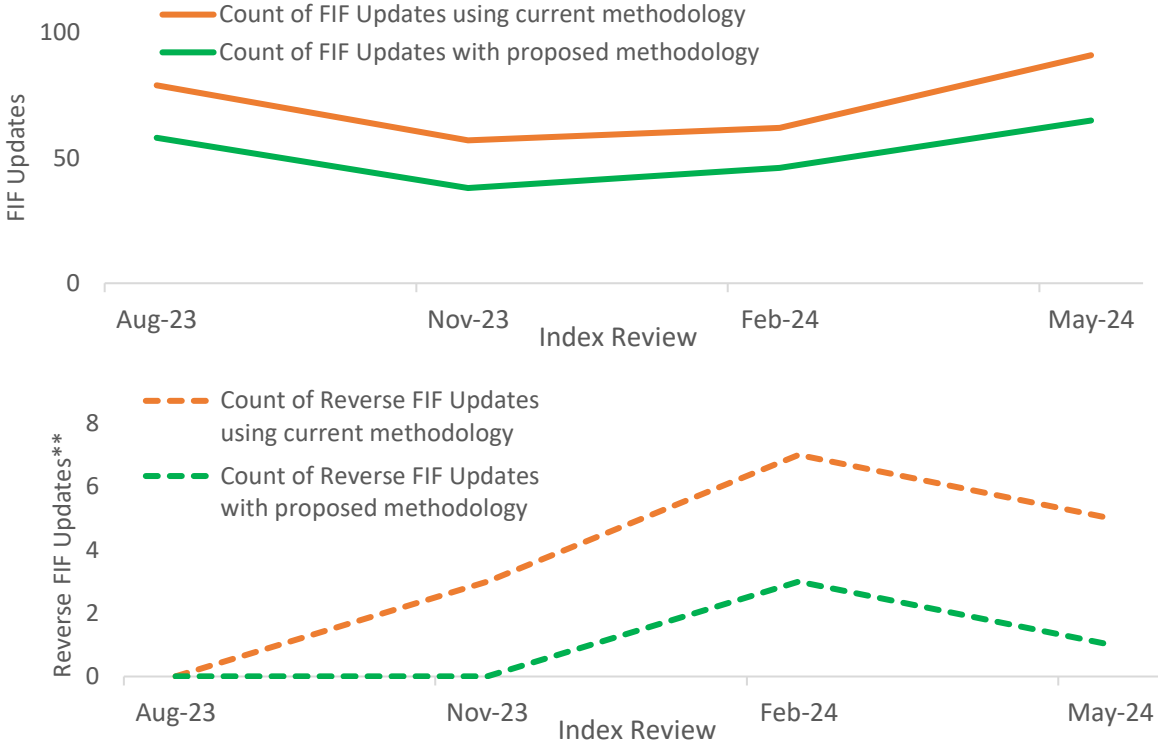
# Simulated Historical Impact: Count of Free Float Changes

- Simulations were conducted using both the current free float adjustment factor methodology and the proposed methodology for the last four Index Reviews. A longer history is available in the appendix
- The count of FIF updates decreased under the proposed methodology, and there was a significant reduction in the count of Reverse FIF updates\*\*

MSCI World Index Simulation



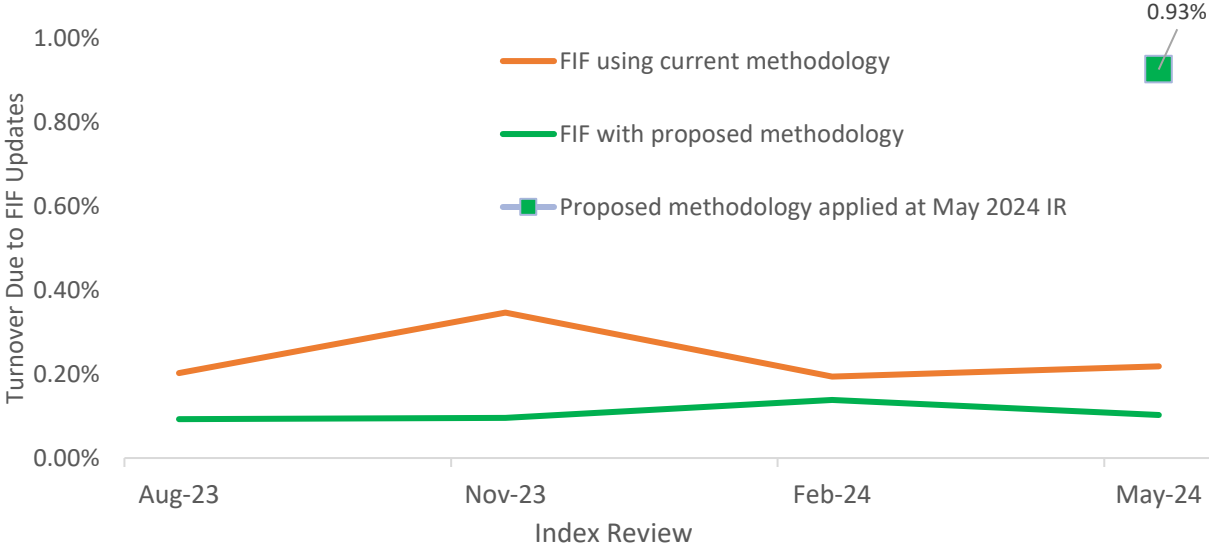
MSCI Emerging Markets Index Simulation



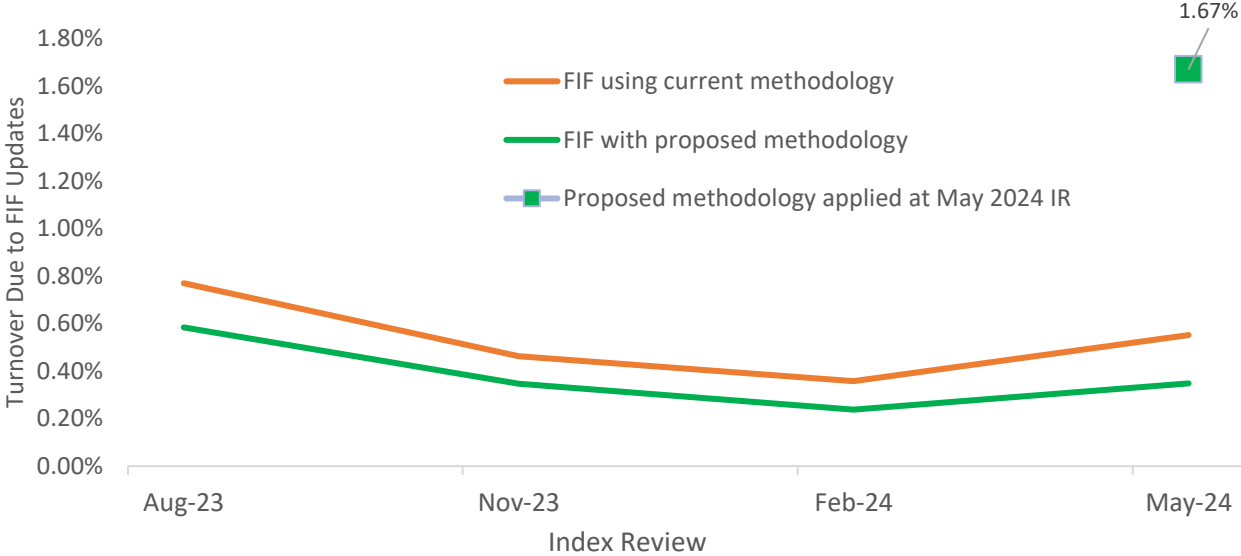
\*\* Reverse turnover occurs when a security experiences a change in its FIF during an Index Review, but in the subsequent Index Review, the FIF trends back towards the original value

# Simulated Historical Impact: Index Turnover

MSCI World Index Simulation



MSCI Emerging Markets Index Simulation



- Based on the simulations from the August 2023 Index Review, the proposed methodology will lead to lower turnover\* resulting from FIF updates in both MSCI World and MSCI Emerging Markets during the Index Review
- As of May 2024, Index Review, the one-time transition to the new methodology would have resulted in the turnover of 0.93% and 1.67% for MSCI World Index and MSCI Emerging Markets Index respectively



\* Note that turnover measures only turnover resulting from FIF updates and does not consider other index review changes such as additions, deletions, changes in number of shares, etc.

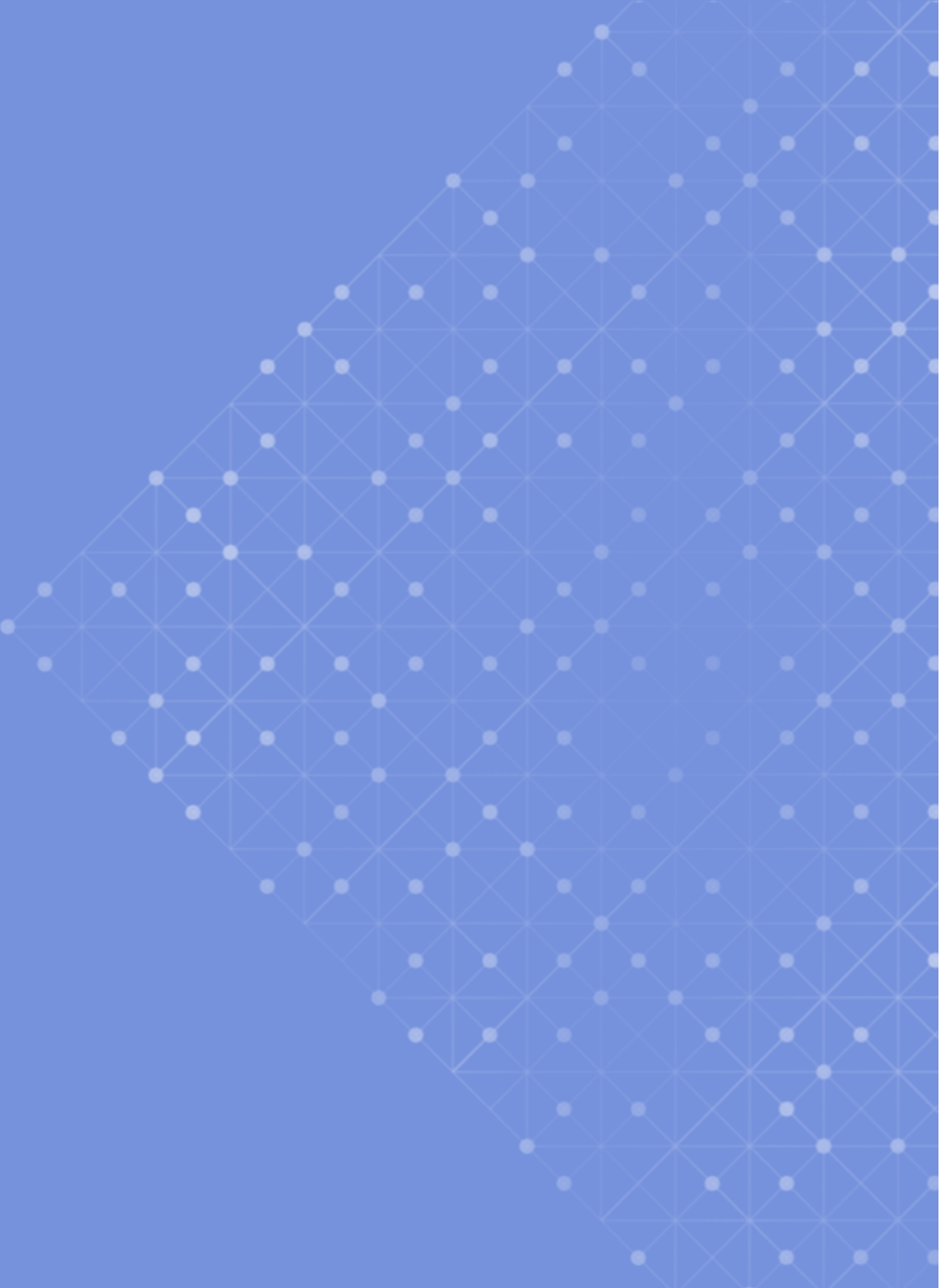
# Discussion Points

- Do you agree with the proposal to enhance the free float adjustment factor methodology?
  - Is it appropriate to apply different levels of precision based on free float levels (i.e., less than 5%, between 5 to 25%, more than 25%)?
  - Are the proposed intervals of  $\pm 2.5\%$ ,  $\pm 0.5\%$  and  $\pm 0.1\%$  appropriate?
  - Is it appropriate to trigger a FIF change in relation to the same proposed intervals?
- Should MSCI restrict the proposed changes in the free float adjustment factor only for securities with low float instead of a complete revamp of the FIF/DIF calculation methodology?
- If the proposal is accepted, should MSCI implement the changes in phases, considering the potential turnover as part of the transition Index Review?



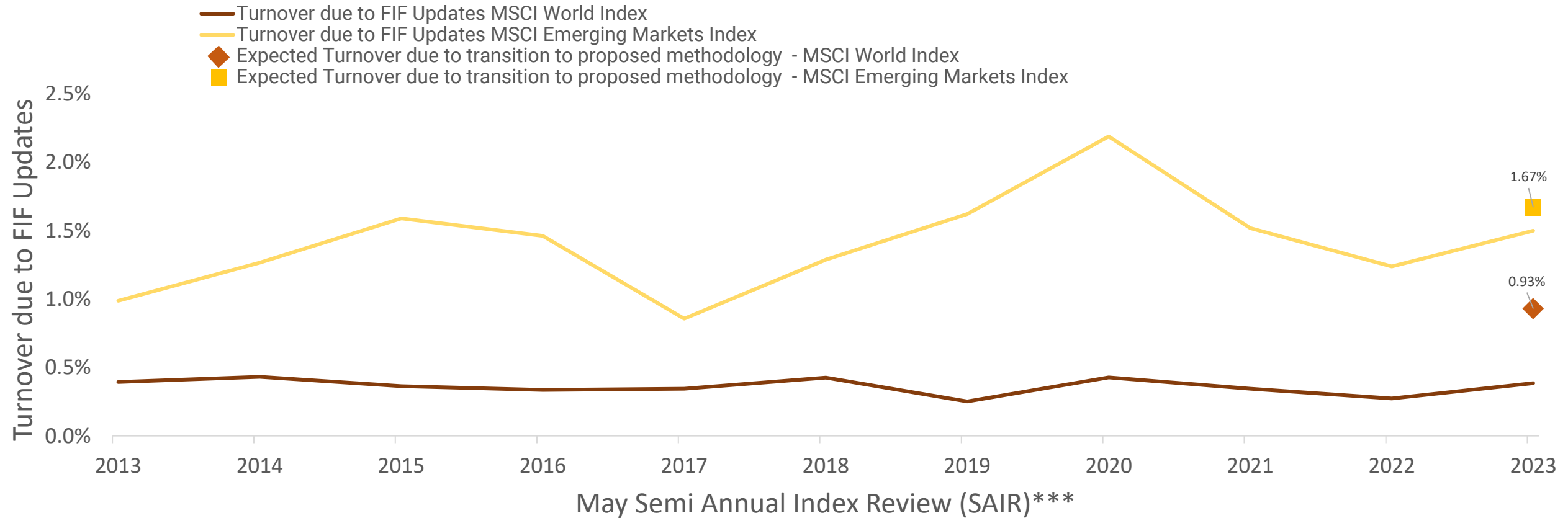
# Appendix

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# Historical Turnover due to FIF updates in May Index Reviews

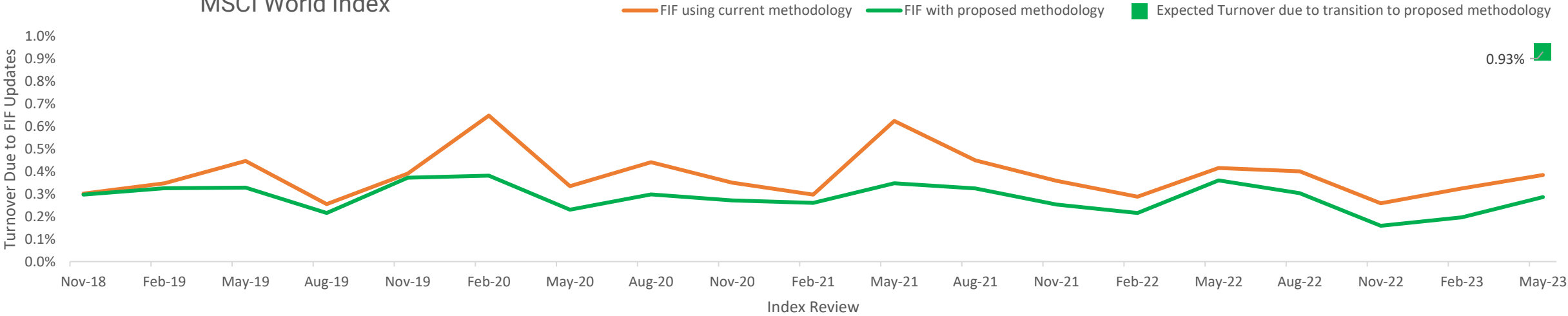
- The below chart represents the actual turnover due to FIF updates in the historical May reviews
- The expected turnover due to transition which is simulated for the May 2024 Index Review at 0.93% for MSCI World Index and 1.67% for MSCI Emerging Market Index and as seen below, historically MSCI Emerging Market Index had turnover above the same while MSCI World has been lower



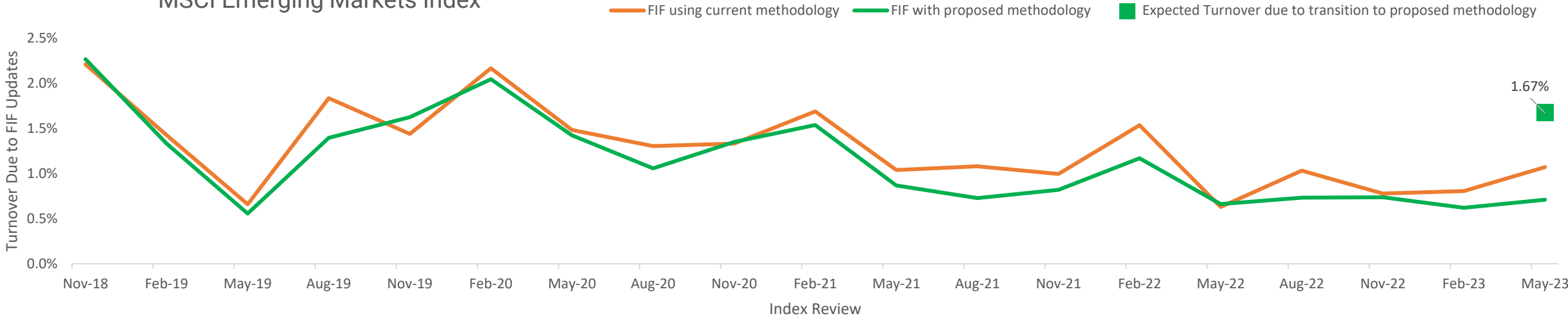
\* Note that turnover measures only turnover resulting from FIF updates and does not consider other index review changes such as additions, deletions, changes in number of shares, etc.  
 \*\* Transition turnover is simulated for the May 2024 Index Review  
 \*\*\*Previously MSCI updated float annually once a year as part of the May Index Review

# Historical 5-year Simulations considering all reviews as QCIR

MSCI World Index



MSCI Emerging Markets Index



\* Note that turnover measures only turnover resulting from FIF updates and does not consider other index review changes such as additions, deletions and changes in number of shares  
 \*\* Transition turnover is simulated for the May 2024 Index Review

# FIF/DIF Calculation Around 5% and 25% Free Float

- For the **new listings** and for **upward free float changes**, FIF/DIF will be equal to the lower bound of the relevant free float interval:

	0.1% increment				0.5% increment				2.5% increment			
Free Float Intervals	0%	[0%,0.1%)	...	[4.9%,5%)	5%	[5%,5.5%)	...	[24.5%,25%)	25%	[25%,27.5%)	...	[97.5%,100%)
FIF values	0	0.000	...	0.049	0.050	0.050	...	0.245	0.250	0.250	...	0.975

- For **downward free float changes**, FIF/DIF will be equal to the upper bound of the relevant free float interval:

	0.1% increment				0.5% increment				2.5% increment			
Free Float Intervals	0%	(0%,0.1%]	...	(4.9%,5%]	5%	(5%,5.5%]	...	(24.5%,25%]	25%	(25%,27.5%]	...	(97.5%,100%]
FIF values	0	0.001	...	0.05	0.050	0.055	...	0.25	0.250	0.275	...	1.000



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\* = toll free

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