

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

## Potential Reclassification from Frontier to Emerging Markets

**March 2019**

*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.*

# RECLASSIFICATION PROPOSAL

- MSCI proposes to reclassify the MSCI Kuwait Index from Frontier 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 2020 Semi-Annual Index Review.
- MSCI will consult with market participants on this reclassification proposal as part of the 2019 Annual Market Classification Review
  - MSCI welcomes any feedback from the investment community on the proposals on or before May 31, 2019.
- Please note that this proposal may or may not lead to any changes to the MSCI Indexes

# BACKGROUND

- The MSCI Kuwait Index was launched on January 23, 2006 and has been part of the MSCI Frontier Markets Index since its inception
- Since May 2017, a number of positive market reforms were implemented. Changes include:

	Previous situation	Current situation	Implementation date of the changes
<b>Investor Registration &amp; Account Set up</b>	<ul style="list-style-type: none"> <li>• Translation of documents and forms to Arabic was required</li> </ul>	<ul style="list-style-type: none"> <li>• The account opening and the registration process has been simplified and the documents are now accepted in English.</li> </ul>	May 2017
<b>Clearing and Settlement</b>	<ul style="list-style-type: none"> <li>• There was an absence of a real Delivery versus Payment (DvP) system as well as failed trades mechanism</li> </ul>	<ul style="list-style-type: none"> <li>• DvP settlement provision was introduced with a buy-in board mechanism to help prevent failed trades.</li> </ul>	April 2018
<b>Custody</b>	<ul style="list-style-type: none"> <li>• Local brokers had unlimited access to trading accounts and local custodians lacked control over the securities as part of the settlement cycle</li> </ul>	<ul style="list-style-type: none"> <li>• An improved false trade mechanism was introduced. Thereby, limiting broker's access to investors' custody accounts.</li> </ul>	April 2018

# UPDATE

- Since being added into the Review List, Kuwait continued to implement its market reforms and these changes include:

	Previous situation	Current situation	Implementation date of the changes
<b>Foreign Ownership Limit (FOL) Level</b>	<ul style="list-style-type: none"> <li>• Foreigners are allowed to own 100% of local Kuwaiti companies, except for the banking sector, where the limit is restricted to 49%.</li> </ul>	<ul style="list-style-type: none"> <li>• Kuwait lifted the Foreign Ownership Limit of 49% to 100% on the banking sector.               <ul style="list-style-type: none"> <li>▪ Any foreign shareholding interest of 5% or more in a bank would require prior approval from the Central Bank of Kuwait</li> </ul> </li> </ul>	December 2018
<b>Transferability</b>	<ul style="list-style-type: none"> <li>• In-kind transfers and off-exchange transactions were manual.</li> </ul>	<ul style="list-style-type: none"> <li>• Testing on automating the system has commenced.               <ul style="list-style-type: none"> <li>▪ Settlement will be on a T+3 cycle.</li> </ul> </li> </ul>	Go-live date is to be confirmed.

# UPDATE (CONTINUED)

- Since being added into the Review List, Kuwait continued to implement its market reforms and these changes include:

	Previous situation	Current situation	Implementation date of the changes
<b>Investor Registration &amp; Account Setup</b>	<ul style="list-style-type: none"> <li>• Registration is mandatory and the full process can take about two weeks.</li> </ul>	<ul style="list-style-type: none"> <li>• Amendments were made in order to make the process for account opening less cumbersome.               <ul style="list-style-type: none"> <li>▪ The term “Global Custodian” is defined as an entity licensed by a foreign regulatory counterpart that applies Financial Action Task Force (FATF) recommendations.</li> <li>▪ Exempting local licensed entities (e.g. subcustodian/Kuwait Clearing Company) from certain documentation requirements to verify client’s identity. This avoids duplication in requiring certain documentations that are verified at the “Global Custodian” level.</li> <li>▪ Regulate the process of relying on 3<sup>rd</sup> parties to conduct client due diligence.</li> </ul> </li> </ul>	October 2018

# SIMULATED CONSTITUENTS FOR MSCI KUWAIT IMI

Company	Full Mcap*	FIF Mcap*	FIF**	Size-Segment
National Bank Of Kuwait	18,147	9,074	0.50	Standard
Kuwait Finance House	13,339	7,336	0.55	Standard
Mobile Telecom Co	6,718	3,359	0.50	Standard
Boubyan Bank	4,598	1,379	0.30	Standard
Agility	3,987	2,193	0.55	Standard
Gulf Bank	2,743	1,234	0.45	Standard
Burgan Bank	2,398	719	0.30	Standard
Mabanee Co Sack	1,997	998	0.50	Standard
Boubyan Petrochemicals	1,641	1,231	0.75	Standard
Human Soft Holding	1,289	967	0.75	Small Cap
Warba Bank	1,108	554	0.50	Small Cap
Kuwait Projects Co Hldgs	1,056	370	0.35	Small Cap
Kuwait International Bk	981	491	0.50	Small Cap
National Ind Grp Holding	744	521	0.70	Small Cap
Integrated Holding	572	401	0.70	Small Cap
Alimtiiaz Investment Co	501	325	0.65	Small Cap
Mezzan Holding	498	199	0.40	Small Cap

Based on simulated result, 17 out of the 18 current constituents of the MSCI Kuwait IMI would be eligible using the Emerging Markets requirements.

# SIMULATED INDEX CONSTITUENT STATISTICS

## Number of Constituents

	Large Cap	Mid Cap	Standard	Small Cap	IMI
Frontier Markets	3	6	9	9	18
Emerging Markets	4	5	9	8	17

Data as of January 22, 2019

The simulations reflect the application of the Semi-Annual Index Review methodology, using the (1) Frontier Markets and (2) Emerging Markets requirements

## Free Float Adjusted Market Capitalization (USD million)

	Large Cap	Mid Cap	Standard	Small Cap	IMI
Frontier Markets	19,769	7,756	27,525	3,987	31,512
Emerging Markets	21,149	6,376	27,525	3,827	31,352

Data as of January 22, 2019

The simulations reflect the application of the Semi-Annual Index Review methodology, using the (1) Frontier Markets and (2) Emerging Markets requirements

- The MSCI Kuwait Index would have the same number of constituents under EM and FM

# SIMULATED IMPACT ON THE MSCI EMERGING MARKETS INDEX (WITH ARGENTINA\*, SAUDI ARABIA\*, AND CHINA A\*\*)

	Pro forma Standard Index		
	Index Market Cap	Weight	# Sec.
<b>EM</b>	<b>5,393,840</b>	<b>100.0%</b>	<b>1,369</b>
<b>EM Asia</b>	<b>3,817,291</b>	<b>70.8%</b>	<b>1,069</b>
China**	1,712,770	31.8%	655
Korea	680,418	12.6%	115
Taiwan	557,153	10.3%	87
India	446,219	8.3%	78
Thailand	123,232	2.3%	36
Indonesia	118,705	2.2%	28
Malaysia	118,626	2.2%	44
Philippines	58,285	1.1%	23
Pakistan	1,884	0.0%	3
<b>EM EMEA</b>	<b>917,998</b>	<b>17.0%</b>	<b>184</b>
South Africa	322,039	6.0%	49
Russia	194,393	3.6%	23
Saudi Arabia*	145,008	2.7%	30
Poland	62,393	1.2%	20
Qatar	54,711	1.0%	10
United Arab Emirates	36,292	0.7%	10
Turkey	33,396	0.6%	18
Kuwait	27,525	0.5%	9
Hungary	16,509	0.3%	3
Greece	11,022	0.2%	6
Czech Republic	8,449	0.2%	3
Egypt	6,262	0.1%	3
<b>EM Latin America</b>	<b>658,550</b>	<b>12.2%</b>	<b>116</b>
Brazil	396,520	7.4%	52
Mexico	144,387	2.7%	26
Chile	57,278	1.1%	17
Colombia	21,622	0.4%	9
Peru	21,189	0.4%	3
Argentina*	17,554	0.3%	9

Note: All market caps are in USD millions. Data as of the close of January 22, 2019

- The simulated MSCI Kuwait Index would have a potential weight of 0.5% in the MSCI Emerging Markets Index

Current weight of MSCI Kuwait Index in MSCI Frontier Markets Index: 23.7%

\*The pro forma figures are based on the MSCI Provisional Argentina Index and MSCI Saudi Arabia Index which are rebalanced using EM requirements.

\*\*The pro forma figures for the MSCI China Index takes into account the 3-step inclusion process for China A shares



# SIMULATED IMPACT ON THE MSCI FM 100 (EX AR EX KW)

	Current Index*		Simulated Index (ex AR ex KW)**	
	# constituents	Weight	# constituents	Weight
KUWAIT	18	22%	0	0%
ARGENTINA	18	18%	0	0%
VIETNAM	21	17%	28	30%
MOROCCO	7	7%	7	10%
KENYA	5	7%	4	10%
NIGERIA	7	6%	7	10%
BANGLADESH	15	6%	20	10%
ROMANIA	6	5%	6	9%
BAHRAIN	4	5%	4	9%
OMAN	5	2%	5	3%
JORDAN	4	2%	3	2%
KAZAKHSTAN	2	1%	3	3%
SLOVENIA	1	0%	1	0%
SRI LANKA	1	0%	2	2%
MAURITIUS	1	0%	1	0%
LEBANON	0	0%	1	1%
ESTONIA	0	0%	1	0%
LITHUANIA	0	0%	1	0%
Total	115	100%	94	100%

## MSCI FM 100 Index (ex AR ex KW) Simulated Top 10 Constituents

Security Name	Country Name	Simulated New Weight
AHLI UNITED BANK (KW)	BAHRAIN	7.74%
VIETNAM DAIRY PRODUCT	VIETNAM	6.98%
SAFARICOM	KENYA	5.56%
MAROC TELECOM	MOROCCO	4.60%
BANCA TRANSILVANIA	ROMANIA	3.39%
ATTIJARIWafa BANK	MOROCCO	3.23%
SQUARE PHARMACEUTICALS	BANGLADESH	3.06%
GUARANTY TRUST BANK	NIGERIA	2.99%
MASAN GROUP CORP	VIETNAM	2.82%
HOA PHAT GROUP JSC	VIETNAM	2.35%

*The full list of 94 securities is available upon request through MSCI's Client Service*

\* Data as of the February 2019 Quarterly Index Review (February 18, 2019)

\*\* Simulated pro forma data as of the February 2018 QIR using SAIR rules (calculation date February 18, 2019, as of date March 1, 2019)

# KEY QUESTIONS

- Is the level of accessibility of the Kuwait equity market to foreign investors sufficient to warrant a reclassification of the MSCI Kuwait Index to Emerging Markets?
- Should MSCI give more time before the reclassification in order for market participants to fully absorb the changes that have been implemented in the market?
- Are there any remaining market accessibility concerns that should prevent the reclassification?
- What is your experience, if any, in setting up accounts to invest in Kuwaiti equities?

# Appendix

# SUMMARY OF THE CHANGES

	<b>Before June 2017 Market Accessibility Review</b>	<b>Current (As of end-February 2019)</b>
Foreign Ownership Limits	49% for the banking sector	No limits
Investor Registration & Account Setup	Registration process can take up to three weeks and documents had to be in Arabic.	Registration process has been simplified, required documents are reduced and can be in English. The process time has been reduced.
Market Regulations	Not in English and hard to locate	All regulations are now in English and publicly available.
Settlement Cycle	T+0 for locals, T+2 for foreigners	T+3 unified cycle
DvP	Not available	Available in BIS Model 1*
Custodian Rejection (fail trade)	Not available	Available
Price limit up/down	5 ticks during the trading session	No limits
Off-exchange trade	Permitted, but limited	Permitted
Securities Borrowing and Lending	Not permitted	Permitted, but limited to market makers
Short Selling	Not permitted	Permitted, but limited to market makers

# PLANNED MARKET DEVELOPMENT

## First Deliverables (Q1 2019)

- Extended securities lending and borrowing (SLB) and short-selling;
- Off-market trades enhancements;
- Introducing an additional trading session – Trade-at-last (TAL);
- Real Estate Investment Trusts (REITs) / Mutual funds;
- Share swap;

## Second Deliverables (Q3 2019)

- Transition from BIS Model 1 to BIS Model 2\*;
- Introduction of a Central Counterparty (CCP) for Cash;
- Introduction of ‘qualified brokers’ as preparation for clearing membership model;
- Account structure / Sub-accounts identification for omnibus accounts;
- Margin lending;
- Support for Repurchase Agreements (REPOs);

# MARKET ACCESSIBILITY REVIEW 2018

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

Note: ++: No Issue; +: No Major Issues, improvements possible; -/? : Improvements needed / extent to be assessed

- Foreign Ownership Limits:** The banking industry is subject to a 49 percent foreign ownership limit. These limitations affect more than twenty six percent of the Kuwaiti equity market.
- Equal Rights to Foreign Investors:** The presence of large strategic shareholders in many Kuwaiti companies may limit the level of transparency and governance in the market.
- Investor Registration & Account Setup: “-/?” to “+”:** The requirements needed for registration with Kuwait Clearing Co. have been reduced, simplified and the documents in English are now accepted. Registration is mandatory and the full process can take about two weeks.
- Market Regulations: “+” to “++”:** All regulations are now in English and publicly available.
- Information Flow:** Stock market information is often not complete and is often not disclosed in a timely manner.

# MARKET ACCESSIBILITY REVIEW 2018

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

Note: ++: No Issue; +: No Major Issues, improvements possible; -/? : Improvements needed / extent to be assessed

- Clearing and Settlement: “-/?” to “+”:** In May 2017, the settlement cycle moved to T+3 for both local and foreign investors and in April 2018, the introduction of a proper delivery versus payment (DvP) settlement provision and proper failed trade management was initiated. Omnibus structures are not widely used since there is a lack of a clear legal basis for them and overdraft facilities remain prohibited.
- Custody: “-/?” to “+”:** The operational efficiency of the DVP model has been enhanced through the introduction in April 2018 of a proper false trade mechanism. This has mostly eliminated the need for segregated custody and trading accounts which were previously required in order to mitigate the risk deriving from local brokers having unlimited access to trading accounts
- Registry / Depository:** The central depository acts as a central registry.
- Transferability:** In-kind transfers and off-exchange transactions are prohibited.

# SIMULATED IMPACT ON THE MSCI FRONTIER MARKETS INDEX (EX AR EX KW)

	Pro forma Standard Index		
	Index Market Cap	Weight	# Sec.
<b>FM</b>	<b>68,187</b>	<b>100.0%</b>	<b>93</b>
<b>FM ex GCC</b>	<b>61,757</b>	<b>90.6%</b>	<b>83</b>
Argentina	0	0.0%	0
Vietnam	17,590	25.8%	16
Morocco	8,964	13.1%	11
Nigeria	7,415	10.9%	12
Kenya	5,517	8.1%	4
Romania	4,115	6.0%	5
Bangladesh	3,278	4.8%	5
Lebanon	2,743	4.0%	4
Mauritius	2,283	3.3%	2
Slovenia	1,956	2.9%	2
Croatia	1,832	2.7%	4
Kazakhstan	1,433	2.1%	3
Jordan	1,207	1.8%	3
Sri Lanka	854	1.3%	2
Senegal	731	1.1%	1
Tunisia	723	1.1%	2
Estonia	516	0.8%	2
Lithuania	254	0.4%	2
Serbia	226	0.3%	2
Ivory Coast	120	0.2%	1
Benin	0	0.0%	0
Burkina Faso	0	0.0%	0
<b>FM GCC</b>	<b>6,430</b>	<b>9.4%</b>	<b>10</b>
Kuwait	0	0.0%	0
Bahrain	4,710	6.9%	5
Oman	1,720	2.5%	5

Note: All market caps are in USD millions. Data as of the close of January 22, 2019



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