CONSULTATION ON CHINA A-SHARES POTENTIAL INCLUSION

May 2017
In June 2016, MSCI announced it would not include China A-Shares into the MSCI Emerging Markets Index citing three remaining obstacles that need to be addressed:

- **Effective implementation of the QFII policy changes and removal of the 20% monthly repatriation limit**
- **Effective implementation of new trading suspension treatment**
- **Resolution of pre-approval requirements by the local exchanges on launching financial products**
WHAT HAS CHANGED?

1. The **Shenzhen Connect was launched** in December 2016
   - Investors can now access approximately 1,480 Shanghai and Shenzhen stocks through the Connect schemes without needing to apply for a license and quota and subject to capital mobility restrictions

2. The implementation of new trading suspension policies by local exchanges has brought the number of **voluntary trading suspensions back to pre-crisis level**
   - However, the number of trading suspensions in the China A-shares market remains by far the highest in the world (> 100 names representing 5.3% of the MSCI China A international IMI Index weight)

3. The 20% QFII repatriation restriction remains unchanged

4. MSCI is in discussions with China exchanges in an effort to reach a resolution on **the removal of pre-approval requirements** on new and **pre-existing** financial products linked to China A shares
   - The breadth of the restrictions is unique in Emerging Markets, as is the possibility that existing financial products based on the MSCI Emerging Markets Index would be in danger of having their trading disrupted if China A-shares were included in Emerging Markets and a Chinese exchange withheld its approval of MSCI’s licensing of the MSCI Emerging Markets Index as the basis of that product
Given the current degree of market development and various accessibility channels that are now available, would international institutional investors consider China A-shares, or a subset of the A-shares opportunity set, investable?

Does the Connect scheme alone provide sufficient accessibility to address an initial allocation to China A-shares?

- Should the index design take into account the unique investability challenges linked to the daily limit and additional market holidays*?

Should the potential 5% inclusion still be linked to broader improvements in all access channels (QFII, RQFII and Connect)?

- What are the main concerns to be addressed?

Please note that this consultation may or may not lead to any change in the MSCI Indexes

*Please refer to the new proposal on slide 6
## ACCESS CHANNELS FOR CHINA A-SHARES

<table>
<thead>
<tr>
<th></th>
<th>Stock Connect</th>
<th>RQFII</th>
<th>QFII</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Quota Size</strong></td>
<td>• No quota limit</td>
<td>• US$218bn</td>
<td>• US$150bn</td>
</tr>
<tr>
<td><strong>Eligible Investor</strong></td>
<td>• All Investors</td>
<td>• Only licensed investors based in selected eligible locations where the RQFII scheme is available</td>
<td>• Only licensed investors that meet certain operation and AUM requirements</td>
</tr>
</tbody>
</table>
| **Quota requirement**| • No requirement | • Quota linked to asset size or investment requirements. To be approved by SAFE  
• Unused quota within a year will be cancelled | • Quota linked to asset size or investment requirements. To be approved by SAFE  
• Unused quota within a year will be cancelled |
| **Capital Mobility** | • No restriction  
• Daily investment quota of RMB 13bn (USD 1.9bn) for Northbound channels and RMB 10.5bn (USD 1.5bn) for Southbound channels | **Open-Ended Funds:**  
- Repatriation: Daily  
- Lock-up: None  
- Remit Period: None  
- Others: Quota required to be used within 1 year upon approval | **Open-Ended Funds:**  
- Repatriation: Daily  
- Lock-up: 3 months  
- Remit Period: N.A.  
- Others: Monthly repatriation cannot exceed 20% of NAV of previous year |
|                      |               | **Others:**  
- Repatriation: Daily  
- Lock-up: 3 months  
- Remit Period: 6 months  
- Others: Monthly repatriation cannot exceed 20% of NAV of previous year |
| **Eligible Investment** | • 1480+ stocks listed on Shanghai and Shenzhen Stock Exchanges | • All securities listed on Shanghai and Shenzhen Stock Exchanges | |
| **Currency**         | • Off-shore RMB (CNH) | • Off-shore RMB (CNH) | • On-shore RMB (CNY) |
# INDEX INCLUSION PROPOSALS

## Original proposal based on the “QFII/RQFII” access framework

<table>
<thead>
<tr>
<th>UNIVERSE</th>
<th>New proposal based on “Connect” access framework</th>
<th>Rationales of index adaptations</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Include Large, Mid and Small Cap companies that satisfy the MSCI GIMI methodology investability rules</td>
<td>• Include only Large Cap companies which are accessible through the Shanghai and Shenzhen Stock Connect programs</td>
<td>• Keep the initial benchmark universe to a reasonable size to improve investability</td>
</tr>
<tr>
<td>• A-shares that have H-shares listings included in the MSCI China Index are eligible for index inclusion</td>
<td>• Exclude A-shares that have H-shares listings included in the MSCI China Index</td>
<td>• Reduce overlap exposures with marginal weight</td>
</tr>
</tbody>
</table>

## INDEX TREATMENTS ON SUSPENSION

<table>
<thead>
<tr>
<th>CORPORATE EVENT AND REBALANCING IMPLEMENTATION</th>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>• Implement index changes linked to corporate events and quarterly index review according to mainland A-shares markets trading calendar (as per the MSCI GIMI methodology)</td>
<td>• Postpone implementation to next day for index changes linked to corporate events and quarterly index review if the event effective date falls on a “Connect” market holiday or due to market closure linked to a daily limit breach</td>
<td>• Ensure index replicability for investors who use the Connect scheme as the primary access channel</td>
</tr>
<tr>
<td>• Remove index constituents that have been suspended for more than 50 days at lowest system price</td>
<td>• Securities suspended for more than 50 days in the past 12 months would not be eligible for index inclusion</td>
<td>• Ensure ongoing investability and replicability of index and minimize potential liquidity risk resulting from prolonged suspension</td>
</tr>
</tbody>
</table>

## FX

<table>
<thead>
<tr>
<th>FX</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Onshore exchange rate (CNY) to be used for index calculation</td>
<td>• Offshore exchange rate (CNH) to be used for index calculation</td>
<td>• Minimize currency drag and potential tracking error due to divergence of CNY and CNH</td>
</tr>
</tbody>
</table>

* The proposal is essentially similar to previous year’s proposal
• By applying the additional index construction rules on the previous slide, the number of China A-shares in the pro-forma MSCI China Index would be reduced to **169** from 448 under last year’s proposal and the total number of constituents in the pro forma MSCI China Index would increase from 150 to 365.

• The weight of China A-shares in the MSCI EM Index would be approximately **0.5%** under the revised 5% inclusion proposal.

• The estimated one way index turnover from the existing MSCI China Index and the MSCI EM Index will be **5.8%** and **1.6%** respectively.

### Current Standard

<table>
<thead>
<tr>
<th>Security</th>
<th>Weight</th>
<th># Sec</th>
<th>Original Proposal (IF = 5%)</th>
<th>New Proposal (IF = 5%)</th>
<th># Securities</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Weight</td>
<td># Sec</td>
<td>Weight</td>
<td># Sec</td>
<td>1 way Turnover</td>
</tr>
<tr>
<td>MSCI China</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A Shares</td>
<td>0.0%</td>
<td>0</td>
<td>3.7%</td>
<td>448</td>
<td>3.66%</td>
</tr>
<tr>
<td>B Shares</td>
<td>0.2%</td>
<td>2</td>
<td>0.4%</td>
<td>4</td>
<td>0.15%</td>
</tr>
<tr>
<td>H Shares</td>
<td>38.6%</td>
<td>70</td>
<td>36.9%</td>
<td>86</td>
<td>1.28%</td>
</tr>
<tr>
<td>Red Chip</td>
<td>16.9%</td>
<td>30</td>
<td>16.3%</td>
<td>38</td>
<td>0.70%</td>
</tr>
<tr>
<td>P Chip</td>
<td>21.5%</td>
<td>34</td>
<td>21.4%</td>
<td>50</td>
<td>1.55%</td>
</tr>
<tr>
<td>Overseas</td>
<td>22.8%</td>
<td>14</td>
<td>21.4%</td>
<td>18</td>
<td>0.31%</td>
</tr>
<tr>
<td>Total</td>
<td>100.0%</td>
<td>150</td>
<td>100.0%</td>
<td>644</td>
<td>7.65%</td>
</tr>
</tbody>
</table>

### MSCI EM

<table>
<thead>
<tr>
<th>Security</th>
<th>Weight</th>
<th># Sec</th>
<th>Original Proposal (IF = 5%)</th>
<th>New Proposal (IF = 5%)</th>
<th># Securities</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Weight</td>
<td># Sec</td>
<td>Weight</td>
<td># Sec</td>
<td>1 way Turnover</td>
</tr>
<tr>
<td>A Shares</td>
<td>-</td>
<td>833</td>
<td>-</td>
<td>1327</td>
<td>2.18%</td>
</tr>
</tbody>
</table>

1. The pro-forma constituents are simulated by applying the additional screening criteria of the new proposal to the MSCI China A International Index. Data as of March 3, 2017. Both proposals also result in slight increases in other share classes after applying the MSCI GIMI methodology to an enlarged universe.
PRO-FORMA WEIGHT OF A-SHARES BASED ON NEW CONNECT BASED PROPOSAL

ACWI

Emerging Markets

Asia Ex Japan

China
3.1%

Rest of EM
7.8%

Rest of DM
21.8%

JP
7.7%

US
53.9%

ACWI

Emerging Markets

Asia ex Japan

China
28.1%

China A-shares
0.1%

China A-shares
(0.5%)

KR
16.7%

TW
14.0%

HK
12.1%

IN
9.9%

SG
4.5%

ID
2.9%

MY
2.8%

TH
2.6%

PH
1.4%

China
33.1%

Asia ex Japan

China A-shares
(0.6%)
How important are the following issues to your investment process? Should the resolution of these issues be linked to the initial 5% inclusion or should they be linked to a higher weight inclusion?

1. Policy risk linked to capital/profit repatriation and other capital mobility constraints
2. Removal of daily investment limit and expansion of opportunity set in the Connect scheme
3. Complete abolishment of quota system (QFII/RQFII)
4. Trading suspension
5. Alignments with international accessibility standards (e.g., DVP, T+2 settlement, ability to transact at market close & etc...)
6. Access to offshore hedging instruments such as a China A-shares futures
7. Any other accessibility issues not mentioned above
MSCI does not currently plan to change the index methodology of the MSCI China A International Index nor the index constituents resulting from this proposal.

The MSCI China A International Index is constructed in accordance with the MSCI Global Investable Market Indexes methodology and aims to reflect the complete investable opportunity set of mainland China A-shares securities from an international investor’s perspective and represents the A share component of the MSCI Emerging Markets benchmark after full inclusion.

The MSCI China A International Index captures large and mid-cap representation and includes the China A-share constituents of the MSCI China All Shares Index. It is based on the concept of the integrated MSCI China equity universe with China A-shares fully included.

As a reminder, the MSCI China All Shares Index (the pro forma MSCI China Index) is constructed based on one integrated China equity universe comprising A-shares, B-shares, H-shares, Red-chips, P-chips and foreign listed Chinese companies.
May 27, 2016
Chinese stock exchanges announced suspension on May 27, 2016.
IMPACT OF ADDITIONAL RULES ON INDEX COMPOSITION

- 448 securities (Original Proposal)
  - Exclude 178 Mid Cap securities
    - 270 Securities (82.3% weighting of Original Proposal)
      - Exclude 61 A-Shares with H-Share constituents
        - 209 securities (54.7% weighting of Original Proposal)
          - Exclude 32 securities suspended for more than 50 days
            - 177 securities (48.5% weighting of Original Proposal)
              - Exclude 8 securities not eligible for Stock Connect
                - 169 securities (New Proposal) (47.4% weighting of Original Proposal)
SECTOR DISTRIBUTION

MSCI China A International Index Sector Distribution

- Telecom Services: 1.8% (New Proposal), 0.9% (Original Proposal)
- Energy: 2.0% (New Proposal), 2.9% (Original Proposal)
- Utilities: 5.9% (New Proposal), 3.7% (Original Proposal)
- Real Estate: 7.1% (New Proposal), 5.8% (Original Proposal)
- Consumer Staples: 10.6% (New Proposal), 5.8% (Original Proposal)
- Health Care: 6.4% (New Proposal), 5.5% (Original Proposal)
- IT: 7.4% (New Proposal), 6.5% (Original Proposal)
- Materials: 7.7% (New Proposal), 7.9% (Original Proposal)
- Consumer Dis.: 8.9% (New Proposal), 12.9% (Original Proposal)
- Industrials: 16.1% (New Proposal), 18.2% (Original Proposal)
- Financials: 23.0% (New Proposal), 27.5% (Original Proposal)

Data as of March 3, 2017
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