

# **MSCI HONG KONG MANDATORY PROVIDENT FUND INDEXES METHODOLOGY**

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<b>Contents</b>		
	1	Introduction to the MSCI Hong Kong Mandatory Provident Fund Indexes 3
	2	Index Construction 4
	2.1	Security Selection 4
	2.2	Addressing Concentration Limit 4
	2.3	Addressing Limit for Specific Securities where Investment May Not Exceed 10% 4
	2.4	Addressing the Minimum 30% Requirement of Hong Kong Dollar Currency Exposure 5
	3	Index Maintenance 7
	3.1	Quarterly Index Review 7
	3.2	Rebalancing due to non-compliance 7
	3.3	Additions and Deletions due to Corporate Events 7
	3.4	Maintenance of the MPFA Investment Restrictions 8
	3.5	Calculation of the MSCI Net Daily Total Return Indexes 8
		Appendix I: Exchanges Approved by MPFA 9
		Appendix II: Withholding Tax 12
		Methodology Book Tracked Changes 16

# 1 Introduction to the MSCI Hong Kong Mandatory Provident Fund Indexes

The Hong Kong Mandatory Provident Fund Schemes Authority (MPFA) regulates the operations of mandatory provident fund (MPF) schemes in accordance with the provisions under the MPF legislation, as well as relevant codes and guidelines. These regulations impose on the MPF funds, among other restrictions, the universe of permissible investments, the level of investment concentration as well as the requirement of maintaining a certain level of Hong Kong Dollar (HKD) exposure.

Constructed based on the MSCI Global Investable Market Indexes (GIMI), the MSCI Hong Kong MPF<sup>1</sup> Indexes take into account these investment restrictions. The MSCI Hong Kong MPF Indexes are divided into three sub-index groups: the MSCI MPF Domestic Indexes, the MSCI MPF Hedged Indexes, and the MSCI MPF Unhedged Indexes, each differs in the mechanism in addressing the MPFA currency exposure requirement.

This document describes the methodology that MSCI uses to calculate the MSCI Hong Kong MPF Indexes.

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<sup>1</sup> The MSCI Hong Kong Mandatory Provident Fund Indexes are independently created and maintained by MSCI without input from or involvement by MPFA. MPFA does not endorse the MSCI Hong Kong Mandatory Provident Fund Indexes.

## 2 Index Construction

### 2.1 Security Selection

#### 2.1.1 Defining the Eligible Universe

The eligible universe of the MSCI Hong Kong MPF Indexes includes all constituent securities of the underlying MSCI Global Investable Market Indexes (“Parent Indexes”) generally listed on approved stock exchanges by the MPFA.

Please note that the MSCI MPF Domestic Hong Kong Index is based on the MSCI Hong Kong Index plus the Hong Kong-listing of HSBC<sup>2</sup>. The MSCI MPF Hong Kong Index is a composite index made up of the MSCI MPF Domestic Hong Kong Index and the MSCI MPF China Index. For any MSCI Hong Kong MPF Index that has a United Kingdom component, the London-listing of HSBC will be removed from the eligible universe.

REITs are included only if they are listed on the approved stock exchanges in the countries approved by the MPFA.

The full list of permissible investments can be found in the Appendix I.

### 2.2 Addressing Concentration Limit

In order to comply with the single issuer concentration limit, MSCI applies a capping of 10% on every company in the MSCI Hong Kong MPF Indexes. This capping is applied at the issuer level. However, a buffer of 10% will be applied to reduce the need of constant rebalancing and excessive index turnover. Specifically, at the point of the index initial construction, the weight of any single issuer is capped at 9% of the index weight. The excess weight of the capped issuer is then proportionally redistributed to other uncapped securities in the index.

### 2.3 Addressing Limit for Specific Securities where Investment May Not Exceed 10%<sup>3</sup>

MSCI applies a capping of 10% on the following securities included in the MSCI Hong Kong MPF Indexes:

<sup>2</sup> The Hong Kong listing of HSBC is exceptionally classified in Hong Kong given its significant size in the Hong Kong stock market. This treatment is different as compared to the country classification rule of the MSCI Global Investable Market Indexes (GIMI) Methodology. At each Index Review, MSCI monitors the investability of the Hong Kong listing of HSBC relative to the investability requirements for the Equity Universe of Hong Kong under the MSCI GIMI Methodology.

<sup>3</sup> As per Section 8 (2) of Schedule 1 to the Mandatory Provident Fund Schemes Regulation

- Stocks of companies listed on a stock exchange that is not approved by the MPFA
- Certificates or receipts whose underlying shares are not listed on a stock exchange approved by the MPFA, or not listed
- REITs subject to 10% group cap as per Appendix I

The capping is applied, as a group, on all such securities in a given index. A 10% buffer will be applied to the capping in order to reduce potential index turnover. The excess weight of capped securities is then proportionally redistributed to other uncapped securities in the index.

## 2.4 Addressing the Minimum 30% Requirement of Hong Kong Dollar Currency Exposure

The MSCI Hong Kong MPF Indexes comprise of the following three sub-index groups<sup>4</sup>, characterized by different index designs to address the 30% Hong Kong Dollar currency exposure requirement:

### 2.4.1 MSCI MPF Domestic Indexes

The MSCI MPF Domestic Indexes apply a floor to the weight of the HKD denominated component and do not involve any currency hedging. Specifically, in order to comply with the requirement of at least 30% Hong Kong Dollar (HKD) currency exposure while applying a buffer to avoid excessive index turnover, a floor of 30% is applied to the weight of the HKD denominated MSCI MPF Hong Kong Index component.

For example, for regional and global indexes including the HKD denominated MSCI MPF Hong Kong Index component and where its weight is less than 35%, the index weight of the HKD denominated MSCI MPF Hong Kong Index component is set to be 35% at initial construction. The weight of the remaining constituents is decreased in proportion to their weight prior to the application of the floor to the HKD denominated securities.

### 2.4.2 MSCI MPF Hedged Indexes

In order to comply with the requirement of at least 30% HKD currency exposure, exposure to currency movements relative to the HKD is partially hedged on a monthly basis based on the MSCI Hedged Indexes methodology. Specifically, the home currency is set to be HKD and the hedged weight for each foreign currency is set to

<sup>4</sup> Please note that due to the original HKD exposure of the regional or global Parent Index, not all three sub-indexes are produced for some regional or global MSCI Hong Kong MPF Indexes.

be 35% of its respective weight in the index on a monthly basis. The MSCI Hedged Indexes methodology is available at:

<http://www.msci.com/index-methodology>

### 2.4.3 MSCI MPF Unhedged Indexes

The MSCI MPF Unhedged Indexes are constructed without any explicit mechanism to address the 30% Hong Kong Dollar currency exposure. These indexes are mainly used as benchmark building blocks in conjunction with other asset classes/segments within an MPF fund that are already exposed to Hong Kong Dollars or for investors who wish to have the flexibility to applying other specific mechanisms to address the 30% Hong Kong Dollar requirement.

## 3 Index Maintenance

### 3.1 Quarterly Index Review

The MSCI Hong Kong MPF Indexes are rebalanced on a quarterly basis, nine business days before the effective dates of the MSCI Index Reviews. The changes resulting from the rebalancing are also announced nine business days before the effective dates of the MSCI Index Reviews and implemented as of the close of the last business day of each February, May, August and November, to coincide with the Index Reviews of their Parent Indexes.

#### 3.1.1 Announcement Policy

The pro forma MSCI Hong Kong MPF Indexes are announced nine business days before the effective date of each Index Review.

### 3.2 Rebalancing due to non-compliance

MSCI Hong Kong MPF Indexes are reviewed for non-compliance on concentration limit, on the limit on securities described in section 2.3 as a group and on Hong Kong dollar currency exposure on a daily basis. The MSCI MPF Indexes will be rebalanced in the event of non-compliance. The constraints are considered to be breached when the weight of an issuer increases above 10%, or the weight of the specific securities described in section 2.3 as a group is greater than 10%. The foreign currency exposure constraint is considered to be breached when the weight of the HKD denominated securities decreases below 30%.

The rebalancing will take place as of the close of the day when the index breaches any constraint, based on closing prices, such that the MSCI Hong Kong MPF Indexes will always be within the constraints before the opening of the following trading day.

In case the pro forma MSCI Hong Kong MPF Indexes become non-compliant between the announcement date and the effective date, the previously announced results will be discarded and a newly rebalanced pro forma index will be announced.

### 3.3 Additions and Deletions due to Corporate Events

A security added to or deleted from the Parent Index following a corporate event will also be added to or deleted simultaneously from the MSCI Hong Kong MPF Indexes.

Details regarding the treatment of corporate events not covered below can be found in the MSCI Corporate Events Methodology Book, available at:

<http://www.msci.com/index-methodology>

In case of MSCI Hong Kong MPF Indexes where the concentration constraint and/or the local currency exposure constraint are triggered, additions are included with an estimated weight based on a rebalancing at the time of addition. The constraint applied on other index constituents is however not changed.

### **3.4 Maintenance of the MPFA Investment Restrictions**

To ensure the MSCI Hong Kong MPF Indexes accurately reflect the MPF regulatory requirements, MSCI reviews the MPF investment restrictions twice a year coinciding with the May and November Index Reviews.

### **3.5 Calculation of the MSCI Net Daily Total Return Indexes**

In the calculation of the MSCI Net Daily Total Return Domestic Indexes, MSCI uses the withholding tax rate applicable to Hong Kong investors, as outlined in Appendix II.



## Appendix I: Exchanges Approved by MPFA

Country	Stock Exchange
Australia	Australian Securities Exchange
Austria	Vienna Stock Exchange
Belgium	Euronext Brussels
Brazil	B3 S.A. - Brasil, Bolsa, Balcão
Canada	Toronto Stock Exchange
China <sup>5</sup>	Shanghai Stock Exchange
	Shenzhen Stock Exchange
Taiwan	Taiwan Stock Exchange
Denmark	Nasdaq Copenhagen
Finland	Nasdaq Helsinki
France	Euronext Paris
Germany	Frankfurt Stock Exchange
Greece	Athens Stock Exchange
India	BSE
	National Stock Exchange of India
Indonesia <sup>4</sup>	Indonesia Stock Exchange
Ireland	Euronext Dublin
Israel	Tel-Aviv Stock Exchange
Italy	Borsa Italiana
Japan	Nagoya Stock Exchange
	Tokyo Stock Exchange
Korea	Korea Exchange
Luxembourg	Luxembourg Stock Exchange

<sup>5</sup> The approved stock exchanges in China, Indonesia and Poland will be eligible starting from May 2021 SAIR.

Country	Stock Exchange
Malaysia	Bursa Malaysia
Mexico	Mexican Stock Exchange
Netherlands	Euronext Amsterdam
New Zealand	NZX
Norway	Oslo Børs
Philippines	Philippine Stock Exchange
Poland <sup>4</sup>	Warsaw Stock Exchange
Portugal	Euronext Lisbon
Singapore	Singapore Exchange Securities Trading
South Africa	Johannesburg Stock Exchange
Spain	Madrid Stock Exchange
Sweden	Nasdaq Stockholm
Switzerland	SIX Swiss Exchange
Thailand	Stock Exchange of Thailand
United Kingdom	London Stock Exchange
USA	NYSE American
	New York Stock Exchange
	NYSE Arca
	Nasdaq PHLX
	NASDAQ Stock Market
	Cboe BZX Exchange

Source: MPFA website. Last updated in November 2020.

[http://www.mpfa.org.hk/eng/legislation\\_regulations/legulations\\_ordinance/guidelines/current\\_version/investment/files/Annex\\_A\\_to\\_III\\_4.pdf](http://www.mpfa.org.hk/eng/legislation_regulations/legulations_ordinance/guidelines/current_version/investment/files/Annex_A_to_III_4.pdf)

In addition, REITs from the approved stock exchanges in the following countries are approved as permissible investments.

Countries not subject to 10% group cap	Countries subject to 10% group cap <sup>6</sup>
Australia	Canada
Hong Kong	France
United Kingdom	Japan
United States of America	Singapore
	Netherlands

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<sup>6</sup> REITs listed on approved stock exchanges in Canada, France, Japan, Singapore and Netherlands will be eligible starting from May 2021 SAIR.

## Appendix II: Withholding Tax

Country Of Incorporation		Withholding Tax Rates (%) <sup>(1)</sup>	Country Of Incorporation		Withholding Tax Rates (%) <sup>(1)</sup>
Code	Name		Code	Name	
AE	United Arab Emirates	0	KR	Korea	15 <sup>(10)</sup>
AN	Netherlands Antilles	0	KW	Kuwait	0
AR	Argentina	7	KY	Cayman Islands	0
AT	Austria	10 <sup>(10)</sup>	KZ	Kazakhstan	15
AU	Australia <sup>(2)</sup>	30	LB	Lebanon	10
BA	Bosnia & Herzegovina	5	LI	Liechtenstein	0 <sup>(10)</sup>
BD	Bangladesh	20	LK	Sri Lanka	15
BE	Belgium	15 <sup>(10)</sup>	LR	Liberia	15
BG	Bulgaria	5	LT	Lithuania	15
BH	Bahrain	0	LU	Luxembourg	10 <sup>(10)</sup>
BM	Bermuda	0	MA	Morocco	13.75
BR	Brazil <sup>(3)</sup>	0	MH	Marshall Islands	0
BS	Bahamas	0	MK	Macedonia	10
BW	Botswana	10	MU	Mauritius	0
CA	Canada	15 <sup>(10)</sup>	MT	Malta	0
CH	Switzerland	10 <sup>(10)</sup>	MX	Mexico <sup>(9)</sup>	0 <sup>(10)</sup>
CL	Chile	35	MY	Malaysia <sup>(5)</sup>	0
CN	China <sup>(4)</sup>	0 or 10	NG	Nigeria	10
CO	Colombia	10	NL	Netherlands	10 <sup>(10)</sup>

Country Of Incorporation		Withholding Tax Rates (%) <sup>(1)</sup>	Country Of Incorporation		Withholding Tax Rates (%) <sup>(1)</sup>
Code	Name		Code	Name	
CW	Curacao	0	NO	Norway	25
CY	Cyprus	0	NZ	New Zealand	15
CZ	Czech Republic	5 <sup>(10)</sup>	OM	Oman	0
DE	Germany	26.375	PA	Panama	10
DK	Denmark	27	PE	Peru	5
EE	Estonia	0	PH	Philippines	25
EG	Egypt	5	PK	Pakistan	10 <sup>(10)</sup>
ES	Spain	10 <sup>(10)</sup>	PL	Poland	19
FI	Finland	10 <sup>(10)</sup>	PR	Puerto Rico	10
FO	Faroe Islands	35	PS	Palestine	0
FR	France	10 <sup>(10)</sup>	PT	Portugal	10 <sup>(10)</sup>
GB	United Kingdom <sup>(6)</sup>	0	QA	Qatar	0
GG	Guernsey	0	RO	Romania	5
GH	Ghana	8	RS	Serbia	10 <sup>(10)</sup>
GI	Gibraltar	0	RU	Russia	10 <sup>(10)</sup>
GR	Greece	5 <sup>(10)</sup>	SA	Saudi Arabia	5
HK	Hong Kong	0	SE	Sweden	30
HR	Croatia	10	SG	Singapore <sup>(7)</sup>	0
HU	Hungary	0	SI	Slovenia	15
ID	Indonesia	10 <sup>(10)</sup>	TH	Thailand	10
IE	Ireland	0 <sup>(10)</sup>	TN	Tunisia	10
IL	Israel	25	TR	Turkey	10
IM	Isle Of Man	0	TT	Trinidad And Tobago	8
IN	India	5 <sup>(10)</sup>	TW	Taiwan <sup>(8)</sup>	21
IT	Italy	10 <sup>(10)</sup>	UA	Ukraine	15
JE	Jersey	0	US	USA	30
JM	Jamaica	33.333	VG	British Virgin Islands	0

Country Of Incorporation		Withholding Tax Rates (%) <sup>(1)</sup>	Country Of Incorporation		Withholding Tax Rates (%) <sup>(1)</sup>
Code	Name		Code	Name	
JO	Jordan	0	VN	Vietnam	0
JP	Japan	10 <sup>(10)</sup>	ZA	South Africa	10 <sup>(10)</sup>
KE	Kenya	15	ZW	Zimbabwe	10

*Last updated in May 2017*

#### Notes:

- Used in the calculation of the MSCI Net Daily Total Return (DTR) Indexes. Withholding tax rates used are the maximum rates of the company's country of incorporation applicable to institutional investors who do not benefit from double taxation treaties.
- For Australian dividends, franking percentage and conduit foreign income are taken into consideration on calculation of the MSCI Net DTR Indexes. The actual withholding tax rate for an Australian dividend ranges from 0% to 30%. For details, please refer to the section 2.3.7.2.1 of the MSCI Index Calculation Methodology.
- Interest on capital is subject to a 15% withholding tax.
- For the MSCI China Index, the withholding tax rates are exceptionally based on Chinese securities' share types, regardless of the company's country of incorporation. B-share and H-share are subject to a 10% withholding tax. P-Chip and Red Chip are subject to a 0% withholding tax, unless a specific withholding tax of 10% is announced by the companies.
- Dividends on Real Estate Investment Trusts (REITS) are subject to a 10% withholding tax.
- Cash dividends paid by companies incorporated in the United Kingdom includes a 10% tax credit. MSCI does not take into consideration the tax credit for both the gross and net dividend amounts. As there is no withholding tax in the United Kingdom, the gross and net amounts of the cash dividends to be reinvested in the MSCI Net Daily Total Return (DTR) indexes are equal.
- Dividends on Real Estate Investment Trusts (REITS) are subject to a 10% withholding tax.
- Dividends on Real Estate Investment Trusts (REITS) are subject to a 15% withholding tax.

9. Dividends on Real Estate Investment Trusts (REITS) are subject to a 30% withholding tax.
10. The rates take into account the double tax treaties between Hong Kong resident investors and the relevant countries. In the calculation of the Net Daily Total Return Indexes, these withholding tax rates are applied to securities listed in the countries specified. Source: Inland Revenue Department website: [http://www.ird.gov.hk/eng/tax/dta\\_rates.htm](http://www.ird.gov.hk/eng/tax/dta_rates.htm)

## Methodology Book Tracked Changes

### **The following sections have been modified since May 2014:**

Appendix I: Exchanges Approved by MPFA

- Addition of Philippine Stock Exchange

### **The following sections have been modified since May 2015:**

Section 3.4: Maintenance of the MPFA Investment Restrictions

- Frequency of reviews changed from once a year to twice a year

### **The following sections have been modified since May 2016:**

Appendix II: Withholding Tax

- Withholding tax rates of Italy and South Africa

### **The following sections have been modified since May 2017:**

Appendix II: Withholding Tax

- Withholding tax rates of Korea and Portugal

### **The following sections have been modified since August 2017:**

Section 1: Introduction

- Updates

Section 3.3: Additions and Deletions due to Corporate Events

- Added clarification

### **The following sections have been modified since May 2018:**

Section 2.1.1: Defining the Eligible Universe

- Updates

Section 2.3: Addressing Limit on Securities not listed on a Stock Exchange Approved by the MPFA

- Added new section

Section 3.1.1 Announcement policy

- Added new section

### **The following sections have been modified since November 2018:**

Appendix I: Exchanges Approved by MPFA

- Cboe BZX Exchange name update



**The following sections have been modified since May 2020:**

Appendix II: Withholding Tax

- Withholding tax rates of India, Finland, Liechtenstein, Luxembourg, Russia, Argentina, Colombia, Egypt, Greece, Kuwait, Sri Lanka, Morocco, Peru, Romania, Serbia, Tunisia, Taiwan

**The following sections have been modified since November 2020:**

Section 2.1.1: Defining the Eligible Universe

- Updates

Section 2.3: Addressing Limit on Securities not listed on a Stock Exchange Approved by the MPFA

- Changed headline
- Added REITs in the section
- Added footnote 3

Appendix I: Exchanges Approved by MPFA

- Addition of Shanghai Stock Exchange, Shenzhen Stock Exchange, Indonesia Stock Exchange and Warsaw Stock Exchange
- B3 S.A. - Brasil, Bolsa, Balcão and Euronext Dublin name update
- Update the country names where REITs listed have been approved as permissible investments

**The following sections have been modified since May 2021:**

Appendix II: Withholding Tax

- Withholding tax rates of Philippines

**The following sections have been modified since November 2021:**

Appendix II: Withholding Tax

- Updated withholding tax rates of Botswana, Croatia, Egypt and Kenya

**The following sections have been modified since May 2022:**

Section 3.2: Rebalancing due to non-compliance

- Clarifications on limits applied to securities described in section 2.3.

Appendix II: Withholding Tax

- Updated withholding tax rates of Serbia, Turkey and Trinidad and Tobago

**The following sections have been modified since May 2023:**

Appendix II: Withholding Tax

- Updated withholding tax rates of Sri Lanka and Morocco

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