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MSCI Overseas China Index: Early Inclusion Proposal

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Summary

- MSCI proposes to allow early inclusions of companies with Initial Public Offerings (IPOs) that are of significant size to the MSCI Overseas China Index
- The proposal would be implemented in two phases
 - Phase I: Early Inclusion of IPOs in between Index Reviews
 - Phase II: Early Inclusion of IPOs during Index Reviews
- The details for the Proposal are set forth in this consultation document
- This proposal may or may not lead to any changes to the MSCI Overseas China Indexes
- MSCI will announce its final decision by July 17, 2014

Current MSCI Oversees China Index Rebalancing Summary

- MSCI Oversees China (“OVC”) Equity Universe: Securities (including ADRs) listed in the USA and Singapore and outside of MSCI China or MSCI China A Equity Universe
 - Must meet 2 out of 3 of the following criteria
 - Headquarters in People’s Republic of China (PRC)
 - Company derives more than 50% of its revenue from PRC
 - Company has more than 50% of assets in PRC
 - The MSCI OVC Indexes are reviewed on a quarterly basis

Nov SAIR	- there are migrations of current IMI constituents - IPOs may be added - the list of eligible securities is re-evaluated
May SAIR	- there are migrations of current IMI constituents - IPOs since the last SAIR are also considered for inclusion
QIRs	- there are only migrations of current IMI constituents - no new security is considered for index inclusion

- SAIR – Semi-Annual Index Review; QIR – Quarterly Index Review

- There are NO EARLY INCLUSIONS for the MSCI OVC Indexes

What is the Proposal trying to solve for?

- The MSCI OVC Index may not fully reflect the potential investment opportunity set due to the lack of an Early Inclusion Rule
 - This includes even securities with very large Initial Public Offerings (IPOs)
- The table below shows the earliest possible inclusion date for the MSCI OVC Index compared to the MSCI Global Investable Market Indexes (GIMI)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
GIMI IPO Large	Feb QIR*	May SAIR	May SAIR	May SAIR*	Aug QIR	Aug QIR	Aug QIR*	Nov SAIR	Nov SAIR	Nov SAIR*	Feb QIR	Feb QIR
GIMI IPO	May SAIR	May SAIR	Nov SAIR	Nov SAIR	Nov SAIR	Nov SAIR	Nov SAIR	Nov SAIR	May SAIR	May SAIR	May SAIR	May SAIR
OVC IPO	May SAIR	May SAIR	Nov SAIR	Nov SAIR	Nov SAIR	Nov SAIR	Nov SAIR	Nov SAIR	May SAIR	May SAIR	May SAIR	May SAIR

*May be included in the upcoming Index Review (IR) if the IPO happens prior to the price cutoff date of the IR which is set in the month

- An IPO in March would only be added in the Nov SAIR which is effective in December, due to the 3-month Seasoning Period
- This is potentially a 9 month delay

Proposal: Phase I – Early Inclusion Rule in between Index Reviews

- Proposed Early Inclusion Rule in between Index Reviews for the MSCI OVC Index
 - For IPOs that are significant in size and meet all the MSCI OVC Index inclusion criteria, an early inclusion outside of the Index Reviews may be considered for inclusion in the Standard Index - MSCI OVC Index
 - In order for an IPO meeting the OVC companies criteria (as described in Sub-section 2.1 of the methodology) to qualify for an early inclusion to the Standard Index, the security must
 - Meet the index constituent eligibility rules and guidelines (described in Sub-section 2.2 of the methodology) with the exception of the length of trading (3-month seasoning period) and liquidity screens,
 - Meet the size-segment investability requirements (described in Sub-section 2.3 of the methodology) and
 - As of the close of its first or second trading day, the security must have
 - a company full market capitalization of at least 1.8 times the Interim Market Size-Segment Cutoff of the MSCI China Index and
 - a free float-adjusted market capitalization of at least 1.8 times one-half of the Interim Market Size-Segment Cutoff of the MSCI China Index
 - If the decision is made to include an IPO early, the inclusion of the security to the MSCI Overseas China Index will be effective after the close of the tenth day of trading of the security

Proposal: Phase I – Early Inclusion Rule in between Index Reviews

■ Historical Impact

- A total of 161 IPOs were reviewed in the May 2014 SAIR and only 5 were added to the MSCI OVC Equity Universe

	IPOs checked	Added to Universe
May-14	161	5
May-13	80	1
May-12	81	0

- Of the 161 IPOs

May 2014 Cutoff* = 2186.14	1.0x	1.5x	1.8x
IPOs	22	14	12
Universe	1	1	-
<hr/>			
May 2013 Cutoff* = 1977.10	1.0x	1.5x	1.8x
IPOs	8	7	7
Universe	-	-	-

* Cutoffs as of price cutoff date for each rebalancing

** The counts are cumulative

- The 12 securities that met 1.8x the company full market capitalization cutoff also met the cutoff as of the first or second trading day, but were not added to the OVC Equity Universe
- Of the 5 securities added to the OVC Equity Universe for the May 2014 SAIR, only one has a company full market capitalization that met at least 1.5x the cutoff

Proposal: Phase II – Early Inclusion Rule during Index Reviews

- **Proposed Early Inclusion Rule during Index Reviews for the MSCI OVC Index**
 - Securities that did not earlier meet the additional size criteria for Early Inclusion may be included in the MSCI OVC Index during an Index Review if they had an IPO up to the month prior to the Index Review (i.e. end of April for the May SAIR), and provided that they meet the criteria for large companies
 - Large Companies are defined as securities that have a company full market capitalization of at least 1.8 times the Interim Market Size-Segment Cutoff of the MSCI China Index and free float-adjusted market capitalization of at least 1.8 times one-half of the Interim Market Size-Segment Cutoff of the MSCI China Index as of the Rebalancing Date for the MSCI OVC Index
 - These companies must in addition
 - Meet the index constituent eligibility rules and guidelines (described in Sub-section 2.2 of the methodology) with the exception of the length of trading (3-month seasoning period) and liquidity screens,
 - Meet the size-segment investability requirements (described in Sub-section 2.3 of the methodology)

Proposal: Phase II – Early Inclusion Rule during Index Reviews

■ Summary

- The table below summarizes the earliest possible inclusion for IPOs:
 - IPOs, as currently defined, may only be added during SAIRs – these securities do not need to meet the criteria for Large Companies
 - The early inclusion rule during Index Reviews will allow the following:
 - Inclusion of Large IPOs during QIRs
 - Inclusion of new Large IPOs (up to the month prior to the rebalancing) during any IR

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Feb QIR	Large IPO								Large IPO	Large IPO	Large IPO	Large IPO
May SAIR	IPO	IPO	Large IPO	Large IPO					IPO	IPO	IPO	IPO
Aug QIR			Large IPO	Large IPO	Large IPO	Large IPO	Large IPO					
Nov SAIR			IPO	IPO	IPO	IPO	IPO	IPO	Large IPO	Large IPO		

- IPOs added to the MSCI OVC Equity Universe during SAIRs that are not included in the MSCI OVC Index in the same SAIR may only be added in the following Nov SAIR when the composition of the MSCI OVC Equity Universe is reviewed
 - The composition of the MSCI OVC Equity Universe is reviewed once a year at the Nov SAIR

Implementation

- Phase I: Early Inclusion in between Index Reviews will be implemented effective immediately after the confirmation announcement is sent
 - Any IPO that trades after the confirmation announcement and qualifies for the MSCI OVC Equity Universe, will be considered and evaluated for Early Inclusion to the MSCI OVC Index
- Phase II: Early Inclusion during Index Reviews will be considered starting Nov 2014 SAIR
 - Large IPOs that start trading in September 2014 and October 2014 and qualify for the MSCI OVC Equity Universe will be considered for Early Inclusion in the Nov 2014 SAIR (if they fail to meet the MSCI OVC Index Early Inclusion Criteria as of the first or second trading day)

Appendix: Impacted MSCI Indexes

Impacted MSCI Indexes

Key MSCI China Indexes	Domestic		Non-Domestic								
	Share Classes	China A	China H	China B	Red Chip	P Chip	HK	HSBC	Taiwan	US	SGP
Domestic China Index											
MSCI China A Index		•									
Non-domestic China Indexes											
NEW! MSCI China All Shares Index		•	•	•	•	•					
NEW! MSCI China A International Index		•									
MSCI China Index			•	•	•	•					
MSCI China H Index			•								
MSCI China B Index				•							
MSCI China Red Chip Index					•						
MSCI China P Chip Index						•					
MSCI China Free Index			•		•	•					
MSCI Hong Kong Index							•				
MSCI Overseas China Index										•	•
China Composite Indexes											
MSCI China A + H Index		•	•								
MSCI China A + B Index		•		•							
MSCI China A + B + H Index		•	•	•							
MSCI International China Index			•	•	•	•				•	•
MSCI China Free + Overseas China Index			•	•	•	•				•	•
MSCI Zhong Hua Index			•	•	•	•	•				
MSCI Zhong Hua + Overseas China Index			•	•	•	•	•			•	•
MSCI Zhong Hua + HSBC Index			•	•	•	•	•	•			
MSCI Golden Dragon Index			•	•	•	•	•		•		
MSCI Golden Dragon (A) Index		•	•	•	•	•	•		•		
MSCI Golden Dragon + Overseas China Index			•	•	•	•	•		•	•	•
MSCI All China Index		•	•	•	•	•	•			•	•
MSCI All China + Hong Kong + Taiwan Index		•	•	•	•	•	•		•	•	•

Appendix: References to the MSCI OVC Methodology

OVC Methodology – Sub-section 2.1

2.1. Defining the eligible equity universe

The MSCI Overseas China Indexes are free float-adjusted market capitalization indexes constructed using similar size and liquidity requirements as the MSCI China Investable Market Indexes under the MSCI GIMI methodology. Equity securities (including ADRs) of overseas Chinese companies listed on the NYSE Euronext - New York, NASDAQ, NYSE AMEX and Singapore Exchange and outside the MSCI China or MSCI China A equity universes are eligible for index inclusion.

Overseas Chinese companies are generally defined as companies that meet two out of three of the following criteria:

- The company's headquarter is located in PRC
- The company derives more than 50% of its revenue from the PRC¹
- The company has more than 50% of its assets in the PRC¹

In some exceptional cases, an additional analysis may be performed to ensure the company meeting the above criteria has a strong linkage to China. The outcome of this analysis may lead to some companies not being eligible for the MSCI Overseas China Indexes despite meeting two out of three of the criteria above.

US -listed companies resulting from reverse mergers¹ and Singapore-listed companies that are currently in the SGX's Watch List² are not eligible for index inclusion.

¹ Only revenue and asset attributed to PRC will be taken into account in this calculation. For cases where the distribution to PRC is bundled with other regions, only distribution to PRC and Hong Kong will be counted.

OVC Methodology – Sub-section 2.2-2.3

2.2. Determining the Investable Equity Universe

To be eligible for index inclusion, securities of companies must conform to the size and liquidity requirements applied to the MSCI China Indexes under the MSCI GIMI methodology at the time of index review³. Specifically, a security should fulfill the **minimum full company market capitalization** and **free float-adjusted market capitalizations** requirements that are applied to the MSCI China Index. A security must have a **Foreign Inclusion Factor (FIF)** equal to or larger than 0.15. In addition, a security must have a **12-month ATVR** of at least 15%, a **3-month Annualized Traded Value Ratio (ATVR)** of at least 15% and a **3-month frequency of trading** of at least 80% over the last 4 consecutive quarters. A minimum of three-month **seasoning period** will be applied to all newly issued securities.

2.3. Allocating companies into Size-Segment Index

The Investable Equity Universe is segmented into the following size-based indexes:

- Investable Market Index (IMI) (Standard + Small Cap)
- Standard Index (Large Cap + Mid Cap)
- Large Cap
- Mid Cap
- Small Cap

The MSCI Overseas China size-based indexes follow identical Size-Segment Cutoffs as the MSCI China size-based indexes. All securities with full company market capitalization equal to or larger than the Size-Segment Cutoff are pre-assigned to that size-segment index.

For a security that is pre-assigned to the Standard Size-Segment to be added to the MSCI Overseas China Standard Index, its free float-adjusted market capitalization must be at least 50% of the Size-Segment Cutoff for the MSCI China Index. For a security that is pre-assigned to the Small Cap Size-Segment to be added to the MSCI Overseas China Small Cap Index, its free float-adjusted market capitalization must be at least 50% of the Size-Segment Cutoff for the MSCI China Investable Market Index.

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