

# CONSULTATION ON SPECIFIC TOPICS RELATED TO INVESTMENT LIMITS

January 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. MSCI may publicly disclose feedback if specifically requested by specific market participants. In that case, the relevant feedback would be published together with the final results of the consultation.*

# SUMMARY

- MSCI launches a consultation on the following proposals to:
  - Introduce specific thresholds for inclusion of companies with Individual Ownership Limits
  - Simplify treatment for Thailand securities (NVDRs)
  - No longer consider Depositary Receipts in calculating Foreign Ownership Limits for Indian securities
  - Delete companies with low foreign room even if such companies have liquid Depositary Receipts
- Should the proposals be adopted, the changes would be implemented starting from the May 2019 Semi-Annual Index Review (SAIR)

**MSCI invites feedback from market participants on or before March 15, 2019 and will announce the results of the consultation on or before March 29, 2019**

# INDIVIDUAL OWNERSHIP LIMITS

# BACKGROUND

- Some companies may set Individual Ownership Limits (IOLs) which restrict ownership of an individual investor to a certain fraction of the company's total capital
- IOLs may be imposed through regulations which could cover an entire market such as in China and India or specific sectors such as the Financials sector in Russia. In other cases, the IOL may be imposed by an issuer, such as Qatar Fuel Co or Mesaieed Petrochemical in Qatar
- Such limits, when too restrictive, may limit the ability of institutional investors to invest in affected companies and therefore impact the replicability of an index
- Currently, MSCI accounts for material IOLs on a case by case basis. MSCI proposes to enhance the treatment of companies where such limits are imposed by specifying inclusion thresholds

# ASSESSING INDIVIDUAL OWNERSHIP LIMITS

**PROPOSAL: ASSESS INDIVIDUAL OWNERSHIP LIMITS RELATIVE TO THE FREE FLOAT LEVEL**

## Proposed Approach

$$\frac{\text{Individual Ownership Limit}^*}{\text{Free Float Factor (FIF or DIF)}} \geq \text{Threshold}$$

\*As a percentage of total capital

- Higher free float levels would result in higher ownership levels by individuals and therefore higher likelihood of breaching the limits. By assessing individual ownership limits relative to free float, MSCI would take into consideration the differences in likelihood of limit breach due to differences in free float level

### **Discussion point**

*Do you agree with the proposal to assess IOL relative to the free float level?*

# PROPOSED THRESHOLDS

**PROPOSAL:** INTRODUCE DIFFERENT THRESHOLDS DEPENDING ON THE IMPLEMENTATION OF THE IOL

## Case 1: IOL is applied at a Holding Level

(i.e. if each fund is individually subject to the limit)

**ENTRY:** Include only securities from the company where (Individual Ownership Limit/ Free Float Factor)  $\geq$  **2%**

**EXIT:** Constituents can remain as long as (Individual Ownership Limit/ Free Float Factor) does not fall below **1%**

## Case 2: IOL is applied at an Investor Level

(i.e. if each investor, aggregating its holdings, is subject to the limit)

**ENTRY:** Include only securities from the company where (Individual Ownership Limit/ Free Float Factor)  $\geq$  **4%**

**EXIT:** Constituents can remain as long as (Individual Ownership Limit/ Free Float Factor) does not fall below **2%**



### Simulated Impact on Selected Securities

e.g. in Qatar,  
the IOLs  
are applied  
at Holding Level  
(per NIN<sup>1</sup>)

Security	Ratio in Int'l Index (based on FIF <sup>2</sup> )	Ratio in Domestic Index (based on DIF <sup>2</sup> )	Impact based on Proposed Thresholds
Mesaieed Petrochemical (QA)	2%/0.25 = 8.0%	2%/0.25 = 8.0%	Eligible for both Int'l and Domestic Indexes
Qatar Fuel Co (QA)	1%/0.49 = 2.0%	<b>1%/0.65 = 1.5%</b>	<b>Eligible for Int'l Index but Ineligible for Domestic Index</b>
Saudi Basic Industries (SA)	1%/0.25 = 4.0%	1%/0.25 = 4.0%	Eligible for both Int'l and Domestic Indexes

1) National Identification Number

2) Free Float data as of December 3, 2018

# PROPOSAL IMPACT AND RATIONALE

- Based on the proposed thresholds, there would be no impact on existing constituents of the MSCI Global Investable Market Indexes
- Cases where IOLs are applicable on a per-holding basis have lower likelihood of limit breach compared to cases where the IOLs are applicable on a per-investor basis (by aggregating the investor's holdings)
  - to reflect the differences in the nature of the implementation of IOLs, MSCI proposes to use two different thresholds to assess each case
- In addition, in order to reduce volatility in the index due to updates in the FIF/DIF, MSCI proposes to apply exit thresholds that are lower than the entry thresholds, i.e. buffers
- The proposed thresholds and the resulting impact were determined based on known cases in Qatar, Saudi Arabia, Spain, and Korea gathered from MSCI's sources and discussions with market participants

# DISCUSSION POINTS

## Discussion points

- *Do you agree with the differentiated thresholds depending on the implementation of the IOL?*
- *Do you agree with the proposed thresholds (i.e. the entry and the exit thresholds)?*
- *Do you agree with the proposal to fully exclude securities that do not meet the thresholds from the MSCI GIMI? Or should such securities be included but at reduced weight?*

## Feedback point

- *Are you aware of any other specific companies or markets with restrictive Individual Ownership Limits?*



# TREATMENT FOR THAILAND SECURITIES

# BACKGROUND ON THAILAND MARKET

- There are three ways to invest in the Thailand market
  1. Local – has no dividends or voting rights for foreign investors
  2. Foreign Share (FGN) – provides all rights for foreign investors but is subject to Foreign Ownership Limits (FOL)
  3. Non-voting Depositary Receipts (NVDRs) – has no voting rights but has the same liquidity pool and price as the Local Share
- Currently, MSCI may include securities using the Local Share and the FGN up to the Foreign Ownership Limit (FOL) and increase the weight of the security only if there are sizeable NVDRs issued. MSCI does not consider limits on the NVDR for banks
  - Exception was applied for Bangkok Bank where the limit was almost breached
- MSCI proposes to enhance its current methodology by:
  - Reflecting NVDR limits for banks
  - Potentially increasing weight of securities when no NVDR limits are applied
  - Clarify rules for inclusion of FGN vs Local Line

# BACKGROUND ON MSCI CURRENT TREATMENT

- The MSCI Thailand Indexes include securities that are represented in two ways where weighting is capped at the FOL of the company, but may be increased if there are sizeable<sup>1</sup> Non-voting Depositary Receipts (NVDRs) issued :

- Most stocks are included in the index using their LOCAL share where FOL is increased for securities with sizeable NVDRs

Security Name	Regulatory Limit	NVDRs issued	FOL	FIF
SIAM COMMERCIAL BANK	46%	9%	0.54	0.54
PTT GLOBAL CHEMICAL	37%	12%	0.49	0.49

- Two stocks have been historically included using their FOREIGN share, and a LOCAL share is added to represent the sizeable NVDRs

Security Name	Regulatory Limit	NVDRs issued	FOL	LIF	FIF
KASIKORNBANK FGN	49%	26%	0.49	1	0.49
KASIKORNBANK			0.26	1	0.26
BANGKOK BANK FGN	25%	34%	0.25	0.5	0.13
BANGKOK BANK			0.34	0	0

<sup>1</sup> Sizeable NVDRs are defined as those representing at least 5% of the existing constituent's total outstanding company NOS and the float-adjusted market capitalization of the NVDR proportion must meet 1x the minimum free float-adjusted market capitalization required for the MSCI Thailand Index.

Buffer rule for updating NVDR: 2% during Nov and May SAIR

# ISSUES WITH CURRENT TREATMENT

1. Since the LOCAL share does not provide economic rights for foreign investors, foreign investors are investing in NVDRs which have NO ownership limits (except for financial institutions)
  - Hence, the weight of some Thai securities could be increased without compromising index investability
2. Issuance limit of NVDRs for financial institutions are not considered
  - All financial institutions have an NVDR issuance limit of 25%, except for Bangkok Bank and Kasikornbank with a 35% limit
  - MSCI currently has exceptional treatment for Bangkok Bank as its limit is almost reached
3. Additional complexities in methodology for Thailand may be avoided (e.g. sizeable NVDR rebalancing)

# SUMMARY OF PROPOSALS

1

Apply investment limits and monitor foreign room for LOCAL securities with limits on NVDR issuance

Note: Currently applicable for financial institutions only

2

Remove FOL for LOCAL securities with no limits on NVDR issuance (i.e. non-financial institutions)

3

If the FOREIGN line is liquid, use both FOREIGN line and the LOCAL line. Otherwise, use only LOCAL line

## RATIONALE

- Applying the NVDR limits will better reflect the available free float for foreign investors
- Adjusting the FIF for foreign room will better reflect the investability of the security
- NVDRs are not limited by any foreign ownership limit, except for financial institutions
- NVDRs and LOCAL securities share the same liquidity pool
- Given that foreign investors have both economic and voting rights from the FOREIGN line, priority is given to the FOREIGN line if the listing is liquid enough to be included in the index
- In cases where there are limits to NVDR issuance, using only the NVDR line would result in underrepresenting the company

# SIMULATED IMPACT: APPLY FOL AND MONITOR FOREIGN ROOM FOR LOCAL SECURITIES (PROPOSAL 1)

- Applying FOL for LOCAL securities with limits on NVDR issuance would result in decreasing the FIF for six securities in the MSCI Thailand IMI, and one deletion from the MSCI Thailand IMI

	New FIF	Current FIF	Change	New Weight - IMI	Current Weight - IMI	% Change	Size-segment
Siam Commercial Bank	0.25	0.54	-0.29	2.0%	5.3%	-3.3%	Standard
<b>Muangthai Capital Public</b>	<b>0.25</b>	<b>0.3</b>	<b>-0.05</b>	<b>0.0%</b>	<b>0.7%</b>	<b>-0.7%</b>	<b>Delete from Standard</b>
Tisco Financial Group	0.25	0.4	-0.15	0.3%	0.5%	-0.3%	Small Cap
Thanachart Capital	0.25	0.49	-0.24	0.3%	0.6%	-0.4%	Small Cap
Kiatnakin Bank	0.25	0.44	-0.19	0.2%	0.5%	-0.3%	Small Cap
Srisawad Corp	0.25	0.49	-0.24	0.2%	0.5%	-0.3%	Small Cap
Ratchthani Leasing	0.25	0.35	-0.10	0.1%	0.2%	-0.1%	Small Cap

- Currently all financial institutions in the MSCI Thailand IMI have enough foreign room (i.e. greater than 25%)
- Bangkok Bank, where LIF of 0 is applied because of investability issues would not meet the minimum foreign room for non-constituents and would remain non-investable

	NVDR Limit	NVDR Issuance	Available Foreign Room	Status
Bangkok Bank	35%	33%	5.71%	Not investable

# SIMULATED IMPACT: REMOVE FOL FOR LOCAL SECURITIES WITH NO LIMITS ON NVDR ISSUANCE (PROPOSAL 2)

- Removing the FOL would result in an increase in the index market capitalization of MSCI Thailand Index by 27%

	Standard	% Change	
Current Mcap	121,256		
Simulated Increase in Mcap	32,619	+27%	Impact of Proposal 2
Simulated Decrease in Mcap	-5,225	-4%	Impact of Proposal 1
Net change in Mcap*	27,394	+23%	Net impact*
Simulated Turnover*	13.8%		

## Current vs Simulated weight of Thailand in MSCI Emerging Markets Index:

	Weight
Current Weight	2.5%
Simulated Weight*	3.0%
Weight Change	+0.5%

- The resulting increase in FIF would result in the addition of four securities to the MSCI Thailand Index

Additions to MSCI Thailand Index (simulated)				
Security Name	New FIF	Current FIF	FIF Change	Index Weight
Intouch Holdings	0.6	0.07	+0.53	2.07%
Total Access Commu	0.3	0.06	+0.24	0.65%
Ratchaburi Electricity	0.55	0.25	+0.30	0.81%
Central Plaza Hotel	0.6	0.4	+0.20	0.65%

# PROPOSAL 3: USE BOTH FOREIGN AND LOCAL LINE IF FOREIGN LINE IS LIQUID

- Use NVDRs and FOREIGN LINE (FGN), *if FGN is liquid*. Otherwise, use NVDR only.

	If FGN is illiquid (most cases)	If FGN is liquid
<b>Security Representation</b>	NVDR only	FGN + NVDR
<b>Free Float Distribution</b>	NVDR: 1 - strategic shareholding, capped by the NVDR limit (if applicable)	FGN: Minimum (DIF, FOL - FOREIGN strategic shareholding) NVDR: Minimum (DIF, 1 - FOL - LOCAL strategic shareholding, capped by the NVDR limit (if applicable))

- Changes in liquidity of FGN, would result in changing the distribution of the free float
  - Similar to Siam Cement in May 2018 SAIR: illiquid FGN (deleted), FIF of local line was increased
  - In case FGN becomes liquid, FGN would be added and FIF of local line will decrease
- Currently, no other liquid FGNS aside from BANGKOK BANK FGN and KASIKORNBANK FGN
  - For current constituents, the impact of this proposal would be that the LIF of 0.5 would be removed for BANGKOK BANK FGN

Security Name	Liquidity	Foreign Room	Regulatory Limit	Local Strategic Holding	Foreign Strategic Holding	New FIF	Comments
BANGKOK BANK	44%	5.7%	35%	4.2%	0.5%	0.00	FGN is liquid, NVDR has low foreign room
BANGKOK BANK FGN	17%	N/A	25%			0.25	
KASIKORNBANK	61%	30.5%	35%	0.0%	0.0%	0.35	FGN is liquid, NVDR has foreign room
KASIKORNBANK FGN	16%	N/A	49%			0.49	



# DISCUSSION POINTS

- Do you agree with the proposal to apply FOL and monitor foreign room for financial institutions which have a limit on NVDR issuance?
- Do you agree with the proposal to remove the FOL for securities represented by the LOCAL line (in cases where there is no issuance limit on NVDRs)?
- Do you agree with the proposal to use both FGN and LOCAL line in cases where there is a liquid FGN?
  - Alternatively, given the decreasing liquidity of the FOREIGN line, should MSCI stop using the FOREIGN line even in cases where they are liquid?
- In other markets outside Thailand where the Foreign Ownership Limits do not actually limit the accessibility/ investability of such securities (i.e. voting rights for foreign investors are adjusted or diluted to meet the breached FOL), should MSCI continue to limit the Foreign Inclusion Factor by the Foreign Ownership Limit?

# FOREIGN OWNERSHIP LIMIT TREATMENT FOR INDIAN SECURITIES WITH DEPOSITORY RECEIPTS

# BACKGROUND (1/2)

- On April 5, 2018, the Securities and Exchange Board of India (SEBI), in consultation with the Reserve Bank of India (RBI), announced a new system for monitoring foreign investment limits, which came into effect starting June 1, 2018. According to the new system, two depositories, namely National Securities Depository Limited (NSDL) and Central Depository Services Limited (CDSL), have been appointed to monitor foreign investments
- NSDL and CDSL have started publishing changes in foreign room in the form of a "Breach List" and "Red Flag/Caution List"
  - The Breach List remains the same as RBI's Ban List, where the foreign investment in a security has reached the overall limit
  - While the Red Flag/Caution List is similar to the RBI's Caution List, the threshold for reporting a security in this list has changed
- MSCI deletes securities from the MSCI India Indexes that are (i) Appearing on the Breach list (ii) Appearing on the Red Flag/Caution list and have foreign room below 3.75% by giving 2 business days' notice
- To compute the head room, the Red Flag List and Breach List published by these depositories consider (i) the aggregate Foreign Portfolio Investments (FPI) against the permissible FPI limit and (ii) the aggregate foreign investments against the overall sectoral limits. Depository Receipts (DRs) are only considered as part of the sectoral limit and not the FPI limit

# BACKGROUND (2/2)

- Currently, MSCI calculates Foreign Ownership Limit (FOL) using the FPI limit. FPI Limit is the extent up to which foreign portfolio investors can invest in any Indian company
  - For companies that have issued Depositary Receipts (DRs) such as ADRs or GDRs, the FOL calculation includes the percentage represented by the depositary receipts
  - MSCI defines the percentage represented by DRs as the number of shares represented by DRs issued at the time of initial offering of the DRs adjusted for subsequent corporate events divided by the total number of shares outstanding
  - Many of the DRs have low levels of liquidity and are not easily accessible to investors.
- MSCI proposes not to include DRs in the calculation of FOL in India in order to better align with the depositories

# PROPOSED CALCULATION FOR INDIA FOL

**Proposal:** No longer consider DRs in calculating the FOL for Indian securities and make it equal to the Foreign Portfolio Investment Limit

- In deriving the foreign room for India, MSCI will consider the lower of:
  - Foreign institutional shareholdings (excluding DRs) set off against the FPI limits
  - All Foreign shareholdings (including DRs) set off against the sectoral limits

## **Discussion point**

*Do you agree with the proposal to remove the DRs added to the FPI limit to derive the FOL for Indian securities?*

# SIMULATED INDEX IMPACT

## Top 10 changes in the MSCI India Index by index impact:

Security Name	Current FIF <sup>^</sup>	Proposed FIF	Index Mcap Impact <sup>~</sup>	Current Weights	Pro-forma Weights
LARSEN & TOUBRO	0.34	0.24	(2598)	1.63%	1.18%
ITC	0.28	0.24	(2005)	2.59%	2.27%
TATA MOTORS	0.55	0.35	(1488)	0.75%	0.49%
MAHINDRA & MAHINDRA	0.6	0.49	(1413)	1.42%	1.19%
DR REDDY'S LABORATORIES	0.69	0.49	(1212)	0.77%	0.56%
GAIL INDIA	0.35	0.24	(1123)	0.66%	0.46%
HINDALCO INDUSTRIES	0.52	0.4	(791)	0.63%	0.50%
BAJAJ AUTO	0.29	0.24	(553)	0.59%	0.50%
TATA STEEL	0.31	0.24	(522)	0.43%	0.34%
LIC HOUSING FINANCE	0.59	0.49	(338)	0.37%	0.31%

## Current vs Pro-forma weight of India in MSCI Emerging Markets Index:

	Weight
Current Weight	8.78%
Pro-forma Weight	8.55%
Weight Change	-0.23%

# Data as of 18th Jan 2019

\* Mcap stands for Market Capitalization

<sup>^</sup> FIF stands for Foreign Inclusion Factor

<sup>~</sup> in Millions USD

- The proposed methodology would have an impact of approximately USD 12.8 billion on the MSCI India Index resulting in a turnover of 2.53% and USD 13.8 billion on the MSCI India IMI resulting in a turnover of 2.27%

# SECURITIES WITH LOW FOREIGN ROOM MAINTAINED IN THE MSCI GIMI

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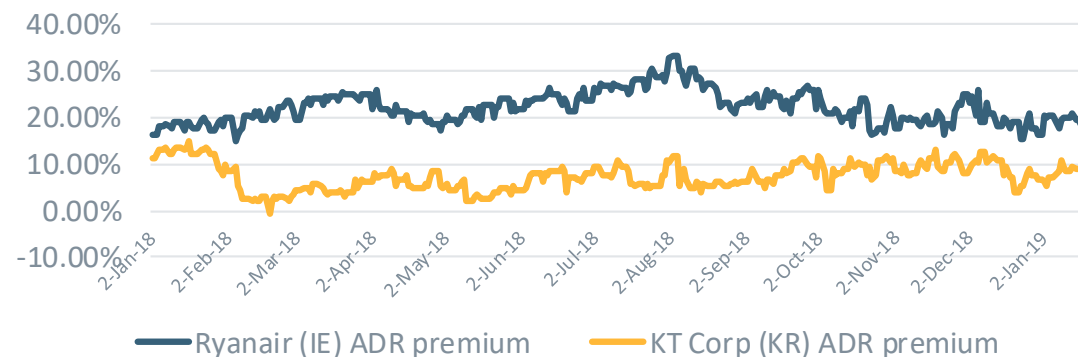
- Currently, a security with low foreign room (below 3.75%) may be retained in the MSCI GIMI if it has a liquid eligible Depositary Receipt (DR). Otherwise, the security will be deleted
- Cases where the DR is trading at a discount/ premium vs the local listing may result in index replicability issues (tracking error)

**Proposal: EXCLUDE SECURITIES WITH LOW FOREIGN ROOM REGARDLESS IF THEY HAVE LIQUID DRs**

## ***Impact:***

- Under the proposal, **Ryanair (IE)** and **KT Corp (KR)** would be deleted from the MSCI GIMI

**Premium trend for impacted MSCI ACWI constituents (USD price of ADR vs local listing)**



## **Discussion Point**

*Should a security whose foreign room has decreased to below 3.75% be excluded from the MSCI GIMI regardless of whether it has a liquid DR?*



# APPENDIX

# SIMULATED WEIGHT INCREASES

## Top 10 Weight Increases for Simulated MSCI Thailand Index

	New FIF	Current FIF	Change		New Weight - Standard	Current Weight - Standard	% Change
Siam Cement	0.65	0.32	+0.33		5.4%	3.3%	+2.1%
Bangkok Dusit Med. Svcs	0.6	0.25	+0.35		3.9%	2.0%	+1.9%
Intouch Holdings	0.6	0.07	+0.53		1.7%	0.0%	+1.7%
Central Pattana Pub Co	0.5	0.3	+0.20		3.0%	2.2%	+0.8%
Ratchaburi Electricity	0.55	0.25	+0.30		0.7%	0.0%	+0.7%
Bangkok Bank Fgn	0.25	0.13	+0.12		1.7%	1.1%	+0.6%
Land & Houses	0.6	0.25	+0.35		1.3%	0.7%	+0.6%
Banpu	0.85	0.4	+0.45		1.3%	0.7%	+0.5%
Central Plaza Hotel	0.6	0.4	+0.20		0.5%	0.0%	+0.5%
Total Access Commu	0.3	0.06	+0.24		0.5%	0.0%	+0.5%

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