

MSCI MARKET CLASSIFICATION FRAMEWORK

Consultation on potential methodology
enhancements

May 2018

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.

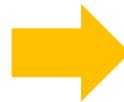
SUMMARY

MSCI is proposing to **enhance** the MSCI Market Classification Framework to better reflect the evolving **investment requirements** of international institutional investors

Objective

Increase the focus on the need of international investors to access a broad range of investment instruments globally

Add an alternative to fully including or excluding markets from the MSCI Indexes following the introduction of certain levels of market accessibility restrictions



Proposal

Change title and definition of the “Competitive Landscape” market accessibility sub-criterion

Introduce the possibility of capping the weight of markets in the MSCI Indexes to address the introduction of certain market accessibility restrictions

CONSULTATION TIMELINE

*MSCI invites feedback from market participants on or **before November 30, 2018** and will announce the results of the consultation on or **before December 31, 2018***

*MSCI would consult **subsequently on an implementation proposal** were these proposed enhancements to the MSCI Market Classification Framework to be adopted fully or partially following this consultation*

AVAILABILITY OF INVESTMENT INSTRUMENTS

1st Proposal

MSCI MARKET CLASSIFICATION FRAMEWORK

The current MSCI Market Classification Framework consists of the following three criteria: economic development, size and liquidity and market accessibility

Criteria	Frontier	Emerging	Developed
A Economic Development A.1 Sustainability of economic development	No requirement	No requirement	Country GNI per capita 25% above the World Bank high income threshold* for 3 consecutive years
B Size and Liquidity Requirements B.1 Number of companies meeting the following Standard Index criteria Company size (full market cap) ** Security size (float market cap) ** Security liquidity	2 USD 797 mm USD 71 mm 2.5% ATVR	3 USD 1,594 mm USD 797 mm 15% ATVR	5 USD 3,187 mm USD 1,594 mm 20% ATVR
C Market Accessibility Criteria C.1 Openness to foreign ownership C.2 Ease of capital inflows / outflows C.3 Efficiency of the operational framework C.4 Competitive Landscape C.5 Stability of the institutional framework	At least some At least partial Modest High Modest	Significant Significant Good and tested High Modest	Very high Very high Very high Unrestricted Very high

* High income threshold for 2016: GNI per capita of USD 12,476 (World Bank, Atlas method)

** Minimum in use for the May 2018 Semi-Annual Index Review, updated on a semi-annual basis

Note: The economic development criterion is only used in determining the classification of Developed Markets while that distinction is not relevant between Emerging and Frontier Markets given the very wide variety of development levels within each of these two universes

EVOLVING NEEDS & REQUIREMENTS OF INVESTORS

Different types of market participants seem to have developed different needs that require the use of different types of investment instruments (e.g., ETFs and exchange traded and over-the-counter derivatives), including index-linked investment instruments

Asset Owners

Access
Hedging
Overlay Strategy

Active Asset Manager

Access
Equitization
Hedging
Leverage

Passive Asset Manager

Access
Equitization
Hedging

Broker Dealer

Hedging
Leverage
Product Creation



- How critical is the use of index linked investment instruments in your investment process?
- What type of investment instruments do you use? How are you using them?

CHANGE OF CRITERION

The current definition of the criterion may be insufficiently clear in highlighting those elements of accessibility which MSCI believes important to international institutional investors. Hence, the proposal to rename it to highlight this more clearly

~~Competitive Landscape~~



Availability of Investment Instruments



- Do you agree that the availability of investment instruments is of importance to your investment process?

NEW DEFINITION

Availability of Investment Instruments Sub-Criterion

Over the years, investors have increasingly been using a variety of investment instruments, such as exchange traded funds, futures, options, swaps and structured products, onshore and offshore, as a complement to direct equity investment to the point that these have become an integral part of their investment processes. Today, the availability of such instruments has become critical to international investors for a number of their investment activities such as gaining exposure to markets, hedging of investments, equitization of cash positions or overlay strategies. Hence, it is expected that stock exchanges, which often have legal or natural monopolies, should not impose clauses in their provision of stock market data, such as securities' prices, that could lead directly or indirectly to restricting the availability of investment instruments globally. These clauses typically restrict investors' access to derived stock exchange information, data and products, including, for example, the provision of independently calculated indexes or the creation of investment instruments based on such indexes. In addition, the imposition of these types of clauses can result in global or regional investment instruments becoming in breach of local market rules, regulations or other restrictions. The existence of these types of practices will lead to a negative assessment.



- Does the proposed new definition meet your requirements and constraints?

ACCESSIBILITY REQUIREMENT

Criteria	Frontier	Emerging	Developed
A Economic Development			
A.1 Sustainability of economic development	No requirement	No requirement	Country GNI per capita 25% above the World Bank high income threshold* for 3 consecutive years
B Size and Liquidity Requirements			
B.1 Number of companies meeting the following Standard Index criteria Company size (full market cap) ** Security size (float market cap) ** Security liquidity	2 USD 797 mm USD 71 mm 2.5% ATVR	3 USD 1,594 mm USD 797 mm 15% ATVR	5 USD 3,187 mm USD 1,594 mm 20% ATVR
C Market Accessibility Criteria			
C.1 Openness to foreign ownership	At least some	Significant	Very high
C.2 Ease of capital inflows / outflows	At least partial	Significant	Very high
C.3 Efficiency of the operational framework	Modest	Good and tested	Very high
C.4 Availability of Investment Instruments	High	Very High	Unrestricted
C.5 Stability of the institutional framework	Modest	Modest	Very high

* High income threshold for 2016: GNI per capita of USD 12,476 (World Bank, Atlas method)

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- Do you agree that there should be some minimum level of availability of investment instruments under the Market Classification Framework?
- Are there some restrictions above that minimum level that you deem not acceptable for the respective classifications, i.e., Developed, Emerging and Frontier?

UNRESTRICTED AVAILABILITY OF INVESTMENT INSTRUMENTS ?

Developed Markets		Emerging Markets	
Australia	Yes	Brazil	No
Austria	Yes	Chile	Yes
Belgium	Yes	China A	No
Canada	Yes	Colombia	Yes
Denmark	Yes	Czech Republic	Yes
Finland	Yes	Egypt	Yes
France	Yes	Greece	Yes
Germany	Yes	Hungary	Yes
Hong Kong	Yes	India	No
Ireland	Yes	Indonesia	Yes
Israel	Yes	Korea	No
Italy	Yes	Malaysia	Yes
Japan	Yes	Mexico	Yes
Netherlands	Yes	Pakistan	Yes
New Zealand	Yes	Peru	Yes
Norway	Yes	Philippines	Yes
Portugal	Yes	Poland	Yes
Singapore	Yes	Qatar	Yes
Spain	Yes	Russia	Yes
Sweden	Yes	South Africa	Yes
Switzerland	Yes	Taiwan	Yes
United Kingdom	Yes	Thailand	Yes
USA	Yes	Turkey	No
		UAE	Yes

EXAMPLES OF RESTRICTIONS

Examples of Restrictions on Investment Instruments

Restrictions on listed and traded derivative products offered by an offshore exchange where local shares represent more than an exchange-specified weight

Restrictions on investment instruments (e.g., futures, options, SWAPs, ETFs) both issued offshore and traded on a regulated exchange where local shares represent more than an exchange-specified weight



- Should restrictions on different types of investment instruments (e.g., listed vs. OTC, ETFs vs. derivatives, single country vs. global) be treated uniformly?

MARKET WEIGHT CAPPING

2nd Proposal

POSSIBLE WEIGHT CAPPING

Local stakeholders can impose market accessibility restrictions that would not fully impair international investors from investing in that market but that may nevertheless make the market less accessible / investable for international investors



In such instances, the **weight** of such markets could be **capped** in the MSCI Indexes instead of fully including or excluding markets from the MSCI Indexes

Examples of Restrictions Reducing the Accessibility of Markets

- Investor Qualification
- Foreign Exchange
- Availability of Investment Instruments
- Registration & Setup
- Clearing & Settlement



- Do you agree on the principle of capping the weight of markets in the MSCI Indexes as an alternative to full inclusion or exclusion of the market if the restrictions do not fully impair access to the market for international investors?

POTENTIAL PAST EXAMPLES

The below examples aim to serve as illustrations where a capping could have been applied in the past

Examples of Restrictions	
Argentina (2009)	Imposition of minimum period during which investments must remain in the country
Egypt (2013)	Foreign exchange liquidity crisis following the imposition of FX restrictions by the Egyptian Central Bank
Nigeria (2016)	Foreign exchange liquidity crisis following the imposition of FX restrictions by the Nigerian Central Bank

POTENTIAL FUTURE EXAMPLES

The below examples aim to serve as illustrations where a capping could be applied in the future

Examples of Restrictions	
Brazil	Restrictions on listed and traded derivative instruments offered by an exchange outside of Brazil based on certain indexes
Korea	Restrictions on listed and traded derivative instruments offered by an exchange outside of Korea based on certain indexes
India	Restrictions on certain investment instruments that are based on certain indexes and are both issued outside of India and traded on a regulated exchange Lengthy and burdensome mandatory registration process subject to the Securities and Exchange Board of India (SEBI) approval for international investors
Turkey	Restrictions on listed and traded derivative products based on certain indexes offered by an exchange outside of Turkey

Note: the above table does not include the China A Shares market that will be included in MSCI EM with a capping factor at 5% starting with the May 2018 Semi-Annual Index Review

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