

# CONSULTATION ON A MARKET RECLASSIFICATION PROPOSAL FOR THE MSCI PAKISTAN INDEX

Potential Reclassification from Frontier to Emerging  
Markets

June 2015

# RECLASSIFICATION PROPOSAL

- MSCI proposes to reclassify the MSCI Pakistan Index from Frontier Markets to Emerging Markets
  - The proposed reclassification would be reflected in all relevant global and regional composite indexes
  - The proposal is to implement the potential reclassification in one step coinciding with the May 2017 Semi-Annual Index Review
- MSCI will consult with market participants on this reclassification proposal as part of the 2016 Annual Market Classification Review
  - MSCI will announce its decision in June 2016
- Please note that this proposal may or may not lead to any changes to the MSCI Indexes

# HISTORICAL BACKGROUND

- MSCI Pakistan Index was removed from MSCI Emerging Markets Index at the end of December 2008 following the deteriorated investability conditions prevailing in the Pakistani equity market. The index was classified as stand-alone
- As announced in February 2009
  - *Proposal to be included in the MSCI Frontier Markets Index*
- MSCI Pakistan was included in the MSCI Frontier Markets coinciding with the 2009 May Semi Annual Index Review
- As announced in June 2009
  - *The Pakistani equity market will need to function without any trading disruptions for some time as a condition to being considered for reclassification in Emerging Markets.*
- As announced in June 2010, not added to Review List for reclassification to EM
  - *Pakistani Market has returned to normal functioning since the removal of the “floor rule” in late 2008. However, the Pakistani Market was still characterized by a very limited number of sizeable securities and some holdover concerns on the institutional framework*
- As announced in June 2011
  - *MSCI Pakistan Index will not be added to the review list primarily due to the limited number of sizable securities*

## RATIONALE FOR PROPOSAL

- The Pakistani equity market underwent a number of positive developments over the course of the past 12 to 18 months
- The Pakistani equity market has grown significantly and its liquidity has greatly improved over the past years
  - As a result, the concerns about the potential for failing to meet size and liquidity criteria should there be a negative market event have receded

## RECENT DEVELOPMENTS

- Launch of Pakistan Unified Corporate Action Reporting System (PUCARS) at Karachi Stock Exchange (KSE) – March 2014
  - PUCARS to provide an automated web-based announcement interface for listed issuers for sharing price sensitive information with market participants
- Restrictions on Negotiated Deal Market (NDM) transactions – April 2014
  - NDMs between a broker's proprietary account and a client sub-account as well as transactions between sub-accounts of different clients with the same broker will be blocked
  - These restrictions are aimed to prevent unauthorized movement of client securities via NDM transactions
- FII's to be taxed independently and are no longer exempted from withholding taxes (July 2014)
- Approval SME Regulations for Karachi Stock Exchange – January 2015
  - Draft regulatory framework for Private Equity is also in place
- Development of an Online Complaint Management System – March 2015

# MARKET ACCESSIBILITY

	Pakistan
<b>Openness to foreign ownership</b>	
Investor qualification requirement	++
Foreign ownership limit (FOL) level	++
Foreign room level	++
Equal rights to foreign investors	++
<b>Ease of capital inflows / outflows</b>	
Capital flow restriction level	++
Foreign exchange market liberalization level	+
<b>Efficiency of the operational framework</b>	
<b>Market entry</b>	
Investor registration & account set up	+
<b>Market organization</b>	
Market regulations	+
Competitive landscape	
Information flow	++
<b>Market infrastructure</b>	
Clearing and Settlement	+
Custody	++
Registry / Depository	++
Trading	++
Transferability	++
Stock lending	-/?
Short selling	-/?
Stability of institutional framework	-/?

- **Foreign Exchange Market Liberalization Level:** No offshore currency market and minor constraints on onshore currency market (e.g., buying and selling done through a Special Convertible Rupee Account)
- **Investor Registration & Account Setup:** Foreign investors are required to open a Special Convertible Rupee Account (SCRA) and obtain a UIN (Unique Identification Number). The registration of UIN takes around 3-4 days to complete
- **Market Regulations:** Regulations have frequently changed over the past few years. In particular, trading on the Pakistani equity market was practically suspended for five months following the implementation of a price floor rule in August 2008
- **Clearing and Settlement:** Nominee status and omnibus structures are available. Overdraft facilities remain prohibited
- **Stock Lending & Short Selling:** Foreign investors are not allowed to undertake short selling or stock lending and borrowing
- **Stability of Institutional Framework:** There have been instances of interventions that challenged the stability of the “free-market” economy as illustrated by frequently changing market regulations

# SIMULATED CONSTITUENTS CHANGE

## Number of Constituents

	Large Cap	Mid Cap	Standard	Small Cap	IMI
Frontier Markets	6	10	16	21	37
Emerging Markets	2	4	6	19	25

Data as of April 20, 2015

## Free Float Adjusted Market Capitalization (USD billion)

	Large Cap	Mid Cap	Standard	Small Cap	IMI
Frontier Markets	4.0	4.1	8.1	2.6	10.7
Emerging Markets	2.7	2.8	5.5	3.8	9.4

Data as of April 20, 2015

- The number of index constituents would be decreased from 16 to 6
  - This change would result in a free float adjusted market capitalization decrease of more than 32%

# SIMULATED INDEX CONSTITUENT LIST

Company	Full Mcap*	FIF Mcap*	FIF**	Size Segment
Oil & Gas Development	7.8	1.2	0.15	Large Cap
MCB Bank	3.1	1.6	0.5	Large Cap
United Bank	2.1	0.6	0.3	Mid Cap
Fauji Fertilizer Co	1.7	0.8	0.45	Mid Cap
Lucky Cement	1.5	0.8	0.5	Mid Cap
Engro Corporation	1.5	0.7	0.45	Mid Cap

Data as of April 20, 2015

\* USD billion

\*\* Foreign Inclusion Factor



# SIMULATED EMERGING MARKETS WEIGHTS

	Pro forma Standard Index		
	FIF Mkt Cap	Weight	# Sec.
<b>EM</b>	<b>4,212,755</b>	<b>100.00%</b>	<b>837</b>
<b>EM Asia</b>	<b>2,907,804</b>	<b>69.02%</b>	<b>545</b>
China	1,048,137	24.88%	144
Korea	634,557	15.06%	108
Taiwan	507,018	12.04%	97
India	311,956	7.41%	71
Malaysia	142,914	3.39%	42
Indonesia	107,541	2.55%	30
Thailand	98,865	2.35%	32
Philippines	56,816	1.35%	21
<b>EM EMEA</b>	<b>713,146</b>	<b>16.93%</b>	<b>164</b>
South Africa	328,124	7.79%	53
Russia	162,700	3.86%	21
Poland	63,784	1.51%	24
Turkey	57,102	1.36%	25
Qatar	37,330	0.89%	13
United Arab Emirates	28,596	0.68%	10
Greece	10,848	0.26%	9
Hungary	8,567	0.20%	3
Egypt	8,170	0.19%	3
Czech Republic	7,926	0.19%	3
<b>EM Latin America</b>	<b>591,804</b>	<b>14.05%</b>	<b>128</b>
Brazil	310,769	7.38%	67
Mexico	183,992	4.37%	28
Chile	55,348	1.31%	18
Colombia	24,769	0.59%	12
Peru	16,926	0.40%	3
<b>Pakistan</b>	<b>5,575</b>	<b>0.13%</b>	<b>6</b>

- The simulated MSCI Pakistan Index would have a potential weight of 0.13% in Emerging Markets

## KEY QUESTIONS

- Is it too early to consider the MSCI Pakistan for reclassification to Emerging Markets given the market's specific accessibility history?
- Are the potential decreases in number of constituents and index market capitalization problematic?
  - If yes, should it be a show stopper?
- Is the potential small weight of the MSCI Pakistan Index in Emerging Markets problematic?
  - If yes, what should be the minimum weight in global indexes that would warrant a reclassification?
- Are there any other market accessibility concerns that should prevent the reclassification?

# APPENDIX

# SIMULATED CONSTITUENT LIST

Company	Full Mcap	FIF Mcap	FIF	small FM	larger FM	EM
Oil & Gas Development	7,828	1,174.23	0.15	Large	Large	Large
Pakistan Petroleum	3,488	348.84	0.10	Large	Large	
MCB BANK	3,122	1,560.81	0.50	Large	Large	Large
Habib Bank	2,673	160.41	0.06	Large	Large	
K-Electric	2,100	105.00	0.05	Large		
United Bank	2,068	620.37	0.30	Large	Mid	Mid
Fauji Fertilizer Co	1,734	780.47	0.45	Mid	Mid	Mid
Lucky Cement	1,528	764.12	0.50	Mid	Mid	Mid
Engro Corporation	1,501	675.24	0.45	Mid	Mid	Mid
National Bank Pakistan	1,229	307.13	0.25	Mid	Mid	Small
Hub-Pow er Co	1,046	366.09	0.35	Mid	Small	Small
Pakistan Telecom	1,045	92.84	0.12	Mid		
Pakistan State Oil Co	1,013	506.45	0.50	Mid	Small	Small
Pakistan Oilfields	889	266.82	0.30	Mid	Small	Small
Fatima Fertilizer	850	170.09	0.20	Mid	Small	Small
Indus Motor Company	827	165.37	0.20	Mid	Small	Small
Kot Addu Pow er Company	765	229.52	0.30	Small	Small	Small
Daw ood Hercules Corp	532	106.48	0.20	Small	Small	Small
Abbot Lab (Pakistan)	524	104.73	0.20	Small	Small	Small
Bank Al-Habib	513	384.62	0.75	Small	Small	Small
Packages	497	149.04	0.30	Small	Small	Small
Fauji Cement Co	455	197.73	0.45	Small	Small	Small
Fauji Fertilizer Bin Qas	451	112.72	0.25	Small	Small	Small
Attock Petroleum	448	89.69	0.20	Small	Small	Small
Bank Alfalah	437	174.99	0.40	Small	Small	Small
Nishat Mills	387	135.56	0.35	Small	Small	Small
Habib Metro Bank	356	106.86	0.30	Small	Small	Small
Maple Leaf Cement	331	115.70	0.35	Small	Small	
Pak Suzuki Motor Co	323	80.67	0.25	Small		
Sui Southern Gas Co	313	62.53	0.20	Small		
Kohat Cement	306	91.67	0.30	Small		
Millat Tractors	261	117.51	0.45	Small	Small	Small
Askari Bank	259	64.87	0.25	Small		
Shell Pakistan	259	51.81	0.20	Small		
Igi Insurance	259	90.56	0.35	Small	Small	Small
Pak Elektron	240	84.05	0.35	Small		
National Refinery	171	42.87	0.25	Small		

Data as of April 20, 2015

- Only 2 companies have a free float adjusted market capitalization of more than USD 1 billion
- Large Cap companies are in general exhibiting low free float
- 6 Mid Cap companies would be migrating to the MSCI Pakistan Small Cap Index

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