

CONSULTATION ON CHINA A-SHARES INDEX INCLUSION ROADMAP

June 2016

EXECUTIVE SUMMARY

- In June 2016, MSCI announced that will delay including China A-shares in the MSCI Emerging Markets Index and China A-shares will remain on the 2017 review list for potential inclusion into Emerging Markets.
- While the overall market accessibility of A shares has continued to improve over the past 12 months, the 2016 consultation feedback identified three remaining obstacles that need to be addressed:
 - *Effective implementation of the QFII policy changes and removal of the 20% monthly repatriation limit*
 - *Effective implementation of new trading suspension treatment*
 - *Resolution of pre-approval requirements by the local exchanges on launching financial products*
- MSCI does not rule out a potential off-cycle announcement should significant positive developments occur ahead of June 2017.

KEY HIGHLIGHTS OF 2017 PROPOSAL

MSCI is maintaining the proposal for a 5% partial inclusion of China A-shares into the MSCI Emerging Markets Index effective in June 2018 in one single phase.

The 5% partial inclusion approximates 1.1% weight of China A shares in the MSCI Emerging Markets Index.

- The Chinese authorities have demonstrated a clear commitment to bring the accessibility of the China A-shares market closer to international standards.
- Recent improvements in the accessibility of the China A-shares market include:
 - *Resolution of the issues regarding beneficial ownership*
 - *Linking QFII Quota allocation to size of investors*
 - *Relaxation of capital mobility restrictions under the QFII scheme*
 - *Enhanced regulations on trading suspensions*
- In addition, the Chinese regulators have also recently announced the expansion of RMB 250 billion RQFII quota to USA. The potential launch of the Shenzhen-Hong Kong Stock Connect is also expected to further improve the overall accessibility of China A-shares.

2016 CONSULTATION FEEDBACK

- Of the various issues highlighted, only the beneficial ownership issue is considered to have been satisfactorily resolved

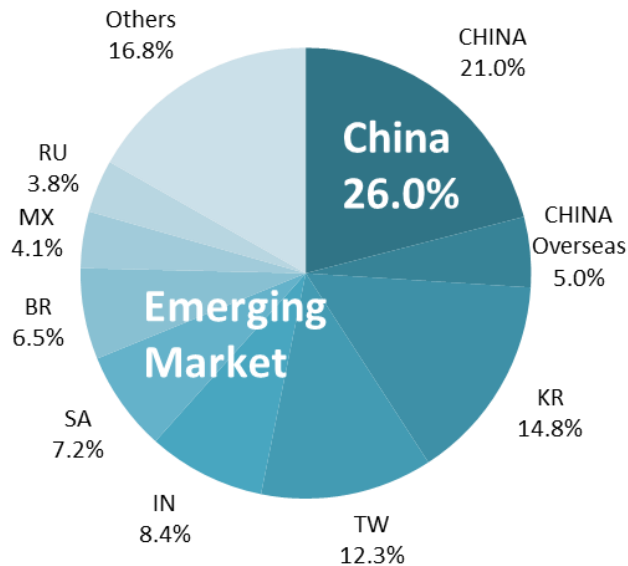
Highlighted Issues by MSCI	Status and Developments	Feedbacks from Market Participants
Beneficial Ownership	<ul style="list-style-type: none"> ✓ Clarification on the beneficial ownership status of securities in QFII and RQFII (including separate accounts). 	<ul style="list-style-type: none"> ✓ International investors are generally satisfied with the clarification by the CSRC
Quota Allocation Process Capital Mobility Restrictions	<ul style="list-style-type: none"> ✓ Base quota is now linked to AUM ranging from US\$20mn to US\$5bn. ✓ Base quota automatically obtained based on AUM through filing with SAFE ✓ Repatriation for QFIIs (including separate accounts) shortened to daily 	<ul style="list-style-type: none"> ❖ Feedback were generally positive however investors need more time to assess the effectiveness of the implemented changes ❖ However, most investors viewed 20% monthly repatriation limit as problematic
Widespread voluntary suspension	<ul style="list-style-type: none"> ✓ Clarification of trading suspension policies from both Shanghai and Shenzhen Stock Exchanges. ✓ Company can only apply for suspension after providing proper reasons and submitting necessary documents to the exchanges ✓ Trading suspension ranges from 10 days to 5 months 	<ul style="list-style-type: none"> ❖ Investors generally welcome greater clarity of the trading suspension rules ❖ More time is needed to assess the effectiveness of the recently announced policy
Pre-approval requirements imposed by stock exchanges	<ul style="list-style-type: none"> ❖ Remain unaddressed 	<ul style="list-style-type: none"> ❖ Institutional investors expressed strong concern over the pre-approval requirements and agreed that the issue needs to be satisfactorily resolved before the inclusion happens

REMAINING OBSTACLES TO BE ADDRESSED

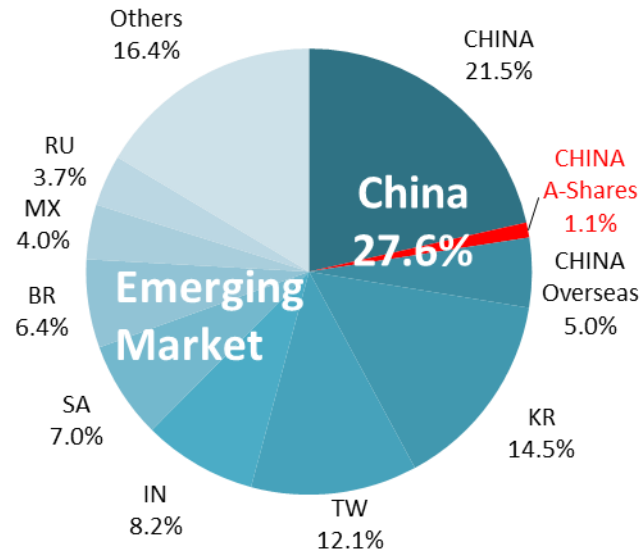
1. Effective implementation of the QFII policy changes and removal of the 20% monthly repatriation limit
 - *Progress has been made on the QFII quota allocation and capital mobility issues but a period of observation on the effectiveness of implemented changes is still required*
 - *Positive experiences on quota applications by international investors, as well as seamless execution of daily capital repatriation*
 - *A complete removal or substantially increase the 20% monthly repatriation limit with a shorter repatriation horizon*
2. Effective implementation of new trading suspension treatment
 - *MSCI welcomes the implementation of the new trading suspension policies but a period of observation on the effectiveness of implemented changes is still required*
 - *Significant reduction of the number of suspended stocks on the Shanghai and Shenzhen exchanges*
3. Resolution of pre-approval requirements by the local exchanges on launching financial products
 - *Ability to launch financial products by any financial institution on any stock exchange internationally if these products are linked to indexes that include China A-shares*

INDEX INCLUSION ROADMAP OF CHINA A-SHARES

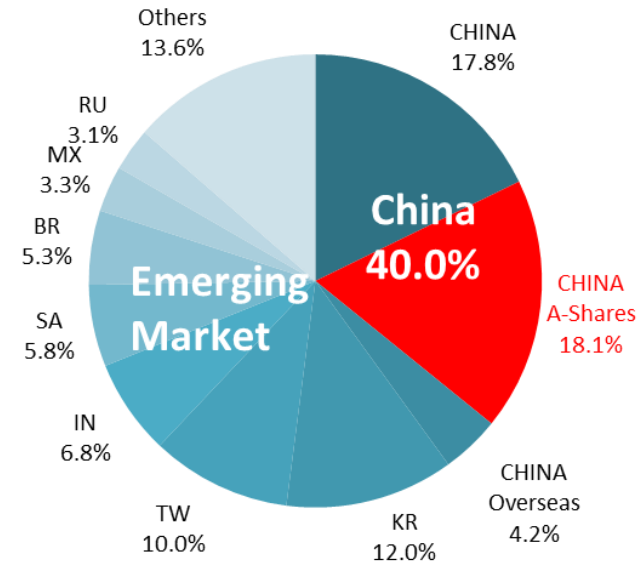
Current Status



Partial Inclusion (5%)



Full Inclusion (100%)



Data as of June 10, 2016

Timeline of Recent Developments

● Feb 2016

- Linking QFII Quota allocation to size of investors
- Relaxation of capital mobility restrictions under the QFII scheme

● May 2016

- MSCI resumes consultation on China A-shares inclusion roadmap

● Jun 2016

Remaining Obstacles:

- Effective implementation of the QFII policy changes and removal of the 20% monthly repatriation limit
- Effective implementation of new trading suspension treatment
- Resolution of pre-approval requirements by the local exchanges on launching financial products

TRANSITION ANALYSIS

- If the partial inclusion proposal is accepted, the number of constituents in the MSCI China Index would increase from 150 to 620 with a majority of new constituents coming from A shares. ¹
- The estimated one way index turnover will be 7.7%, comparable to the first-phase transition of overseas listed China ADRs in November 2015.

	Current Standard		Pro forma (IF* = 5%)			# Securities	
	Weight	# Sec	Weight	# Sec	1 way Turnover	Add	Del
MSCI China A	100%	814	100%	431	27.30%	-	383
Large Cap	66.7%	302	82.7%	268		5	39
Mid Cap	33.3%	512	17.3%	164		27	375
MSCI China A IMI	100%	1981	100%	1847	20.40%	98	232
Large Cap	50.3%	302	55.0%	268		5	39
Mid Cap	25.1%	512	11.6%	164		27	375
Small Cap	24.5%	1167	33.4%	1415		250	2
MSCI China	100%	150	100%	620	7.71%	470	-
A Shares	0.0%	0	3.9%	431	3.95%	431	0
B Shares	0.3%	2	0.4%	4	0.15%	2	0
H Shares	39.9%	72	37.7%	83	0.86%	11	0
Red Chip	19.4%	30	18.5%	37	0.61%	7	0
P Chip	21.0%	33	21.2%	49	1.80%	16	0
Overseas#	19.4%	13	18.3%	16	0.43%	3	0
MSCI EM		835	100%	1305	2.15%	470	-
A Shares	-	-	1.1%	431	1.12%	421	-
MSCI EM (include LC only)		835	100%	1141	1.96%	306	-
A Shares (include LC only)	-	-	0.8%	268	0.93%	271	-

Data as of June 10, 2016

1. The pro forma index constituents are based on the MSCI China A International Index.

KEY DISCUSSION POINTS

1. What has been your experience with regards to:
 - The QFII policy relaxations with regards to quota allocation and capital mobility?
 - The change in regulation governing trading suspensions on the A shares market?
2. Do you see the 20% monthly repatriation limit as a road block to the inclusion?
 - Would the launch of the Shenzhen Stock Connect alleviate the 20% monthly repatriation issue?
3. Given the QFII quota is now linked to the asset size of investors and potentially sufficient to cater for a larger allocation, does a 5% initial inclusion still represent a reasonable proposal ? Should MSCI consider a higher percentage for the initial inclusion?
4. Would you agree with the proposed one-phase transition plan and implementation timeline?

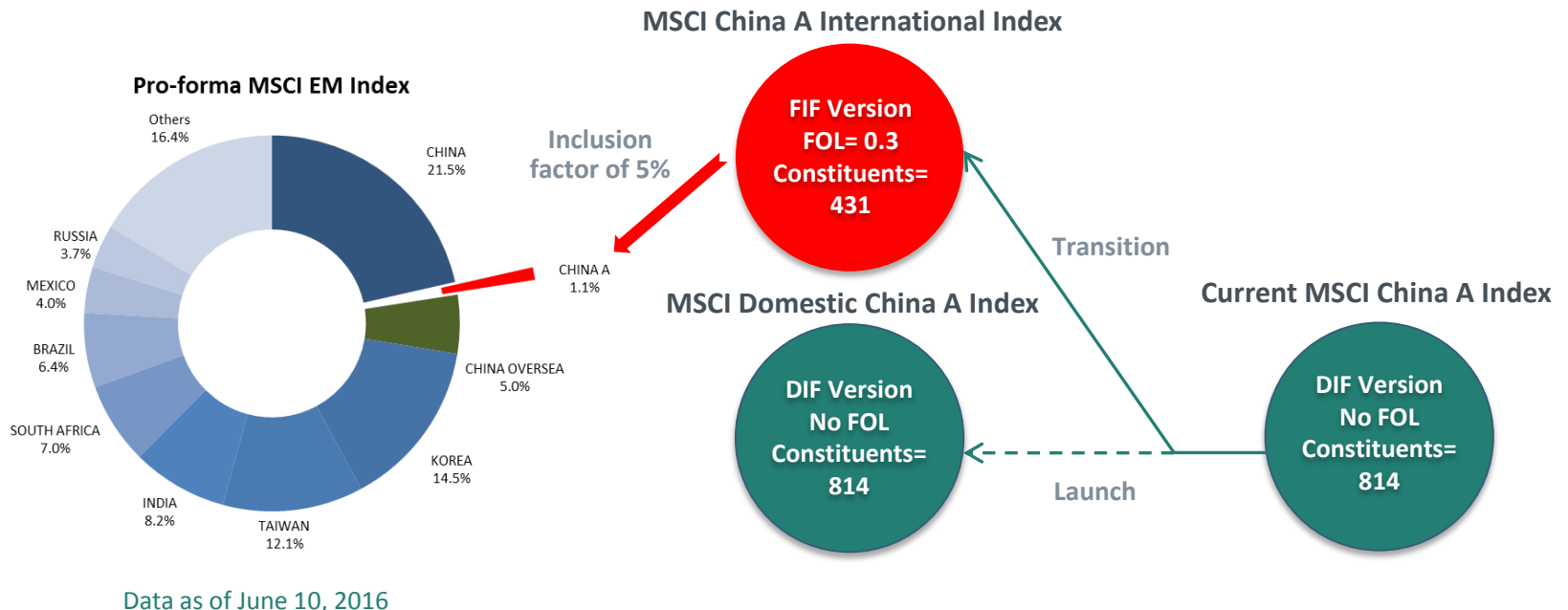
APPENDIX

PROPOSAL FOR 5% INITIAL INCLUSION REMAINS INTACT

- MSCI is maintaining its proposal to include China A-shares in the MSCI China Index in steps starting with a partial Inclusion Factor of 5%
 - The inclusion in the MSCI China Index would be reflected in its corresponding composite indexes, including the MSCI Emerging Markets Index, simultaneously
 - The pro forma MSCI China Index would be constructed based on one integrated China equity universe comprising A-shares, B-shares, H-shares, Red-chips, P-chips and Overseas listed China companies
 - A 5% Inclusion Factor would be applied to the FIF-adjusted market capitalization of China A-shares in the pro forma MSCI China Index
 - The free float-adjusted market capitalization of China A-shares would be evaluated based on the Foreign Inclusion Factor (FIF) subject to a 30% Foreign Ownership Limit (FOL)
 - The implementation of this proposal would coincide with the May 2018 Semi-Annual Index Review
 - Any subsequent increase in the Inclusion Factor of China A-shares in the MSCI Emerging Markets would be subject to positive market liberalization developments and public consultation with market participants
- Please note that this proposal may or may not lead to any changes to the MSCI Indexes

FOR EXISTING MSCI CHINA A INDEX CLIENTS

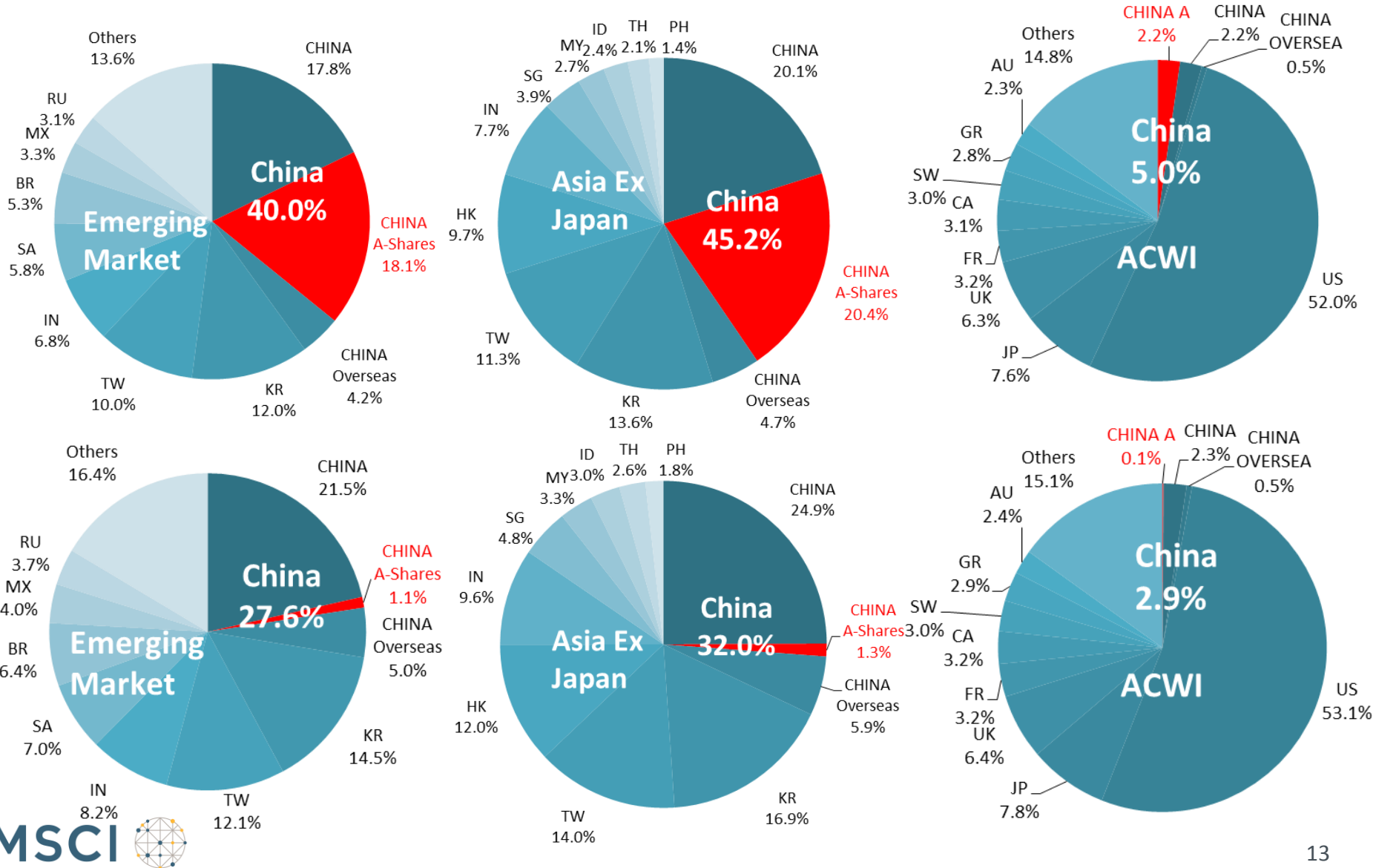
- Existing clients who benchmarked to the MSCI China A Index can consider transitioning to the MSCI China A International Index. The index is available since 2015.
- In addition, MSCI proposes to maintain the MSCI China A Index as a **domestic index** for clients who wish to gain a deeper and broader access to the China A-share opportunity set
 - Question: Does it make sense to disconnect the minimum size threshold with the MSCI Global Investable Market Indexes?*



KEY ACCESS CHANNELS TO CHINA A-SHARES

	RQFII		QFII		Stock Connect
Eligible Investors	Institutional investors based in selected eligible locations Individual Quota: None		Institutional investors that meet certain operation and AUM requirements Base quota ranging from US\$20 million to US\$ 5 billion		All investors
Application Process	Need license (CSRC) and quota (SAFE) The process can range from weeks to months		<ul style="list-style-type: none"> Applications for base quota will be filed with SAFE via onshore custodians Applications for quota exceeding US\$5 billion will be required to apply to SAFE directly for approval 		N.A.
Capital Mobility	<u>Open-Ended Funds:</u> -Repatriation: Daily -Lock-up: None -Remit Period: None -Others: Quota required to be used within 1 year upon approval	<u>Others:</u> -Repatriation: Monthly -Lock-up: 1 year -Remit Period: 6 months	<u>Open-Ended Funds:</u> -Repatriation: Daily -Lock-up: 3 months -Remit Period: N.A. -Others: Monthly repatriation cannot exceed 20% of NAV of previous year	<u>Others:</u> -Repatriation: Daily -Lock-up: 1 year -Remit Period: 6 months -Others: Monthly repatriation cannot exceed 20% of NAV of previous year	No restriction
Equity Coverage Universe	All securities listed on Shanghai and Shenzhen Stock Exchanges				570+ stocks listed on Shanghai Stock Exchange

POSSIBLE INDEX INCLUSION ROADMAP



ABOUT MSCI

For more than 40 years, MSCI's research-based indexes and analytics have helped the world's leading investors build and manage better portfolios. Clients rely on our offerings for deeper insights into the drivers of performance and risk in their portfolios, broad asset class coverage and innovative research.

Our line of products and services includes indexes, analytical models, data, real estate benchmarks and ESG research.

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