

Consultation on Potential Enhancement to the Size and Liquidity Requirements of the MSCI Market Classification Framework

PROPOSAL FOR CONSULTATION

This consultation may or may not lead to the implementation of any or all of the proposed changes in the highlighted or any other MSCI 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 result of the consultation.

October 2024

Executive Summary

- MSCI is consulting on the Size and Liquidity (S&L) Requirements of the MSCI Market Classification Framework. The proposal incorporates Entry and Maintenance criteria to the existing S&L Requirements.
- These enhancements aim to build explicit methodological rules to primarily address (1) markets barely meeting S&L Requirements for a higher classification and (2) markets failing S&L Requirements for its current classification.
- Through these rules, the objective of this proposal is to increase the stability and transparency of market classifications by potentially (1) reducing the risk of reverse reclassifications and (2) applying consistent treatment for potential downward reclassifications for markets failing S&L Requirements.
- Should this consultation lead to the implementation of any or all of the proposed changes, MSCI aims to implement the proposal starting from the 2025 Market Classification Review.

MSCI welcomes feedback from the investment community on this topic until **March 31, 2025**. MSCI will announce the results of this consultation in **Q2 2025**.

Background

- MSCI evaluates each market across three dimensions, including S&L Requirements, to determine if a consultation on a proposal for potential reclassification is warranted at the Annual Market Classification Review (MCR).

Current Market Classification Criteria (using 2024 MCR thresholds)*	Frontier Market (FM)	Emerging Market (EM)	Developed Market (DM)
Economic Development			
Size and Liquidity Requirements			
Number of companies meeting the following Standard Index criteria	1	3	5
Company size (full market cap)**	USD 126 mm	USD 2,548 mm	USD 5,096 mm
Security size (float market cap)**	USD 63 mm	USD 1,274 mm	USD 2,548 mm
Security liquidity	2.5% ATVR	15% ATVR	20% ATVR
Market Accessibility Criteria			

- However, the existing S&L Requirements within the Market Classification Framework can present some challenges:
 1. If a market is upgraded when it barely meets the S&L Requirements, the market may be at greater risk of being downgraded shortly thereafter if its companies experience a significant decline in size and liquidity.
 2. There are no defined rules for when MSCI would consult on the downward reclassification of a market that has been consistently failing the S&L Requirements for its current classification.

Details on Proposal and Rationale

- The introduction of S&L Entry and Maintenance Requirements may help mitigate the existing challenges as they are aimed at enhancing stability of market categories and consistency of treatment. While these will serve as general triggers for a potential consultation, MSCI will assess each unique case independently to decide on whether to consult.

Market Classification Criteria: Proposed Size and Liquidity Requirements	FM	EM	DM
Entry Requirement			
Minimum number of companies meeting Standard Index criteria* over last 8 Index Reviews	1	3	5
Maintenance Requirements			
Minimum number of companies meeting Standard Index criteria**, <u>AND</u>	-	1	1
Minimum number of securities in the Market Investable Equity Universe	1	3	5

Note: For regionally consolidated Developed Markets (e.g., DM Europe), the proposal is to apply S&L Requirements on each individual market within the region, while for regionally consolidated Emerging and Frontier Markets, S&L will be assessed on a consolidated basis (i.e., treated as a single market).

- Rationale for introducing S&L Entry Requirements
 - Evaluating S&L requirements over 8 Index Reviews (2 years) ensures a market has a persistent track record of meeting the thresholds.
- Rationale for introducing S&L Maintenance Requirements
 - Defining the minimum number of companies meeting Standard Index criteria for which a reclassification consultation could be triggered would provide more transparency into the classification process.
 - Additionally requiring a minimum number of investable securities ensures that Index Continuity Rules*** can be applied for a country index.

* Evaluated using Standard Index criteria for new constituents. For more details, please refer to the MSCI Global Investable Market Indexes (GIMI) Methodology.

** Evaluated using Standard Index criteria for existing constituents (e.g., 2/3 Company Full Mcap, 2/3 Security Float Mcap and 2/3 12M- and 3M-ATVRs), in line with the MSCI GIMI Methodology.

*** Index Continuity Rules, described in the MSCI GIMI Methodology, avoid the temporary inclusion or exclusion of market indexes in composite indexes at different times. For more details, please refer to the [Appendix](#).

Back Test: Impact of Proposal on Past Reclassifications

- The below table describes the impact of the proposal on reclassifications to and from DM and EM from June 2008* to June 2024. Downward reclassifications prompted by market accessibility issues were not included.
- The proposals were not tested for FM as the [changes to the MSCI Frontier Market Indexes Methodology](#) implemented starting at the Aug. 2023 Index Review significantly relaxed the size requirements for FM constituents.

Class	Reclassified To (Assessed using S&L Entry Requirements)	Reclassified From (Assessed using S&L Maintenance Requirements)
DM	<ul style="list-style-type: none"> ✓ Israel would have met the S&L Entry Requirements at the time of its consultation launch and review period (2008-2009) 	<ul style="list-style-type: none"> ▪ Greece (2012-2013) would not have been consulted on its removal from DM based on S&L only since it did not: <ul style="list-style-type: none"> (a) had fewer than 1 company meeting DM Standard Index criteria or (b) had fewer than 5 securities in its DM investable universe
EM	<ul style="list-style-type: none"> ✓ Qatar (2008-2013), UAE (2008-2013) and Saudi Arabia (2017-2018) also would have met S&L Entry Requirements ▪ Pakistan (2015-2016), Argentina (2016-2018) and Kuwait (2018-2019) would have been consulted for inclusion to EM 1 year later than their original consultation launch dates under S&L Entry Requirements 	<ul style="list-style-type: none"> ▪ Morocco (2012-2013) would have not been consulted on its removal from EM based on S&L only since it did not: <ul style="list-style-type: none"> (a) had fewer than 1 company meeting EM Standard Index criteria or (b) had fewer than 3 securities in its EM investable universe ✓ Pakistan failed S&L Maintenance Requirements at the 2021 MCR as it had 0 companies meeting EM Standard Index criteria at the May 2021 Semi Annual Index Review. This coincides with the original consultation launch date to remove it from EM

* Selected as start date as (1) MSCI announced the conclusion of its market classification study in June 2008 – this later evolved into the current Market Classification Framework, and (2) the transition to the current MSCI GIMI Methodology was completed effective June 2008.

Note 1: years in parenthesis for each market are the years of review period for their reclassification (i.e., launch of consultation to announcement of reclassification decision).

Note 2: back testing was performed using data at Semi-annual Index Reviews (prior to Feb. 2023 Index Review) and Quarterly Comprehensive Index Reviews (since Feb. 2023 Index Review).

Please see the disclosure at the end of this document regarding simulated and back tested data.

Implications on Current Market Classifications: Markets at Risk of Downward Reclassification

- The below table lists the Emerging and Frontier Markets maintained under Index Continuity Rules* as of the August 2024 Index Review. These markets are at a relatively higher risk of not meeting S&L Maintenance Requirements if implemented. However, latest data indicates that they currently pass the proposed requirements, i.e., they meet the minimum number of companies passing Standard Index criteria and minimum number of investable securities.
- There are currently no Developed Markets under Index Continuity, and individual markets within the MSCI DM Europe Index each meet the proposed S&L Maintenance Requirements.

Market	Under Index Continuity Rules Since	Companies Passing Std Index Criteria (Aug. 2024 IR)	Number of Investable Securities** (Aug. 2024 IR)
Emerging Markets			
Egypt	May 2020 Index Review	2	9
Peru	February 2023 Index Review	3	4
Czech Republic	August 2023 Index Review	3	5
Frontier Markets			
Serbia	August 2024 Index Review	1	2

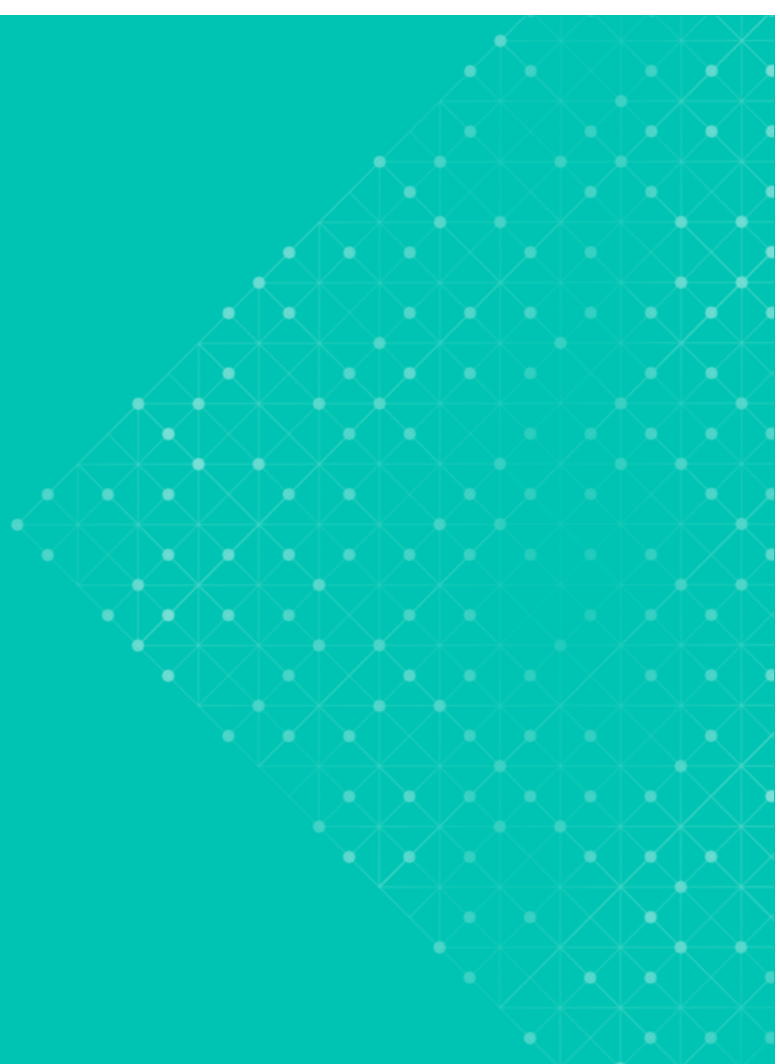
* Index Continuity Rules, described in the MSCI GIMI Methodology, avoid the temporary inclusion or exclusion of market indexes in composite indexes at different times. For more details, please refer to the [Appendix](#).

** Securities included in the Market Investable Equity Universe as described in sections 2.2 and 3.1.2 of the MSCI GIMI Methodology.

Discussion Points

- Do the current minimum numbers of companies under the Market Classification Framework's S&L Requirements (5, 3 and 1 for DM, EM and FM, respectively) continue to be appropriate? Should these thresholds change?
- Do you agree with the proposal to implement Entry and Maintenance S&L Requirements?
- Do you agree with the proposed methodology and thresholds used for identifying potential market upgrades and downgrades, including number of companies required across market classifications and assessment timeframes?
 - Would any alternative methodology or thresholds be preferred over the base proposal?
- Do you agree to apply the proposed S&L Requirements on an individual market basis for regionally consolidated Developed markets, while assessing on a consolidated basis for regionally consolidated Emerging and Frontier markets?
- Do you agree to implement changes starting from the MSCI 2025 Market Classification Review?
 - As part of the MSCI 2025 Market Classification Review, the classification of markets would be evaluated using the proposed S&L Requirements.
 - The current consultation on a [potential reclassification of Bulgaria to Frontier Market status](#) would not be impacted by these proposals.

Appendix



Current MSCI Market Classification Framework

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	1	3	5
Company size (full market cap)***	USD 126 mm	USD 2,548 mm	USD 5,096 mm
Security size (float market cap)***	USD 63 mm	USD 1,274 mm	USD 2,548 mm
Security liquidity	2.5% ATVR	15% ATVR	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 operational framework	Modest	Good and tested	Very high
C.4 Availability of Investment Instrument	High	High	Unrestricted
C.5 Stability of the institutional framework	Modest	Modest	Very high

Index Continuity Rules

- As described in section 2.4 of the MSCI Global Investable Market Indexes (GIMI) Methodology, in order to achieve index continuity, as well as provide some basic level of diversification within a market index, a minimum number of five constituents will be maintained for a Developed Market Standard Index and a minimum number of three constituents will be maintained for an Emerging Market Standard Index.
- Further, for the maintenance of Frontier Market Indexes as described in section 5.2.4 of the MSCI GIMI Methodology, if after the application of the index construction methodology, a Standard Index does not contain any security, then the largest security by free float-adjusted market capitalization among the securities included in the Market Investable Equity Universe is added to the Standard Index.
- For more details, please refer to the [MSCI GIMI Methodology](#).

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