

# Follow-up Consultation on Constituent Weighting and Capping Methodology for the MSCI Islamic Index Series

## MSCI ISLAMIC INDEX SERIES METHODOLOGY

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.

October 2024

# Background and Proposal

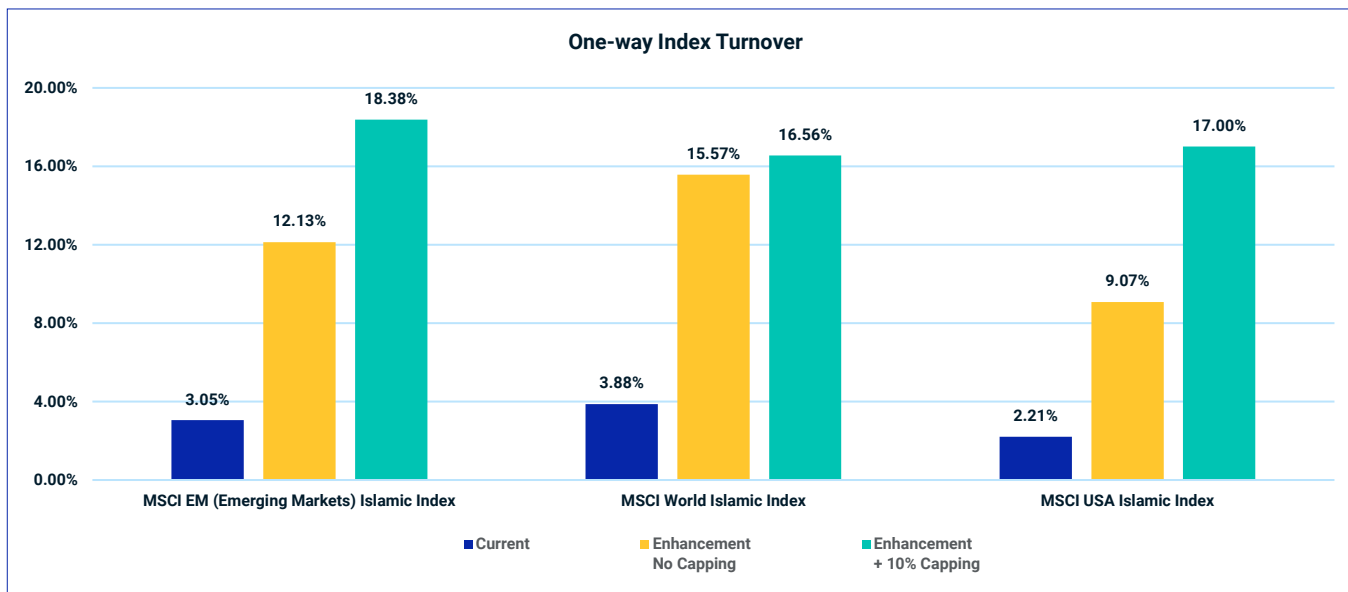
- MSCI conducted a consultation from June 28, 2024 to September 13, 2024 on enhancements to the MSCI Islamic Index Series Methodology to address the potential index turnover and concentration issues.
- During this consultation, some market participants expressed concerns on the concentration risk in the MSCI Islamic Index Series. While the proposed methodology enhancements in the consultation may partially address these concerns, a capping methodology may still be warranted.
- Consequently, MSCI launches a follow-up consultation on constituent weighting and capping methodology to further address the **index concentration** in the MSCI Islamic Index Series.
- More specifically, MSCI proposes the following:
  - to introduce an issuer level capping of 10% to the MSCI Islamic Index Series, and
  - to consider phased implementation of the capping.
- MSCI welcomes feedback from the investment community until October 31, 2024. MSCI will announce the results of this consultation, including the implementation schedule, on or before November 29, 2024.

# Proposed Capping Methodology

- MSCI proposes to cap each MSCI Islamic Series Index independently using the following methodology:
  - Define Parent Indexes as the non-Islamic version of the Islamic Indexes (e.g., MSCI USA Index for the MSCI USA Islamic Index).
  - Consider the Parent Indexes as either Broad or Narrow based on the below definition:
    - Broad Parent Indexes are those Parent Indexes where the largest capitalization weight in the index is less than or equal to 10%;
    - while Narrow Parent Indexes are those Parent Indexes where the largest capitalization weight in the index is more than 10%.
  - Apply the capping as follows:
    - Cap issuers in the MSCI Islamic Indexes based on Broad Parent MSCI Indexes at 10%.
    - Cap issuers in the MSCI Islamic Indexes based on Narrow Parent MSCI Indexes at the maximum weight in the Parent Index.

# Simulated Impact on Index Turnover

- MSCI simulated scenarios for the MSCI EM (Emerging Markets) Islamic Index, MSCI World Islamic Index and MSCI USA Islamic Index to assess the indicative impact on implementing the methodology enhancement and capping at the time of the May 2024 Index Review.



- "Current" refers to the index turnover of the MSCI EM (Emerging Markets) Islamic Index, MSCI World Islamic Index and MSCI USA Islamic Index based on current methodology, "Enhancement" refers to the index turnover of the indexes applied the enhancement rules from previous consultation as described on Slide 8 and "Capping" refers to the index turnover of the indexes applied the issuer capping methodology as described on Slide 3.

- The bar in the chart (Y-axis) represents the index turnover of the indexes under each scenario from the index review.

# Simulated Impact on Index Turnover

- The weight of the below issuers would have been capped in the MSCI EM (Emerging Markets) Islamic Index, MSCI World Islamic Index and MSCI USA Islamic Index if the methodology enhancement and capping were implemented at the time of the May 2024 Index Review. Below are the corresponding weights under different scenarios:

Index	Issuers	Country	Current	Enhancement No Capping	Enhancement + 10% Capping
MSCI EM (Emerging Markets) Islamic Index	TAIWAN SEMICONDUCTOR MFG	TAIWAN	25.66%	22.89%	10.00%
MSCI EM (Emerging Markets) Islamic Index	SAMSUNG ELECTRONICS CO	KOREA	11.89%	10.66%	10.00%
MSCI World Islamic Index	MICROSOFT CORP	USA	18.06%	15.38%	10.00%
MSCI USA Islamic Index	MICROSOFT CORP	USA	26.92%	24.63%	10.00%

# Discussion Points

- Is it appropriate to introduce an issuer capping of 10% for the MSCI Islamic Index Series?
- Should MSCI consider phased implementation for Capping?
- Should MSCI consider other capping mechanisms and/or levels for the MSCI Islamic Index Series?

# Appendix

---

ADDITIONAL DETAILS ON THE CONSULTATION PROPOSAL

# Details of Methodology Enhancement to the MSCI Islamic Index Series

- MSCI will apply the following enhancements to the Financial Screening for the MSCI Islamic Index Series:
  - Enhancement 1:** To introduce an “Exit Buffer” for financial ratios based on ‘total debt’ and ‘sum of a company’s cash and interest-bearing securities’ for existing constituents:
    - A security that would otherwise be deleted due to not meeting the financial ratio threshold(s) of 33.33% would be retained in the index as long as the following conditions are met: 1) it remains within the Exit Buffer of 35% and 2) its 4-quarter rolling average (including current index review) remains equal to or below the Financial Ratio Threshold of 33.33%.
    - The security would be deleted from the index if its financial ratio breaches the Financial Ratio Threshold of 33.33% for 3 consecutive index reviews even if it continues to meet the above conditions.
  - Enhancement 2:** To extend the Entry Buffer and the Financial Ratio Threshold of financial ratio based on ‘sum of a company’s accounts receivables and cash’:
    - The Entry Buffer will increase from 30% to 46%.
    - The Financial Ratio Threshold will increase from 33.33% to 70%.
- The table below summarizes the thresholds to be used in the Financial Screening for the MSCI Islamic Index:

#	Ratio	Entry Buffer	Financial Ratio Threshold	Exit Buffer
1	Total Debt	30%	33.33%	35%
2	Sum of a company’s cash and interest-bearing securities	30%	33.33%	35%
3	Sum of a company’s accounts receivables and cash	46%	70%	n/a

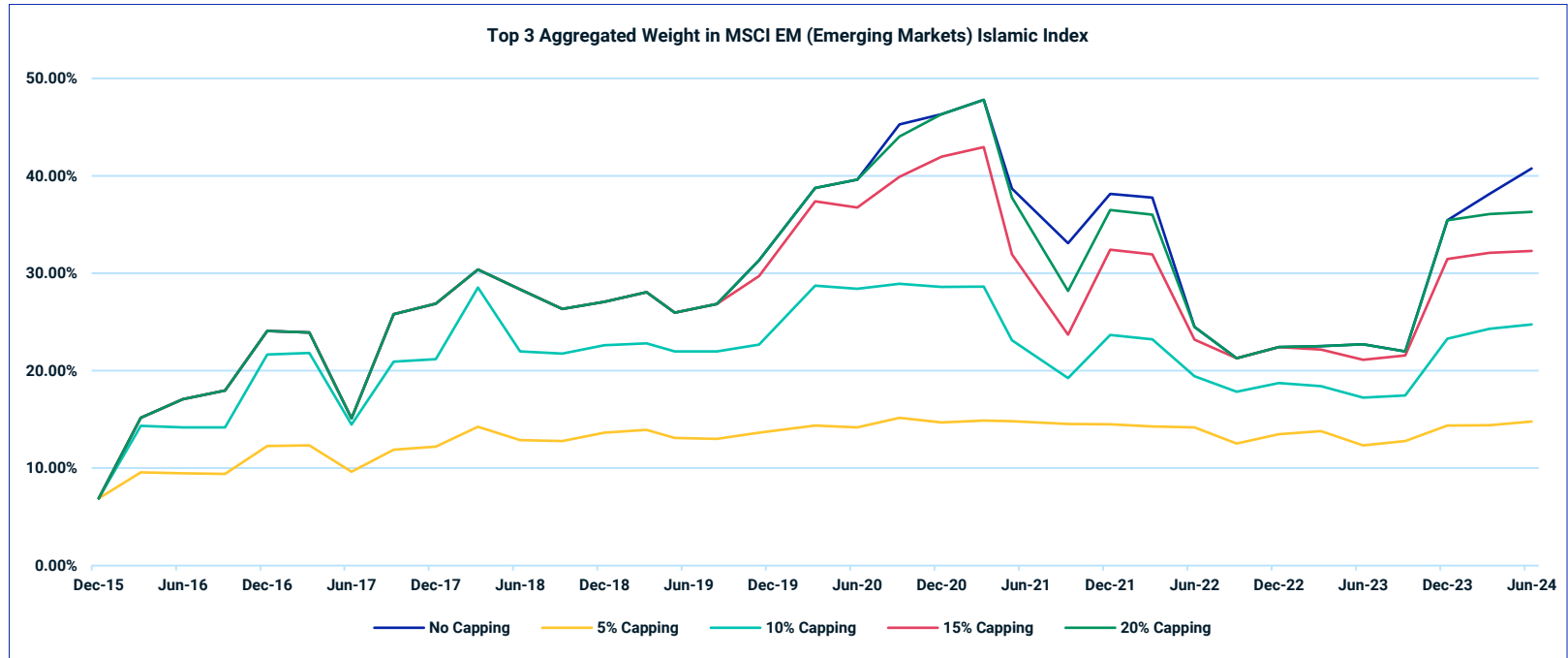
\* Total assets is used as the denominator for financial ratio calculation in the MSCI Islamic Index Series.



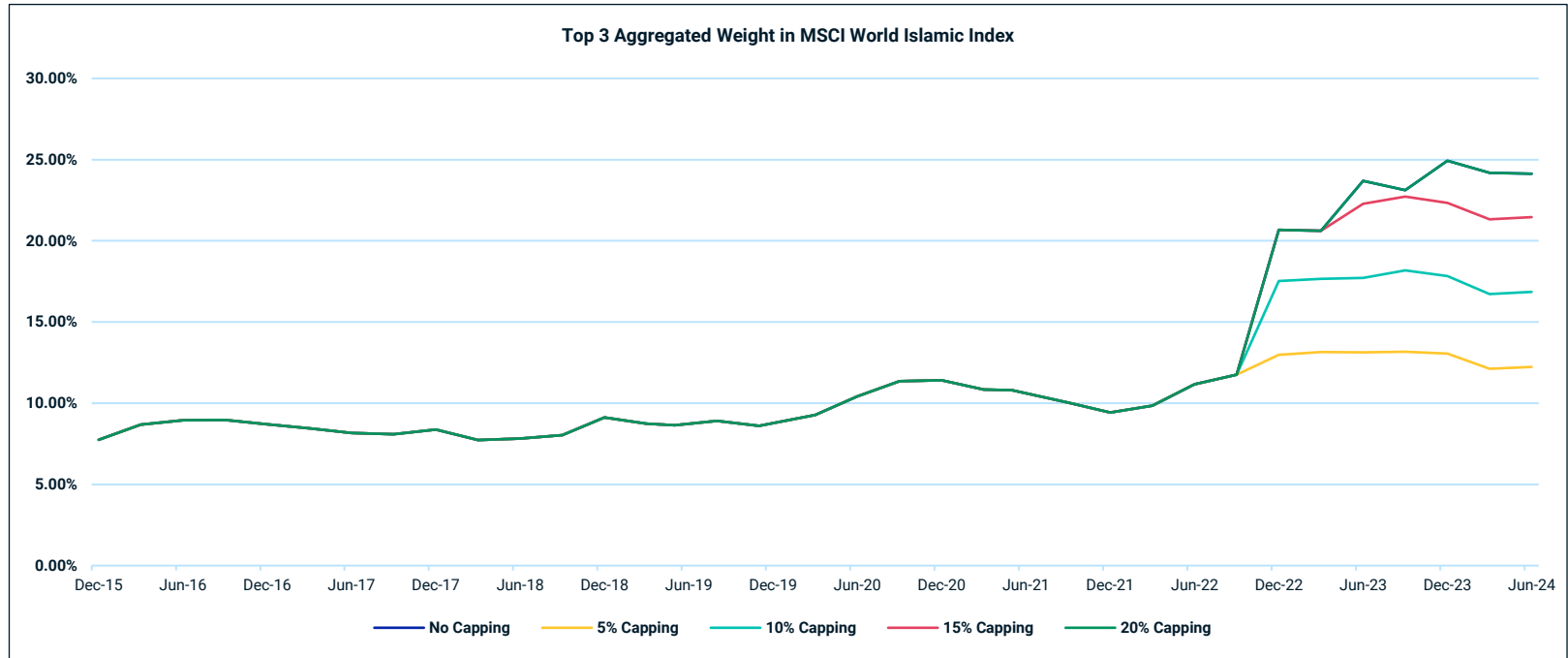
# Capping Methodology Simulation

- MSCI simulated scenarios of **issuer capping at 5%, 10%, 15% and 20%** for the MSCI EM (Emerging Markets) Islamic Index, MSCI World Islamic Index and MSCI USA Islamic Index to assess the historical impact as per the current methodology in the period of December 2015 to June 2024.
- MSCI simulated scenarios of issuer capping at 5%, 10%, 15% and 20% for the MSCI EM (Emerging Markets) Islamic Index, MSCI World Islamic Index and MSCI USA Islamic Index to assess the indicative impact on implementing the methodology enhancement and capping at the time of the May 2024 Index Review.

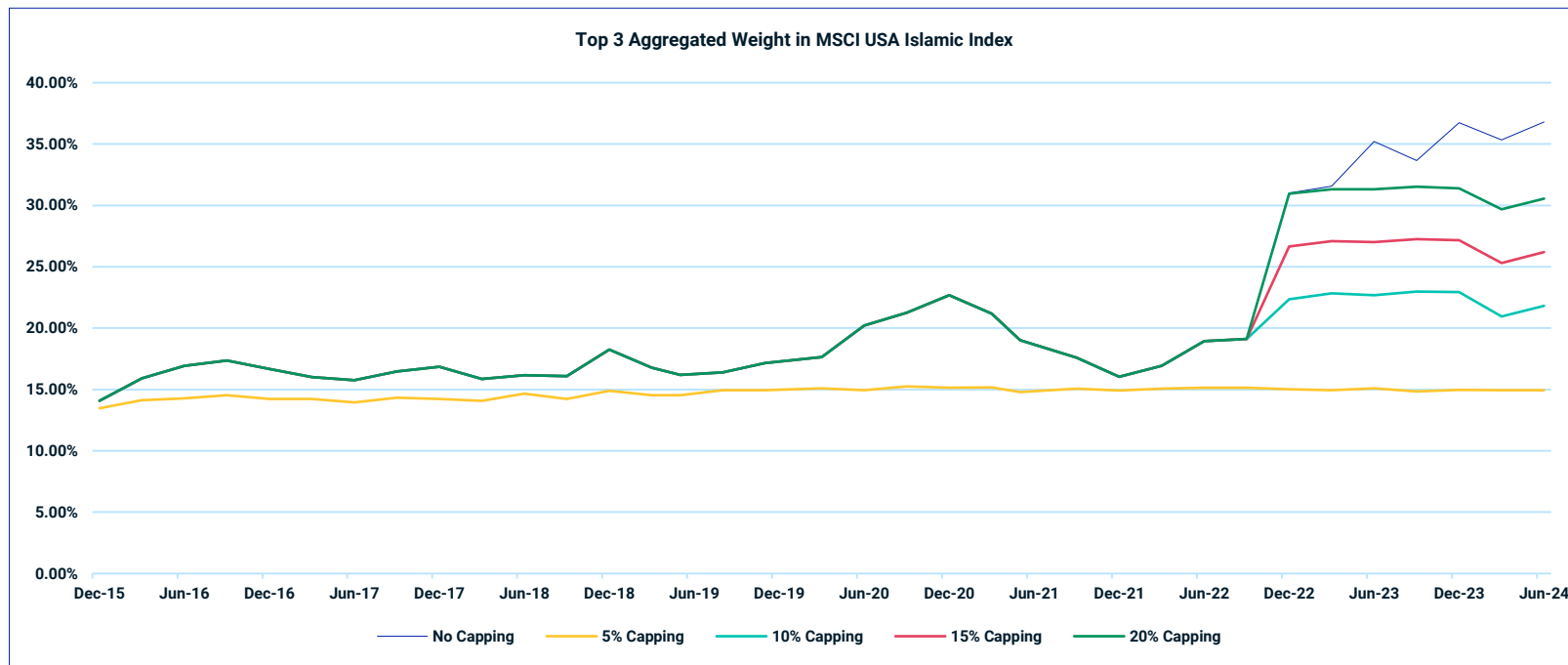
# Simulated Historical Impact of Capping



# Simulated Historical Impact of Capping



# Simulated Historical Impact of Capping



# Simulated Historical Impact of Capping

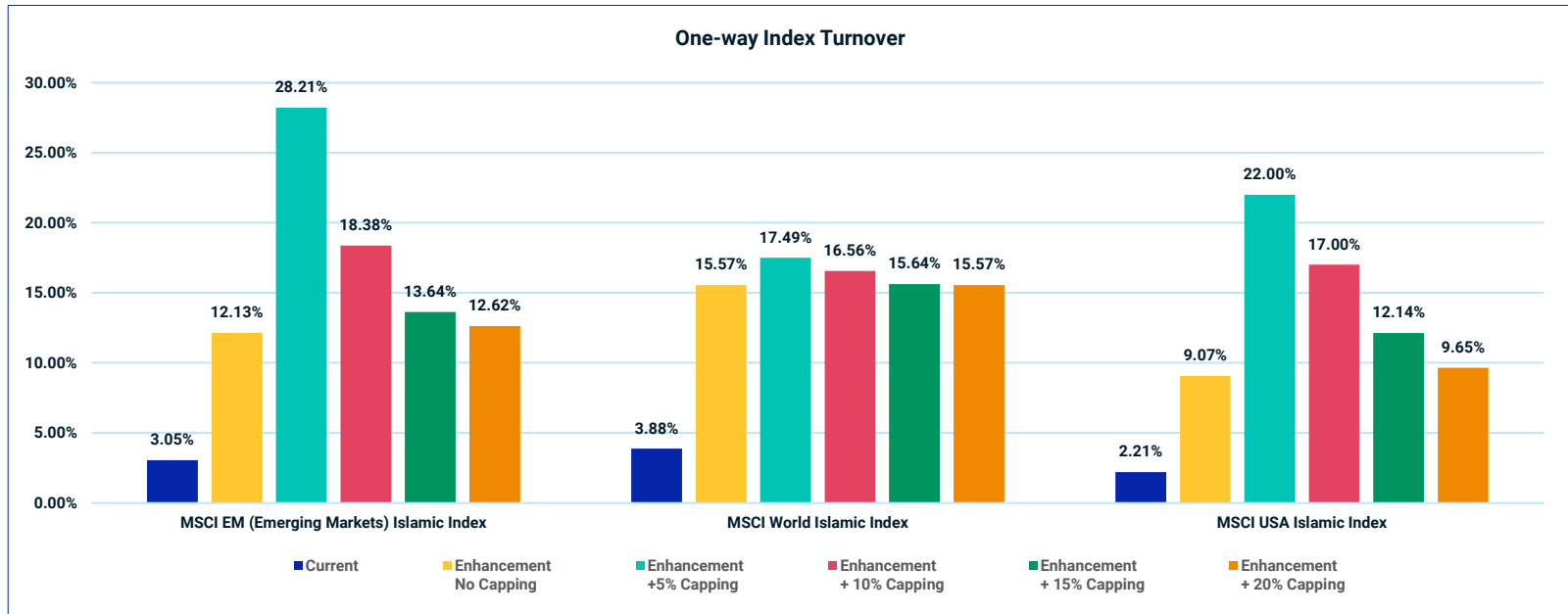
## Key Metrics

MSCI EM (Emerging Markets) Islamic Index	No Capping	5% Capping	10% Capping	15% Capping	20% Capping
Total Return* (%)	8.5	6.5	7.8	8.4	8.4
Total Risk (%)	16.8	16.3	16.6	16.9	16.8
Tracking Error (%)	0	3.5	2	1	0.3
Historical Beta	1	0.95	0.98	1	1
Number of Constituents***	291	291	291	291	291
Top 10 Constituents Weight (%)	42	28.9	35.7	40.5	41.7
Turnover** (%)	33.8	26.9	32.2	33.9	34.5
MSCI World Islamic Index	No Capping	5% Capping	10% Capping	15% Capping	20% Capping
Total Return* (%)	10	9.6	9.8	10	10
Total Risk (%)	15.1	15.2	15.2	15.2	15.1
Tracking Error (%)	0	0.9	0.5	0.1	0
Historical Beta	1	1	1	1	1
Number of Constituents***	445	445	445	445	445
Top 10 Constituents Weight (%)	25.5	24	24.7	25.4	25.5
Turnover** (%)	21.1	20.6	21.2	21.5	21.1
MSCI USA Islamic Index	No Capping	5% Capping	10% Capping	15% Capping	20% Capping
Total Return* (%)	10.7	10.2	10.1	10.4	10.6
Total Risk (%)	15.5	15.6	15.6	15.5	15.5
Tracking Error (%)	0	1.5	1.1	0.7	0.3
Historical Beta	1	1	1	1	1
Number of Constituents***	137	137	137	137	137
Top 10 Constituents Weight (%)	43.2	39.1	41.7	42.3	42.8
Turnover** (%)	25.1	26.5	24.7	25.4	26

Period: Dec 31, 2015 to Jun 03, 2024. \* Gross returns annualized in USD \*\* Annualized one-way index turnover over index reviews \*\*\* Monthly averages

# Simulated Indicative Impact of Capping

- Below chart indicates the one-way index turnover under each scenario of implementing methodology enhancement and issuer capping at the time of May 2024 Index Review.



- “Current” refers to the index turnover of the MSCI EM (Emerging Markets) Islamic Index, MSCI World Islamic Index and MSCI USA Islamic Index based on current methodology, “Enhancement” refers to the index turnover of the indexes applied the enhancement rules from previous consultation as described on Slide 8 and “Capping” refers to the index turnover of the indexes applied the issuer capping methodology as described on Slide 3.

- The bar in the chart (Y-axis) represents the index turnover of the indexes under each scenario from the index review.

# About MSCI: Index

MSCI is a leading provider of critical decision support tools and services for the global investment community. With over 50 years of expertise in research, data and technology, we power better investment decisions by enabling clients to understand and analyze key drivers of risk and return and confidently build more effective portfolios. We create industry-leading research-enhanced solutions that clients use to gain insight into and improve transparency across the investment process. To learn more, please visit [www.msci.com](http://www.msci.com).

The process for submitting a formal index complaint can be found on the index regulation page of MSCI's website at: <https://www.msci.com/index-regulation>.

# Notice and Disclaimer

This document and all of the information contained in it, including without limitation all text, data, graphs, charts (collectively, the "Information") is the property of MSCI Inc. or its subsidiaries (collectively, "MSCI"), or MSCI's licensors, direct or indirect suppliers or any third party involved in making or compiling any Information (collectively, with MSCI, the "Information Providers") and is provided for informational purposes only. The Information may not be modified, reverse-engineered, reproduced or disseminated in whole or in part without prior written permission from MSCI. All rights in the Information are reserved by MSCI and/or its Information Providers.

The Information may not be used to create derivative works or to verify or correct other data or information. For example (but without limitation), the Information may not be used to create indexes, databases, risk models, analytics, software, or in connection with the issuing, offering, sponsoring, managing or marketing of any securities, portfolios, financial products or other investment vehicles utilizing or based on, linked to, tracking or otherwise derived from the Information or any other MSCI data, information, products or services.

The user of the Information assumes the entire risk of any use it may make or permit to be made of the Information. NONE OF THE INFORMATION PROVIDERS MAKES ANY EXPRESS OR IMPLIED WARRANTIES OR REPRESENTATIONS WITH RESPECT TO THE INFORMATION (OR THE RESULTS TO BE OBTAINED BY THE USE THEREOF), AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, EACH INFORMATION PROVIDER EXPRESSLY DISCLAIMS ALL IMPLIED WARRANTIES (INCLUDING, WITHOUT LIMITATION, ANY IMPLIED WARRANTIES OF ORIGINALITY, ACCURACY, TIMELINESS, NON-INFRINGEMENT, COMPLETENESS, MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE) WITH RESPECT TO ANY OF THE INFORMATION.

Without limiting any of the foregoing and to the maximum extent permitted by applicable law, in no event shall any Information Provider have any liability regarding any of the Information for any direct, indirect, special, punitive, consequential (including lost profits) or any other damages even if notified of the possibility of such damages. The foregoing shall not exclude or limit any liability that may not be applicable law be excluded or limited, including without limitation (as applicable), any liability for death or personal injury to the extent that such injury results from the negligence or willful default of itself, its servants, agents or sub-contractors.

Information containing any historical information, data or analysis should not be taken as an indication or guarantee of any future performance, analysis, forecast or prediction. Past performance does not guarantee future results.

The Information may include "Signals," defined as quantitative attributes or the product of methods or formulas that describe or are derived from calculations using historical data. Neither these Signals nor any description of historical data are intended to provide investment advice or a recommendation to make (or refrain from making) any investment decision or asset allocation and should not be relied upon as such. Signals are inherently backward-looking because of their use of historical data, and they are not intended to predict the future. The relevance, correlations and accuracy of Signals frequently will change materially.

The Information should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. All Information is impersonal and not tailored to the needs of any person, entity or group of persons.

None of the Information constitutes an offer to sell (or a solicitation of an offer to buy), any security, financial product or other investment vehicle or any trading strategy.

It is not possible to invest directly in an index. Exposure to an asset class or trading strategy or other category represented by an index is only available through third party investable instruments (if any) based on that index. MSCI does not issue, sponsor, endorse, market, offer, review or otherwise express any opinion regarding any fund, ETF, derivative or other security, investment, financial product or trading strategy that is based on, linked to or seeks to provide an investment return related to the performance of any MSCI index (collectively, "Index Linked Investments"). MSCI makes no assurance that any Index Linked Investments will accurately track index performance or provide positive investment returns. MSCI Inc. is not an investment adviser or fiduciary and MSCI makes no representation regarding the advisability of investing in any Index Linked Investments.

Index returns do not represent the results of actual trading of investible assets/securities. MSCI maintains and calculates indexes, but does not manage actual assets. The calculation of indexes and index returns may deviate from the stated methodology. Index returns do not reflect payment of any sales charges or fees an investor may pay to purchase the securities underlying the index or Index Linked Investments. The imposition of these fees and charges would cause the performance of an Index Linked Investment to be different than the MSCI index performance.

The Information may contain back tested data. Back-tested performance is not actual performance, but is hypothetical. There are frequently material differences between back tested performance results and actual results subsequently achieved by any investment strategy.

Constituents of MSCI equity indexes are listed companies, which are included in or excluded from the indexes according to the application of the relevant index methodologies. Accordingly, constituents in MSCI equity indexes may include MSCI Inc., clients of MSCI or suppliers to MSCI. Inclusion of a security within an MSCI index is not a recommendation by MSCI to buy, sell, or hold such security, nor is it considered to be investment advice.

Data and information produced by various affiliates of MSCI Inc., including MSCI ESG Research LLC and Barra LLC, may be used in calculating certain MSCI indexes. More information can be found in the relevant index methodologies on [www.msci.com](http://www.msci.com).

MSCI receives compensation in connection with licensing its indexes to third parties. MSCI Inc.'s revenue includes fees based on assets in Index Linked Investments. Information can be found in MSCI Inc.'s company filings on the Investor Relations section of [msci.com](http://msci.com).

MSCI ESG Research LLC is a Registered Investment Adviser under the Investment Advisers Act of 1940 and a subsidiary of MSCI Inc. Neither MSCI nor any of its products or services recommends, endorses, approves or otherwise expresses any opinion regarding any issuer, securities, financial products or instruments or trading strategies and MSCI's products or services are not a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such, provided that applicable products or services from MSCI ESG Research may constitute investment advice. MSCI ESG Research materials, including materials utilized in any MSCI ESG Indexes or other products, have not been submitted to, nor received approval from, the United States Securities and Exchange Commission or any other regulatory body. MSCI ESG and climate ratings, research and data are produced by MSCI ESG Research LLC, a subsidiary of MSCI Inc. MSCI ESG Indexes, Analytics and Real Estate are products of MSCI Inc. that utilize information from MSCI ESG Research LLC. MSCI Indexes are administered by MSCI Limited (UK) and MSCI Deutschland GmbH.

Please note that the issuers mentioned in MSCI ESG Research materials sometimes have commercial relationships with MSCI ESG Research and/or MSCI Inc. (collectively, "MSCI") and that these relationships create potential conflicts of interest. In some cases, the issuers or their affiliates purchase research or other products or services from one or more MSCI affiliates. In other cases, MSCI ESG Research rates financial products such as mutual funds or ETFs that are managed by MSCI's clients or their affiliates, or are based on MSCI Inc. Indexes. In addition, constituents in MSCI Inc. equity indexes include companies that subscribe to MSCI products or services. In some cases, MSCI clients pay fees based in whole or part on the assets they manage. MSCI ESG Research has taken a number of steps to mitigate potential conflicts of interest and safeguard the integrity and independence of its research and ratings. More information about these conflict mitigation measures is available in our Form ADV, available at <https://adviserinfo.sec.gov/firm/summary/169222>.

Any use of or access to products, services or information of MSCI requires a license from MSCI. MSCI, Barra, RiskMetrics, IPD and other MSCI brands and product names are the trademarks, service marks, or registered trademarks of MSCI or its subsidiaries in the United States and other jurisdictions. The Global Industry Classification Standard (GICS) was developed by and is the exclusive property of MSCI and S&P Global Market Intelligence. "Global Industry Classification Standard (GICS)" is a service mark of MSCI and S&P Global Market Intelligence.

MIFID2/MIFIR notice: MSCI ESG Research LLC does not distribute or act as an intermediary for financial instruments or structured deposits, nor does it deal on its own account, provide execution services for others or manage client accounts. No MSCI ESG Research product or service supports, promotes or is intended to support or promote any such activity. MSCI ESG Research is an independent provider of ESG data.

Privacy notice: For information about how MSCI collects and uses personal data, please refer to our Privacy Notice at <https://www.msci.com/privacy-pledge>.





# Contact Us

AMERICAS	EUROPE, MIDDLE EAST & AFRICA	ASIA PACIFIC
United States +1 888 588 4567 *	South Africa + 27 21 673 0103	China + 86 21 61326611
Canada + 1 416 687 6270	Germany + 49 69 133 859 00	Hong Kong + 852 2844 9333
Brazil + 55 11 4040 7830	Switzerland + 41 22 817 9777	India + 91 22 6784 9160
Mexico + 52 81 1253 4020	United Kingdom + 44 20 7618 2222	Malaysia 1800818185 *
	Italy + 39 02 5849 0415	South Korea +82 70 4769 4231
	France + 33 17 6769 810	Singapore +65 67011177
		Australia +612 9033 9333
		Taiwan 008 0112 7513*
		Thailand 0018 0015 6207 7181*
		Japan +81 3 4579 0333

\* = toll free

[msci.com/contact-us](https://www.msci.com/contact-us)