

CONSULTATION ON A MARKET RECLASSIFICATION PROPOSAL FOR THE MSCI ICELAND INDEX

Potential Reclassification from Standalone to Frontier Markets

August 2019

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.

Reclassification Proposal

- MSCI proposes to reclassify the MSCI Iceland Index from Standalone to Frontier 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 2020 Semi-Annual Index Review
- MSCI proposes to apply the minimum size requirements for Smaller Frontier Markets, and a minimum liquidity requirement of 15% Annualized Traded Value Ratio (ATVR) for Average Liquidity markets
- MSCI will consult with market participants on this reclassification proposal until October 31, 2019
 - MSCI will announce its decision in November 2019
- Please note that this proposal may or may not lead to any changes to the MSCI Indexes

BACKGROUND

- Iceland has lifted most of the capital controls it has instituted since 2008

	2017	2018	2019
Capital Flow Restrictions	<ul style="list-style-type: none"> While investment in equities was generally exempted, other investments including domestic currency deposits were subject to special reserve requirements: <ul style="list-style-type: none"> - 1 year holding period - 40% Special Reserve Ratio (SRR) - 0% interest rate on capital flow accounts with the Central Bank 	<ul style="list-style-type: none"> New inflows of foreign currency up to a total of ISK 100 million were no longer affected by the SRR For inflows beyond the threshold and existing accounts, the SRR was lowered from 40% to 20% 	<ul style="list-style-type: none"> The SRR was lowered from 20% to 0% SRR remains not applicable for equity investments
Foreign Exchange Liberalization Level	<ul style="list-style-type: none"> Central Bank organized auctions to buy offshore króna assets in exchange for cash payment in foreign currency Most restrictions on FX transactions were lifted, with the exception of some such as: <ul style="list-style-type: none"> - FX transactions between residents and non-residents without the intermediation of a financial undertaking - Derivatives trading for purposes other than hedging 	<ul style="list-style-type: none"> Central Bank continued to buy offshore króna assets FX restrictions remained the same since 2017 	<ul style="list-style-type: none"> The offshore market for the króna no longer exists FX restrictions remained the same since 2017
MSCI Standard Constituents	<ul style="list-style-type: none"> Not available (index launched in June 2018) 	<ul style="list-style-type: none"> One Standard constituent 	<ul style="list-style-type: none"> Two Standard constituents

MARKET ACCESSIBILITY REVIEW 2019

Market Accessibility Assessment

Openness to foreign ownership

Investor qualification requirement	++
Foreign ownership limit (FOL) level	++
Foreign room level	++
Equal rights to foreign investors	++

Ease of capital inflows / outflows

Capital flow restriction level	-/?
Foreign exchange market liberalization level	-/?

Efficiency of the operational framework

Market entry	
Investor registration & account set up	+
Market organization	
Market regulations	++
Information flow	++
Market infrastructure	
Clearing and settlement	++
Custody	++
Registry / Depository	++
Trading	++
Transferability	++
Stock lending	-/?
Short selling	-/?

Availability of Investment Instrument

Stability of institutional framework	++
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- **Capital Flow Restriction Level:** Repatriation proceeds must be linked to security transactions and it has to be reported to the central bank
- **Foreign Exchange Market Liberalization Level:** There is no offshore currency market and there are some constraints on the onshore currency market
- **Investor Registration & Account Set Up:** Registration is required, but the process is efficient
- **Stock Lending/ Short Selling:** Allowed but is not an established market practice

Simulated Constituents of the MSCI Iceland Indexes (1/2)

Company	Full Mcap*	FIF Mcap*	FIF**	Size-Segment
Marel	3,681	2,761	0.75	Standard
Arion Banki	1,130	734	0.65	Standard
Reitir Fasteignafelag	465	442	0.95	Small Cap
Hagar	418	418	1	Small Cap
Icelandair Group Holding	390	191	0.49	Small Cap
Festi	338	321	0.95	Small Cap
Siminn	336	319	0.95	Small Cap
Reginn	323	258	0.8	Small Cap
Eimskipafelag Islands	268	201	0.75	Small Cap
Eik Fasteignafelag	241	205	0.85	Small Cap
Vatryggingafelag Islands	201	171	0.85	Small Cap

Based on the simulated results, 11 out of the 12 constituents of the MSCI Iceland IMI would be eligible using the Frontier Markets requirements

Data as of July 18, 2019

The simulation reflects the application of the Semi Annual Index Review methodology, using the Frontier Markets requirements for Smaller FM and Average Liquidity Markets

* USD million

** Foreign Inclusion Factor

Simulated Constituents of the MSCI Iceland Indexes (2/2)

Number of Constituents

	Large Cap	Mid Cap	Standard	Small Cap	IMI
Standalone Markets	1	1	2	10	12
Frontier Markets	1	1	2	9	11

Data as of July 18, 2019

The simulations reflect the application of the Semi-Annual Index Review methodology, using the (1) Standalone Markets and (2) Frontier Markets requirements for Smaller FM and Average Liquidity Markets

Free Float Adjusted Market Capitalization (USD million)

	Large Cap	Mid Cap	Standard	Small Cap	IMI
Standalone Markets	2,761	734	3,495	2,833	6,328
Frontier Markets	2,761	734	3,495	2,525	6,020

Data as of July 18, 2019

The simulations reflect the application of the Semi-Annual Index Review methodology, using the (1) Standalone Markets and (2) Frontier Markets requirements for Smaller FM and Average Liquidity Markets

- The MSCI Iceland Index would continue to have two constituents under Frontier Markets with a free float adjusted market capitalization of USD 3,495 million
- The MSCI Iceland Small Cap Index would have one less constituent which would result in a decrease in the free float adjusted market capitalization by USD 308 million

Simulated Impact on the MSCI Frontier Markets Index (ex Kuwait)

	Pro forma Standard Index		
	Index Market Cap	Weight	# Sec.
FM	74,895	100.0%	89
FM ex GCC	67,370	90.0%	80
Vietnam	18,906	25.2%	16
Morocco	10,049	13.4%	11
Nigeria	6,911	9.2%	10
Kenya	6,028	8.0%	4
Romania	5,173	6.9%	5
Iceland	3,495	4.7%	2
Bangladesh	2,798	3.7%	4
Lebanon	2,508	3.3%	4
Mauritius	2,154	2.9%	2
Slovenia	1,890	2.5%	2
Croatia	1,553	2.1%	3
Kazakhstan	1,502	2.0%	2
Jordan	1,162	1.6%	3
Sri Lanka	777	1.0%	2
Senegal	705	0.9%	1
Tunisia	692	0.9%	2
Estonia	466	0.6%	2
Lithuania	249	0.3%	2
Serbia	208	0.3%	2
Ivory Coast	144	0.2%	1
Benin	0	0.0%	0
Burkina Faso	0	0.0%	0
FM GCC	7,525	10.0%	9
Bahrain	6,161	8.2%	5
Oman	1,365	1.8%	4

Note: All market caps are in USD millions. Data as of the close of July 18, 2019

- The simulated MSCI Iceland Index would have a potential weight of 4.7% in the MSCI Frontier Markets Index

Simulated Impact on the MSCI Frontier Markets 100 Index (ex Kuwait)

	Current Index (ex AR)*		Simulated Index (ex KW inc IS)**	
	# of constituents	Weight	# of constituents	Weight
KUWAIT	19	25%	0	0%
VIETNAM	28	15%	29	30%
MOROCCO	7	11%	7	10%
KENYA	4	9%	4	9%
NIGERIA	7	9%	7	9%
BAHRAIN	5	8%	5	8%
ROMANIA	6	8%	6	8%
BANGLADESH	13	7%	15	8%
KAZAKHSTAN	3	3%	3	3%
OMAN	5	2%	5	2%
JORDAN	3	2%	3	2%
SRI LANKA	2	1%	2	1%
MAURITIUS	1	0%	1	0%
LITHUANIA	0	0%	1	0%
TUNISIA	0	0%	1	0%
ICELAND	0	0%	11	9%
	103		100	

*Data based on the pro forma index (post reclassification of Argentina and without application of the phasing rules) as part of the May 2019 Semi-Annual Index Review

** Simulated pro forma data as of the May 2019 SAIR (calculation date May 15, 2019, as of date May 29, 2019)

MSCI FM 100 Index (ex KW inc IS)
Simulated Top 10 Constituents

Security Name	Country	Simulated New Weight
AHLI UNITED BANK (KW)	BAHRAIN	6.1%
VINGROUP JSC	VIETNAM	5.6%
SAFARICOM	KENYA	5.1%
VIETNAM DAIRY PRODUCT	VIETNAM	5.0%
MAROC TELECOM	MOROCCO	3.9%
MAREL	ICELAND	3.6%
VINHOMES JSC	VIETNAM	3.5%
BANCA TRANSILVANIA	ROMANIA	2.9%
ATTIJARIWafa Bank	MOROCCO	2.8%
SQUARE PHARMACEUTICALS	BANGLADESH	2.6%

The full list of 100 securities is available upon request through MSCI's Client Service

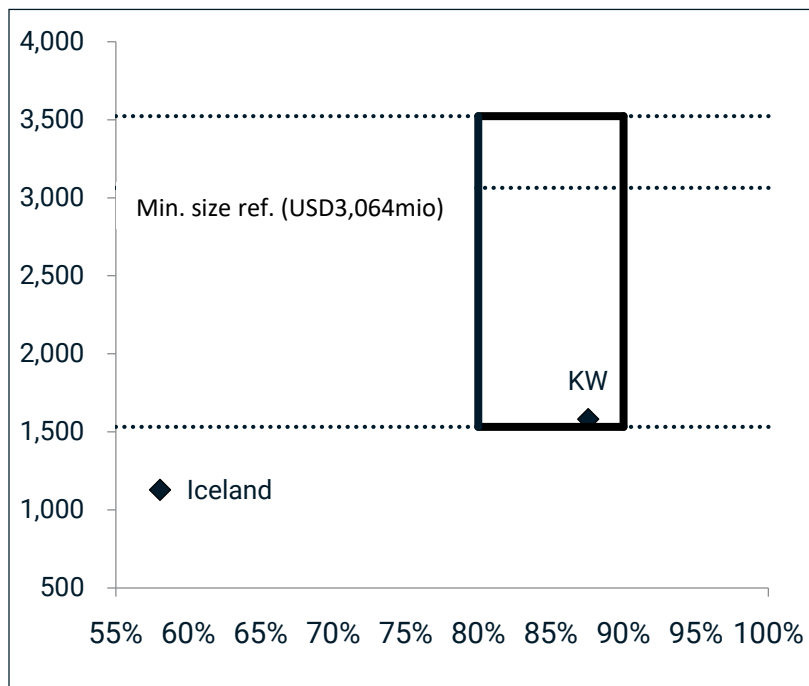
■ Key Questions

- Is the level of accessibility of the Iceland equity market for foreign investors sufficient to warrant a reclassification of the MSCI Iceland Index to Frontier Markets?
- Should MSCI give more time before the reclassification in order for market participants to fully absorb the changes that have been implemented in the market?
- Are there any remaining market accessibility concerns that should prevent the reclassification?
- What is your experience, if any, in setting up accounts to invest in Iceland equities?
- Should Iceland be reclassified to Frontier Markets, would it be appropriate to include Iceland in the list of eligible markets for the MSCI Frontier Markets 100, MSCI Frontier Markets 15% Capped and the MSCI Frontier Markets ex GCC 15% Capped Indexes?

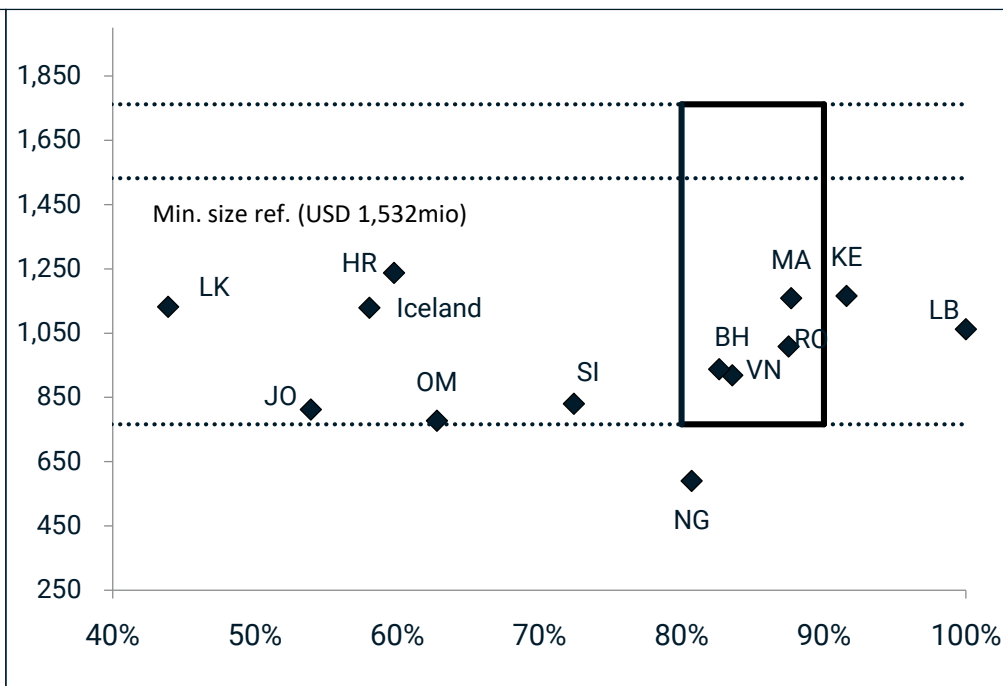
Appendix

Size Profile of Iceland

Larger FM

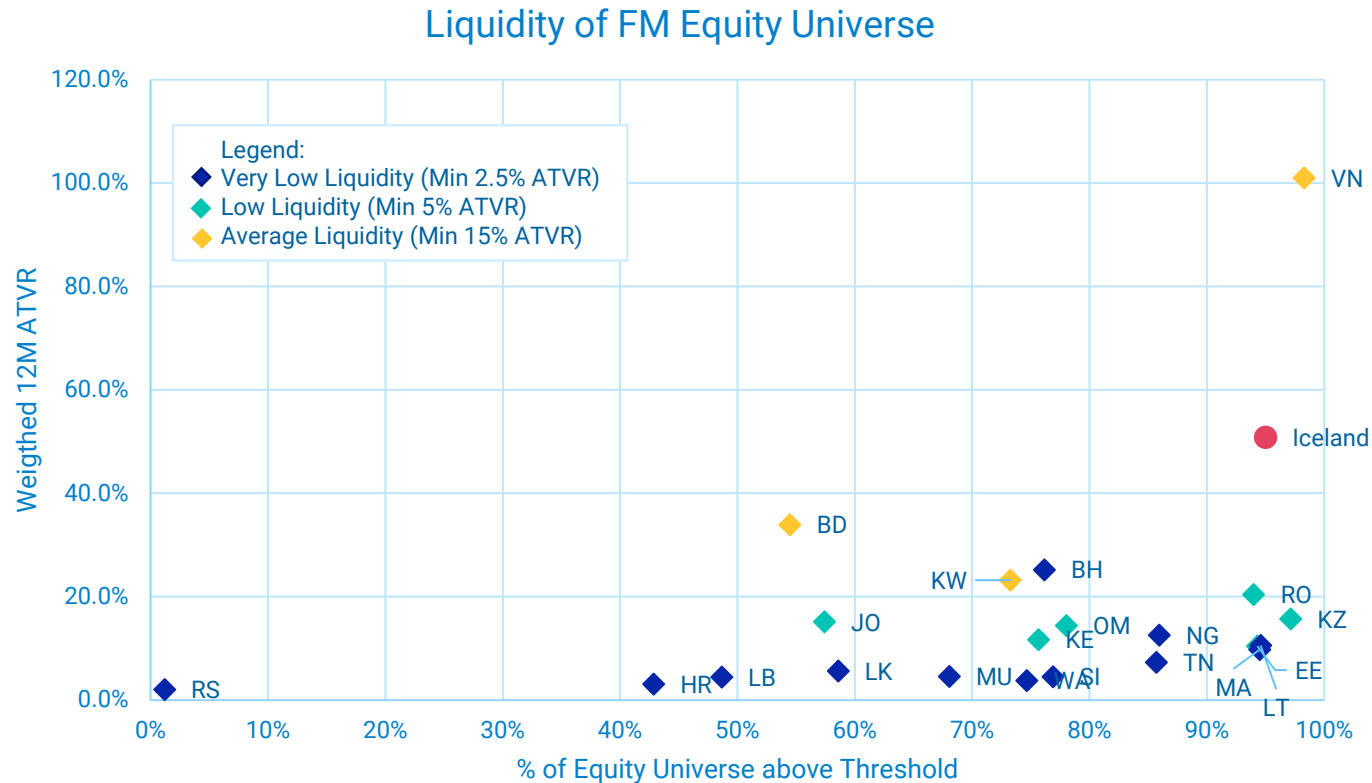


Smaller FM



- Smaller Frontier Markets size requirements are more appropriate for the MSCI Iceland Index to have at least 2 Standard constituents

► Liquidity Profile of Iceland against FM



- Iceland's Weighted ATVR is within range of the Average Liquidity Markets
- About 95% of the Equity Universe for Iceland meets the minimum 15% ATVR

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