

MSCI Response

to the

EU CONSULTATION DOCUMENT ON THE REGULATION OF INDICES

A Possible Framework for the Regulation of the Production and Use of Indices serving as Benchmarks in Financial and other Contracts

November 2012

MSCI Inc. is a leading provider of investment decision support tools to institutional investors globally, including asset managers, banks, hedge funds and pension funds. MSCI products and services include indices, portfolio risk and performance analytics, and governance tools.

The company's flagship product offerings are the: MSCI equity indices; Barra multi-asset class factor models, portfolio risk and performance analytics; RiskMetrics multi-asset class market and credit risk analytics; MSCI ESG (environmental, social and governance) research screening, analysis and ratings; ISS governance research and outsourced proxy voting and reporting services and FEA valuation models and risk management software for the energy and commodities markets. MSCI is headquartered in New York, with research and commercial offices around the world. MSCI has approximately 6200 customers worldwide across MSCI's different business units.

MSCI equity indices have been calculated for more than 40 years, and today MSCI calculates over 150,000 equity indices per day. MSCI Equity Index families include country and regional indices, size indices (large cap, small cap, micro cap), sector indices, style (value/growth) indices, strategy indices, thematic indices and ESG indices. MSCI also calculates custom indices, by applying client screens and constraints to MSCI Equity Indices.

MSCI Equity Indices are used worldwide by:

- assets owners to help them with their mandate decisions and with reviewing their managers' performance;
- active asset managers so that they can actively manage their funds against an index and report performance;
- passive fund managers to issue passive funds and ETFs based on the indices;
- broker dealers for providing trading execution services, creating OTC and non-OTC derivative financial products and writing research more generally; and
- stock exchanges to create equity index linked futures and options contracts.

We appreciate the opportunity to respond to this consultation. We are happy to answer any further questions that the Commission may have.

We have responded to the relevant questions below and have also chosen to provide additional information in sections where we thought it was necessary to help Commission better understand the impact of potential regulation on the industry and market users.

Chapter 1. Indices and Benchmarks: What they are, who produces them and for which purposes

Section 1.1 Types of Indices.

The Commission has rightly pointed out that there are different types of indices across different asset classes, and it is important to recognize that different types of indices:

- have different methodologies,
- use different types of data sources,
- have different data collection methods,
- use different index calculation methods and approaches, and
- can be used for different purposes.

It is important to clarify up front that LIBOR/EURIBOR are very different from many types of indices. For LIBOR/EURIBOR, the input data is based on a select set of estimates of the price at which interbank lending might take place. Because the input data is based on estimates and the number of data inputs is low, the individuals and banks can have a direct impact on the ultimate LIBOR/EURIBOR rate. Because the individuals and banks can directly benefit from their estimates, this provides fertile ground for manipulation. It is these shortfalls specific to LIBOR/EURIBOR that are the issue.

However, it should not be assumed that indices generally suffer the same problems.

MSCI Equity Indices, for example, are calculated using market prices and other market transaction data and public market data that is available and licensed from third party market data providers. Such market data includes the numbers of shares, corporate actions, fundamental company data, dividends, exchange rates, forward rates, measures of liquidity such as trading volumes, percentage of shares available for sale to international investors (free float), etc. We have agreements with approximately 150 different data providers, who provide data used in our equity indices. These market data providers, such as stock exchanges, license their data to us for a fee and subject to use and redistribution restrictions. The data can be delivered to MSCI directly by those different market data providers or through distributors who also charge a fee and impose use and redistribution restrictions. Certain fundamental company data, such as revenues and earnings numbers, may be sourced from publicly available company

annual reports and other publicly available company filings. Clients do not submit data to be included in MSCI Equity Indices and we do not source data using surveys, panels or samples.

MSCI Equity Indices are calculated strictly in accordance with our rules-based methodologies which are publicly available on our website, www.msci.com. Stocks are added or removed from our indices based solely on whether they meet the thresholds as outlined in the methodologies. We rebalance our indices quarterly or semi-annually as detailed in our methodologies and we publicly announce the results of those rebalancings on dates that are publicly announced in advance. The treatment of corporate actions is handled on a daily basis and is announced to clients. MSCI often consults the investment community in new methodologies and methodological changes. MSCI announces new methodologies and methodological changes publicly in advance. The public announcements are available on our website, www.msci.com.

Companies do not pay to be included in any MSCI Equity Indices, and the inclusion of companies in MSCI Equity Indices is in no way tied to any client subscriptions to any MSCI products and services. Whether or not a company is included in the MSCI Equity Indices is strictly determined by whether it meets the thresholds in the methodologies, which are again, publicly available.

MSCI has robust governance structures and rigorous calculation processes in place. MSCI observes strict Chinese Walls that separate (physically and by rule) those involved in equity index calculation and maintenance from those who are not. Employees of MSCI engaged in equity index calculation and maintenance are not permitted to trade in stocks (other than MSCI Inc. stock). We have general trading blackouts around our index rebalancing announcements.

The quality of our equity indices and methodologies and the integrity of our index calculation and maintenance processes and governance structures are fundamental to our brand.

Further, MSCI does not create or trade financial products based on MSCI Equity Indices, and as such, MSCI does not have an interest in the outcome of the performance levels of any particular index. MSCI licenses the MSCI Equity Indices to different types of institutional investors that use MSCI Equity Indices in many different ways and MSCI has no role in determining that usage.

Section 1.2 Producers of Indices

MSCI is a publicly traded company (NYSE: MSCI). We are independent and are not affiliated with any CCP, stock exchange, bank, asset manager or other financial institution. We have been calculating equity indices for over 40 years. You can find out more about us at www.msci.com.

Section 1.3 METHODOLOGIES

Section 1.3.1 Underlying data

As explained above, MSCI Equity Indices are calculated using market prices and other market transaction data and public market data that are available and licensed from third party market data providers under license agreements or sourced from company public filings.

Clients do not submit data to be included in MSCI Equity Indices and we do not source data using panels or surveys or samples.

Section 1.3.2 Calculation Methodology

MSCI Equity Indices are calculated in accordance with our index methodologies and significant skill and effort is applied in the research and creation of the methodology, the calculation of the index in accordance with methodological thresholds, and the maintenance of the indices. As mentioned above, our index methodologies are on our website, www.msci.com.

As part of the data calculation process, the many different types of datafeeds that we receive from market data providers and distributors need to be mapped, normalized, cross-referenced, etc. to allow us to calculate both real time and end of day indices.

Index maintenance includes daily processing of corporate actions, while index rebalancings occur quarterly or semi-annually in accordance with the index methodologies, which again, are on our website on www.msci.com.

The extent of the effort in calculating and maintaining the MSCI Equity Indices is revealed by the statistics below (for the period from January 2010 through September 2012). The MSCI Equity Index Production Team:

- calculates
 - over **150,000** end of day indices
 - over **8,200** indices in Real-Time with index level distributions every **15** or **60** seconds
- distributes
 - **thousands** of products daily to clients
- answers
 - over **625** client queries per month
- processes
 - over **175** sources of data from vendors, validated with cross checks
 - data covering over **24,000** securities across **75** countries
 - over **650** corporate events per month
 - over **3,900** fundamental data updates per month
 - over **3,300** dividend reinvestments per month
 - over **2,000** float updates per month

As mentioned above, MSCI also regularly consults with the investment community regarding index methodologies. Current consultations can be found on www.msci.com.

Section 1.4 USES OF INDICES

Section 1.4.1 Benchmarks for Financial, Commercial and Non Commercial Purposes and

Section 1.4.2 Uses other than as a benchmark

As mentioned above, MSCI Equity Indices are used by a variety of types of financial institutions for a variety of different purposes.

MSCI Equity Indices are used worldwide by:

- assets owners to help them with their mandate decisions and with reviewing their managers' performance;
- active asset managers so that they can actively manage their funds against an index and report performance;
- passive fund managers to issue passive funds and ETFs based on the indices;
- broker dealers for providing trading execution services, creating OTC and non-OTC derivative financial products and writing research more generally; and
- stock exchanges to create equity index linked futures and options contracts.

Section 1.4 DEFINING INDICES & BENCHMARKS

We believe that is important to highlight a few points:

- Flawed regulations can have harmful and costly unintended consequences that are disruptive to the market and negatively impact investors. The issues with LIBOR/EURIBOR are specific. That is not the lens through which to view all index providers.
- Broad definitions of indices and benchmarks will encompass many more providers of market data than traditional "financial indexes".
- Whether "benchmarks" and "indices" are different or used interchangeably is an important distinction that needs to be addressed.

Box 1

(1) Which benchmarks does your organisation produce or contribute data to?

MSCI has been calculating equity indices for over 40 years, and currently calculates over 150,000 equity indices per day. MSCI Equity Indices aim to measure relevant opportunity sets and our index families include country and regional indices, size indices (large cap, small cap, micro cap), sector indices, style (value/growth) indices, strategy indices, thematic indices and ESG indices. MSCI also calculates custom indices by applying client screens and constraints to

MSCI Equity Indices.

(2) Which benchmarks does your organization use? What do you use each of these benchmarks for? Has your organization adopted different benchmarks recently and if so why?

The MSCI index business creates and calculates indices.

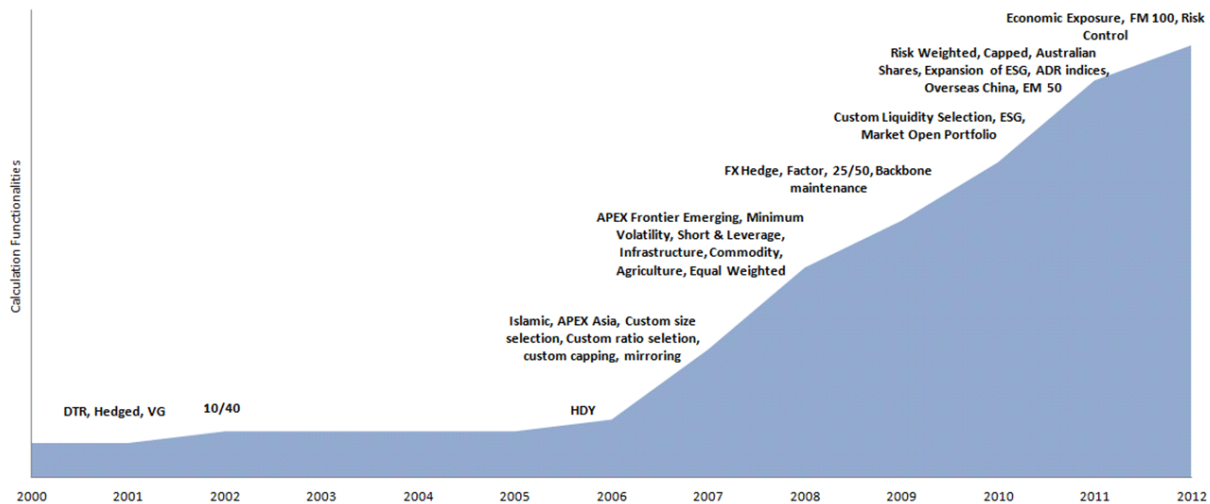
Other MSCI business units (such as the Barra and RiskMetrics) develop and license portfolio risk analytics software that our clients use to manage and assess risk in their portfolios. Our clients can request access to a wide variety of indices and we provide access to those indices through our risk analytics platforms.

(3) Have you recently launched a new benchmark or discontinued existing ones?

MSCI continually launches new indices.

Since 2000, MSCI has launched 37 new index methodologies and calculation capabilities. See below.

Since 2000, MSCI has introduced **37** new index methodologies and calculation capabilities



Clients also regularly request custom indices, which MSCI calculates by applying client screens and constraints to MSCI Equity Indices.

(4) How many contracts are referenced to benchmarks in your sector? Which persons or entities use these contracts? And for which purposes?

MSCI licenses MSCI Equity Indices to financial institutions that create financial products linked

to the performance of the index. These financial products include as passive funds, exchange traded funds (ETFs), exchange listed derivatives (futures and options) and over the counter (OTC) derivatives (swaps, structured notes, etc.) and non-OTC derivatives (notes, certificates, warrants, etc).

Our ETF clients include Blackrock, SSGA, UBS, Credit Suisse, Deutsche Bank, HSBC. ETFs on MSCI Equity indices are listed in the US, Canada, Europe, Japan, Singapore, Australia, Hong Kong, Taiwan and China, Latin America, South Africa, and other smaller countries. Over 50 different indices are utilized in these licenses. A list of ETFs that are based on MSCI Equity Indices can be found on our website, www.msci.com under the “Licensing” section link on the home page.

The three main exchanges licensed to create futures contracts on MSCI Equity Indices are: SGX, Eurex and NYSE Liffe. Exchanges that are licensed to list options contracts on MSCI Equity Indices include SGX, Eurex, Taifex, Nasdaq, and PHLX. More than 30 different indices are utilized in these licenses. A list of futures and options contracts on MSCI Equity Indices can also be found on our website, www.msci.com under the “Licensing” section link on the home page.

(5) To what extent are these benchmarks used to price financial instruments? Please provide a list of benchmarks which are used for pricing financial instruments and if possible estimates of the notional value of financial instruments referenced to them.

Please see the answer to question 4 above.

Based on estimates from March 31, 2012 as reported on September 30, 2012 (based on eVestment, Lipper and Bloomberg data), almost US\$7 trillion in assets are benchmarked to MSCI Equity Indices.

Because there is no publicly available measure of the assets in mutual funds and derivatives overall, we cannot the estimates for those financial products linked to MSCI Equity Indices.

(6) How are benchmarks in your sector set? Are they based on real transactions, offered rates or quotes, tradable prices, panel submissions, samples? Please provide a description of the benchmark setting methodology.

As explained above, MSCI Equity Indices are calculated using market prices and other market transaction data and public market data that are available and licensed from third party market data providers or sourced from company public filings. Most market data, such as prices from international stock exchanges, are provided for a fee and subject to use and redistribution restrictions. That data can delivered to MSCI directly by those market data providers or through distributors who also charge a fee and impose use and redistribution restrictions. Certain company fundamental data (such as revenues and earnings) is sourced from company annual reports and other publicly available company filings.

MSCI Equity Indices do not source data using surveys, panels or samples.

(7) What factors do you consider to be the most important in choosing a reliable benchmark? Could you provide examples of benchmarks which incorporate these factors?

Two things matter most to institutional investors when they select an equity index: accuracy and investability.

First, institutional investors want their index to be an accurate and timely representation of the specific equity market the index claims to represent.

MSCI addresses institutional investor requirements for accuracy by having transparent methodologies available on our website and a robust market classification framework. These important elements ensure the index reflects all investment opportunities without gaps or overlaps and captures changes in markets in a timely manner.

Second, institutional investors want their index to be investable and replicable.

MSCI addresses institutional investor needs for investability mainly through three important elements of its methodology. First, we make extensive use of buffer zones to reduce turnover. Second, we ensure that corporate events are implemented in a timely manner and in a way that can be replicated in actual portfolios. Third, we use multiple liquidity measures to ensure that the stocks that are included in the index are investable.

By focusing on accuracy and investability, MSCI Equity Indices are widely recognized as objective measures of markets, fair benchmarks for managers, and cost effective solutions for index replication vis a vis actual portfolios.

Chapter 2. Calculation of Benchmarks: Governance and Transparency.

As a general principal, MSCI's methodologies are rules-based. MSCI Equity Indices are calculated using market prices and other market transaction data and public market data that is available and licensed from third party market data providers or sourced from company public filings (not estimates, subjective or opinion as detailed in 'Figure 1 – The Benchmark Process' of the Consultation). The internal MSCI processes to calculate indices, such as rebalancings and corporate actions treatment, are governed by methodologies that are available on www.msci.com. Creation, maintenance and implementation of our methodologies are overseen by four internal committees, staffed internally by employees who are separated by a Chinese wall (physically and by rule) from the rest of the MSCI organization.

Box 2

(8) What kinds of data are used for the construction of the main indices used in your sector? Which benchmarks use actual data and which use a mixture of actual and estimated data?

As explained above, the MSCI Equity Indices are market cap equity indices, which use real equity trading prices from a large selection of international exchanges, along with other market data, which is licensed for a fee. MSCI also uses company fundamental data such as revenues and earnings in some of its indices, which is publicly available in company reports and other publicly available company filings.

(9) Do you consider that indices that do not use actual data have particular informational or other advantages over indices based on actual data?

The types of data that is available for index calculation may be dependent on the asset class of the index.

Indices that use actual data or public market data (like equity indices) where strong governance structures exist, are unlikely to suffer from conflicts of interest and opportunities for manipulation.

However, for other asset classes there may not be observable market transactions available. In that case, other measures may be used to protect against conflicts of interest and opportunities for manipulation. These measures may be asset class specific and may not have relevance to other asset classes.

(10) What do you consider are the advantages and disadvantages of using a mixture of actual transaction data and other data in a tiered approach?

We believe it is advisable to use actual market transaction data or public market data where it is available and where it is possible. For equity indices that is more likely the case. However, for other types of asset classes, actual transactions may not be available.

(11) What do you consider are the costs and benefits of using actual transactions data for benchmarks in your sector? Please provide examples and estimates.

We believe it is advisable to use actual market transaction data or public market data where it is available and where it is possible. For equity indices that is more likely the case. However, for other types of asset classes, actual transactions may not be available.

Box 3

(12) What specific transparency and governance arrangements are necessary to ensure the integrity of benchmarks?

This may be dependent upon and specific to the asset class.

The MSCI index calculation and production process is governed by extensive process control checks to ensure accuracy and timeliness. We use rules-based methodologies available on our website to ensure transparency and consistency. Finally we have several decision committees to ensure oversight and validation of complex and/or highly impactful implementation issues. These committees include the Universe Management Committee which deals with constituent level data points, the Global Constituent Committee, which addresses complex corporate events, the Equity Index Committee, which is responsible for all changes and enhancements to index methodology, and the Index Policy Committee, which is responsible for policy level index methodology decisions.

(13) What are the advantages and disadvantages of imposing governance and transparency requirements through regulation or self-regulation?

Different forms of regulation have different costs associated with them.

Indices that use actual data or public market data (like equity indices) where strong governance structures exist, are unlikely to suffer from conflicts of interest and opportunities for manipulation. It is unclear what regulations would achieve in these situations.

Treating all asset classes under one umbrella with overly broad legislation that is not appropriately tailored can have costly, unintended consequences. As indices are the basis of listed and non-listed products, changes that are disruptive to the market would negatively impact investors.

Further, regulation that requires index providers to make their intellectual property (for which they normally charge a fee to access) freely available without restriction, allowing others to free-ride, could result in index providers exiting the European market. This would result in less competition in Europe amongst index providers and less index choices for investors.

(14) What are the advantages and disadvantages of making contributing data or estimates to produce benchmarks a regulated activity? Please provide your arguments.

In situations where:

- (i) the market data providers generally provide datafeeds that are based on observable transactions,
- (ii) the same datafeeds are provided to different types of licensees for a variety of different uses,
- (iii) the market data providers cannot influence (and do not have a direct interest in) the

outcome of the ultimate index performance levels,

the conflicts of interests and opportunities for manipulation that exist for LIBOR/EURIBOR, do not exist. As such, it is unclear what regulations would achieve in these situations.

The disadvantages of regulating the market data providers include added costs and delay throughout the index production chain, which would impact the investors.

Box 4

(15) Who in your sector submits data for inclusion in benchmarks? What are the current eligibility requirements for benchmarks' contributors?

As explained above, MSCI Equity Indices are calculated using data from multiple data sources. Most market data (such as prices) are provided by international stock exchanges) is licensed for a fee and subject to use and redistribution restrictions. The data is delivered to MSCI directly by those different market data providers or through distributors who also charge a fee and impose use and redistribution restrictions. Certain company fundamental data (such as revenues and earnings) is sourced from company annual reports and other publicly available company filings.

MSCI Equity Indices do not source data using surveys, panels or samples.

(16) How should panels be chosen? Should safeguards be provided for the selection of panel members, and if so which safeguards?

We are unable to provide detailed comments because we do not source data using panels.

(17) How should surveys of data used in benchmarks be performed? What safeguards are necessary to ensure the representativeness and integrity of data gathered in this way?

We are unable to provide detailed comments we do not source data using surveys.

(18) What are the advantages and disadvantages of large panels? Even in the case of large panels could one panel member influence the benchmark?

We are unable to provide detailed comments because we do not source data using panels.

(19) What would be the main advantages and disadvantages to auditing of panels? Please provide examples.

We are unable to provide detailed comments because we do not source data using panels.

(20) Where indices rely on voluntary contributions, do you consider that there are factors which may discourage the making of these contributions and if so why?

We are unable to provide detailed comments because we do not source data using voluntary contributions.

(21) What do you consider to be the advantages and disadvantages of mandatory reporting of data? Please provide examples.

We are unable to provide detailed comments because we do not source data using mandatory data contributions.

(22) For entities contributing to benchmarks which are regulated by financial regulation, what would be the advantages and disadvantages of bringing their benchmark submissions under the scope of this framework?

See the answer to question 14.

Price assessments that use surveys, panels, and voluntary contributions are one segment of the market and are very different from many other types of indices, such as equity indices.

Box 5

(23) Do you consider that responsibility for making adjustments if inadequate data is available should rest with the contributor of the data, the index provider or the user of the index?

Equity index providers cannot make adjustments to the market data providers' data (e.g., stock exchange prices). In fact, it would be completely inappropriate for the index provider to do so.

With respect to our own index changes, MSCI addresses index adjustments as outlined in the 'MSCI Index Calculation Methodology' as available on www.msci.com.

(24) What is the formal process that you use to audit the submissions and calculations?

The MSCI Equity Index Production team is governed by the following processes:

- extensive process control checks to ensure accuracy and timeliness
- rules-based methodology to ensure transparency and consistency
- decision committees to ensure oversight and validation of complex and/or highly impactful implementation issues

For certain datasets where there are multiple data sources (such as prices), the MSCI Equity

Index Production team performs data verification activities to verify the extent to which the different datafeeds match.

Below are some statistics relating to certain types of data checks for the period January 2010 through September 2012.

Data Type	Volume Processed
corporate events	650 per month
dividends reinvested	3,300 per month
fundamental data updates	3,900 per month
float updates	2,000 per month
securities prices	24,000 per day
securities identifiers	95,000 per day

(25) If there are any weaknesses identified in the audit, who are they reported to and how are they addressed? Is there a follow up process in place?

Complex or non standard cases are escalated to our decision committees (which are outlined above). These committees are staffed with experienced professionals. This process ensures proper oversight and minimizes key person risk.

(26) How often are submissions audited, internally or externally, and by what means? Do you consider the current audit controls are sufficient? What additional validation procedures would you suggest?²⁸

Please see the answer to question 25.

(27) What are the advantages and disadvantages of a validation procedure? Please provide examples.

Please see the answer to question 25.

(28) Who should have the responsibility for auditing contributed data, the index provider or an independent auditor or supervisor?

With respect to market prices and other market transaction data and public market data that are available, the purpose of auditing such data is unclear.

As explained above, MSCI performs certain data checks where there are multiple data sources, but MSCI has no way to confirm whether the underlying data itself is correct or incorrect.

Equity indices are provided on real time, delayed real-time and end of day basis. Having third parties audit datafeeds for all equity indices across the industry is unrealistic. MSCI alone

calculates over 150,000 indices per day.

(29) What are the advantages and disadvantages of making benchmarks a regulated activity? Please provide your arguments.

The disadvantages of flawed regulations are that they can have harmful, unintended consequences that are disruptive to the market and negatively impact investors. This includes increased costs to the investors and the introduction of delays throughout the index production chain. In addition, regulations that reduce index providers' ability to protect their intellectual property rights, could drive out index providers from the European market which means there is less competition among index providers in Europe and less choice for financial products for European investors.

For indices/index asset classes where index methodologies are publicly available, index production governance structures are robust and market prices and other market transaction data and public market data are used, it is unclear what regulation would achieve, as the methodologies and governance structure remove any issues of conflicts of interest and opportunities for manipulation up front.

At MSCI:

- Our indices are based on market prices and other market transaction data and public market data.
- We have strict Chinese Walls in place separating teams that work on equity index maintenance and calculation from other employees. Those who work on equity index maintenance and calculation are subject to trading policies that prohibit them from trading in stock, other than MSCI stock.
- We have blackout periods in place prohibiting all employees from trading in any stock around the quarterly index rebalancing announcements.
- Our methodologies are publicly available on www.msci.com.
- We rebalances our indices on a quarterly basis and publicly announces those changes.
- We publish the quarterly index rebalancing dates a year in advance.
- Our methodological changes are publicly announced.
- We hold public consultations on methodological changes to existing indices. MSCI often holds public consultations on new index development.
- We publish research papers and hold webinars and research conferences on topical subject matter.
- We provide 24x5 client services support for its clients.

We have been calculating indices for 40 years. We provide transparency with respect to our methodology and index changes and we have strong governance structures in place. That is why clients choose MSCI. Regulation would not motivate MSCI to engage in these activities. MSCI engages in these activities to maintain the integrity of the MSCI brand.

Chapter 3: The Purpose and Use of Benchmarks

Box 6

(30) Is it possible and desirable to restrict the use of benchmarks? If so, how, and what are the associated costs and benefits? Please provide estimates.

As mentioned above, MSCI Equity Indices are used worldwide by:

- assets owners to help them with their mandate decisions and with reviewing their managers' performance;
- active asset managers so that they can actively manage their funds against an index and report performance;
- passive fund managers to issue passive funds and ETFs based on the indices;
- broker dealers for providing trading execution services, creating OTC and non-OTC derivative financial products and writing research more generally; and
- stock exchanges to create equity index linked futures and options contracts.

Restricting and/or changing the ways in which financial institutions could use equity indices would have wide ranging ramifications on those businesses and would impact listed and non-listed products on which the equity indices are based.

(31) Should specific benchmarks be used for particular activities? By whom? Please provide examples.

As mentioned above, equity indices are licensed to, and use by many, different types of financial institutions for many different purposes. Those financial institutions are able to review index methodologies which are posted on line. The financial institution, whether it is the pension fund, asset manager, stock exchange or broker dealer, determines whether any particular index meets its particular investment requirements for its particular usage. The equity index provider does not make these decisions.

(32) Should benchmarks developed for wholesale purposes be used in retail contracts such as mortgages? How should non-financial benchmarks used in financial contracts be controlled?

We are unclear what is meant by "benchmarks developed for wholesale purposes".

As we calculate equity indices, we cannot provide detailed responses to the second question.

(33) Who should have the responsibility for ensuring that indices used as benchmarks are fit for purpose, the provider, the user (firms issuing contracts referenced to benchmarks), the trading venues or regulators?

Equity indices are used for many different purposes by many different types of clients.

Financial institutions determine whether any particular index methodology and approach fits their particular investment requirements. Index providers cannot determine that for its clients and it is inappropriate for index providers to so do.

Chapter 4: Provision of Benchmarks by Private or Public Bodies

Box 7

(34) Do you consider some or all indices to be public goods? Please state your reasons.

Equity indices are not public goods. Equity indices constitute intellectual property which is protected by national and international laws and conventions. Because index providers own the intellectual property, index providers can restrict access and use of indices through access controls and license agreements.

MSCI Equity Indices are licensed pursuant to license agreements and access and use is governed by those license agreements.

(35) Which role do you think public institutions should play in governance and provision of benchmarks?

What role public institutions play depends on the reasons for the involvement.

(36) What do you consider to be the advantages and disadvantages of the provision of indices by public bodies?

MSCI calculates over 150,000 equity indices per day. Our index production team consists of over one hundred employees around the world. That is strictly for index production. That does not include our client services and other support teams. Our index production team:

- calculates
 - over **150,000** end of day indices
 - over **8,200** indices in Real-Time with index level distributions every **15** or **60** seconds
- distributes
 - **thousands** of products daily to clients
- answers
 - over **625** client queries per month
- processes
 - over **175** sources of data from vendors, validated with cross checks
 - data covering over **24,000** securities across **75** countries
 - over **650** corporate events per month
 - over **3,900** fundamental data updates per month
 - over **3,300** dividend reinvestments per month
 - over **2,000** float updates per month

The members of the Index Industry Association (which include MSCI, FTSE, S+P, Russell, Markit, Nasdaq) collectively calculate over 1,000,000,000 indices. That is just a handful of index providers calculating equity and fixed income indexes. That does not include other asset classes such as commodities and real estate. Further, those are the “traditional” financial index providers. Broadly defining “indexes” could also include many other types of market data providers.

It is difficult to see how public bodies could establish the systems, processes, and expertise to take over the index calculations functions across countries and asset classes. Not only is there the expense of obtaining and maintaining the infrastructure, but there is also the expense negotiating the license agreements and paying the license fees for the market data. It is also difficult to see what advantage there would be if public bodies were to calculate equity indices. If methodologies are publicly available, governance structures are robust and market data based on observable transactions is used, then public bodies would be no better at following those methodologies than private companies. Further, as equity indices are the basis of listed and non-listed financial products, the potential risks of disruption to the market are significant.

Additionally, indices are protected by national and international intellectual property laws and conventions, and nationalizing index calculation would conflict with those laws and conventions.

(37) Which indices, if any, would be best provided by public bodies?

If index methodologies are publicly available, index production governance structures are robust and market data based on observable transactions is used, then there is no reason to believe that public bodies would be better at following those methodologies than private companies. Further, without the expertise in calculating indices, public bodies could be worse.

If data collection process and methodologies allow for conflicts of interest and manipulation and the data contributors can benefit from their submissions, then the public bodies calculating the index would still have the same problem. There’s no reason to believe that the public bodies will be any better than private bodies at calculating the index. For example, if LIBOR were suddenly calculated by a public body instead of the BBA, without any other adjustments to the LIBOR rules, there would still be problems. The data submitted by the banks would still be based off of estimates, and banks and individuals would still be able to manipulate, influence and directly benefit from their submissions.

Chapter 5: Impact of Potential Regulation: Transition, Continuity and International Issues.

Box 8

(38) What conflicts of interest would arise in the provision of indices by public bodies? What would be the best way of avoiding these conflicts of interest?

If conflicts of interest are built into methodologies and the data contributors can benefit from their submissions, then it doesn't matter who calculates the index. The conflicts will still exist. In the case of LIBOR/EURIBOR, if the contributing banks can improperly influence and still benefit from the ultimate rate by submitting estimates, it doesn't matter whether the BBA or the Commission calculate the actual rate.

(39) What are the likely transition challenges, costs and timelines for relevant benchmarks? Please provide examples.²⁹

With respect to equity indices, transition logistics and costs depend on how the client is using the index. If the index is the basis of the pension fund's mandate, then that will have a cascading affect to the asset managers fulfilling that mandate.

For funds based on indices, switching indices is possible, but takes work. It is possible that an index provider may do this themselves, transitioning to a newer methodology, or implementing a change more relevant to the changing market conditions. The simplest example is moving a country from one index to another when it is reclassified between Developed and Emerging Markets. MSCI has a set process to do this over time, with changes announced to the public in advance along a pre publicized schedule, to assist in reducing market impact, so all market participants hear the relevant news simultaneously, in advance to plan their reaction.

Financial product providers can transition between benchmarks for commercial or other reasons. This can be timely and costly depending on several factors. For example, do the products need to be reregistered, are there guidelines around making any move cost effective to the end investor, do end investors need to be notified or consulted with? Does the product name need to change. Costs can depend on the type of product and jurisdiction of listing.

There will also be trading costs associated with moving and physical index replication or hedging in the case of passive products (less so active funds). This will depend on the size of the fund, the difference in the indices and the liquidity of the underlying market. A current example is the transition of \$150Bn of passive Vanguard ETFs from MSCI Indices to FTSE indices.

(40) How do you consider that the adoption of new benchmarks could be ensured? Is this best framed in terms of encouraging or mandating the use of particular benchmarks?

Adoption of a new equity indices cannot be ensured. The most popular indices have all evolved naturally in the markets in different ways. Adoption needs to happen by several types of users

at once or in order. These users will have different needs for example, indices are chosen by large asset owner to assess their holdings and allocate assets. They will then issue mandates, which asset managers will take on. These interact with factors like the liquid hedging instruments, based on separate indices chosen by the exchanges for example. Brokers will trade OTC on a variety of indices, and offer best prices on those most easy for them to hedge, which can push their end clients to choose one over another based on cost.

(41) How can reforms of the regulation of benchmarks be most easily implemented?

This depends on the scope and type of regulation, who is being regulated and how.

(42) What positive or negative impacts, if any, do you see on small and medium-sized enterprises of the possible regulation of indices, and how could any negative impacts be mitigated?

This would depend on the types of indices being regulated.

In theory, regulation of indices could provide another layer of security to the end investor, that the index is appropriately managed and not adversely influenced by another market participant. However if that risk does not exist, then the downside is the cost of regulation, which will result in administrative cost, and the requirement to have infrastructure around the index calculation. This cost would be born either by the regulating body or the index calculator and would potentially be recouped in fees charged to the end investor.

(43) Are there other impacts which should be considered? If so please specify the nature of these impacts and provide evidence.

If regulation is applied, it should be under a commercial business model rather than a government body, to ensure the industry still have choice to move to the best service provider, and new innovative indices are created to meet client demand.

Box 9

(44) In which countries are benchmarks used in your sector produced? From which countries are data used for the production of benchmarks in your sector sourced? In which countries are benchmarks used in your sector used?

MSCI has offices in 20 countries around the world, in emerging, developed and frontier markets. Index production takes place in a number of our offices around the world. We source data from stock exchanges and other data providers around the world, in developed, emerging and frontier markets. We have clients around the world, in developed, emerging and frontier markets.

(45) Are there non-EU benchmarks which could serve as substitutes? Are there non-EU benchmark providers which could produce similar benchmarks?

This question does not apply to equity indices. Equity indices represent ways to measure opportunity sets. Those opportunity sets can be based on countries, regions, sector, styles, themes, etc. The institutional investor chooses the index that matches the opportunity set that investor wishes to use.

MSCI and many other equity index providers have global businesses and calculate indices clients globally.

(46) Are there international benchmarks which could serve as substitutes for national benchmarks?

This question does not apply to equity indices. Equity indices represent ways to measure opportunity sets. Those opportunity sets can be based on countries, regions, sector, styles, themes, etc. The investor chooses the index that matches the opportunity set the investor wishes to use.

Equity indices are generally substitutable. Their adoption is a commercial decision by the client based on the client's requirements and acceptance. For example, MSCI calculates MSCI Germany Large Cap Index, which has similarities with the DAX index, but is not widely recognized by retail investors so not used for derivatives. Also futures, options and other liquid instruments are already established on the DAX index, making it very difficult for other users to switch to MSCI Germany Indices (completely unrelated to the cost of the index license) based on the hedging cost of using the liquid hedging instruments such as futures.

MSCI and other indices providers produce country indices that can replace national benchmarks, and clients can choose to accept these or not. In some cases many ETFs are based on an index such as MSCI Japan index rather than the TOPIX or the Nikkei 225, for example.

For example, Vanguard recently announced their decision to switch the benchmarks of several of their large AUM US listed ETFs from MSCI to another benchmark provider.

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MSCI Inc. is a leading provider of investment decision support tools to investors globally, including asset managers, banks, hedge funds and pension funds. MSCI products and services include indices, portfolio risk and performance analytics, and governance tools.

The company's flagship product offerings are: the MSCI indices with almost USD 7 trillion estimated to be benchmarked to them on a worldwide basis¹; Barra multi-asset class factor models, portfolio risk and performance analytics; RiskMetrics multi-asset class market and credit risk analytics; MSCI ESG (environmental, social and governance) Research screening, analysis and ratings; ISS governance research and outsourced proxy voting and reporting services; FEA valuation models and risk management software for the energy and commodities markets; and CFRA forensic accounting risk research, legal/regulatory risk assessment, and due-diligence. MSCI is headquartered in New York, with research and commercial offices around the world.

¹As of March 31, 2012, based on eVestment, Lipper and Bloomberg data.

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