



恒生指數
HANG SENG INDEXES

Update on
the Proposal to Enhance the Hang Seng China Enterprises Index as Regards
Providing a Representative

'China Index of Hong Kong Market'

23 November 2018

The proposal contained in this document is for the purpose of holding discussions with market participants and various stakeholders. It may or may not lead to changes to the Hang Seng China Enterprises Index ("HSCEI").



Executive Summary

Objective:

- To enhance the representativeness of Hang Seng China Enterprises Index (“HSCEI”) for Mainland securities listed in Hong Kong

Background:

- HSCEI, originally a pure H-share index, is transforming into a more comprehensive China benchmark by including Red-chips and private enterprises (“P-chips”) in the index
- As announced in August 2017, Hang Seng Indexes Company Limited (“Hang Seng Indexes”) fixed the number of Red-chips and P-chips (“Red/P-chips”) to be added to the HSCEI at 10. The 10 new constituents were added in March 2018 and the weightings of these constituents are being increased in five stages between March 2018 and March 2019
- This proposal is for the management of the HSCEI after this transition period

Proposals:

Progressively increase the number of Red-chip and P-chip constituents:

- Hang Seng Indexes proposes to keep the total number of constituents at 50 while progressively increasing the number of Red/P-chip constituents beginning from the June 2019 rebalancing, until the fix on the number of Red/P-chip constituents is removed (*Proposed Change 1*)
- Hang Seng Indexes aims to remove the fix on the number of Red/P-chip constituents in the December 2019 rebalancing, which implies that the enhancement would be implemented through three rebalancings (*Proposed Change 2*)

Fast Entry Mechanism to include sizable Red-chips and P-chips:

- Normally, eligible Red/P-chips are required to have a listing history of at least three years. Hang Seng Indexes proposes to introduce a Fast Entry Mechanism that will allow for the timely inclusion of sizable Red/P-chips with listing histories of 1 to 2 years (*Proposed Change 3*)

Consultation:

- Hang Seng Indexes welcomes feedback from market participants on these proposals until 31 December 2018. The results of the consultation are expected to be announced in January 2019

Ongoing Transition Period of the Enhancement

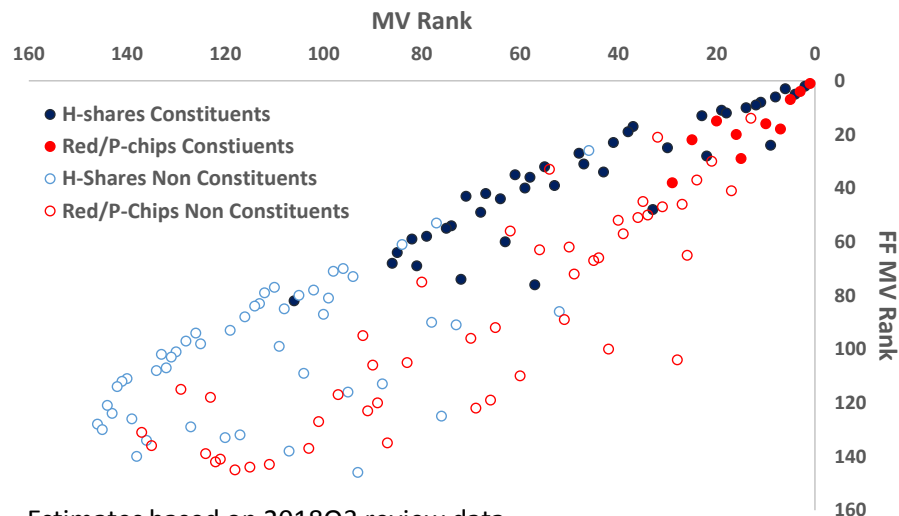
- The number of H-shares constituents in the HSCEI remains at 40 and the regular constituent change exercises are conducted as usual
- Ten Red/P-chip constituents have been added to the HSCEI. The full impact of their inclusion is being brought over five phases by using an inclusion factor and an adjusted cap level in each phase according to the following table:

Phase	Month	Inclusion Factor	Adjusted Cap Level
1	March 2018	0.2	2%
2	June 2018	0.4	4%
3	September 2018	0.6	6%
4	December 2018	0.8	8%
5	March 2019	1.0	10%

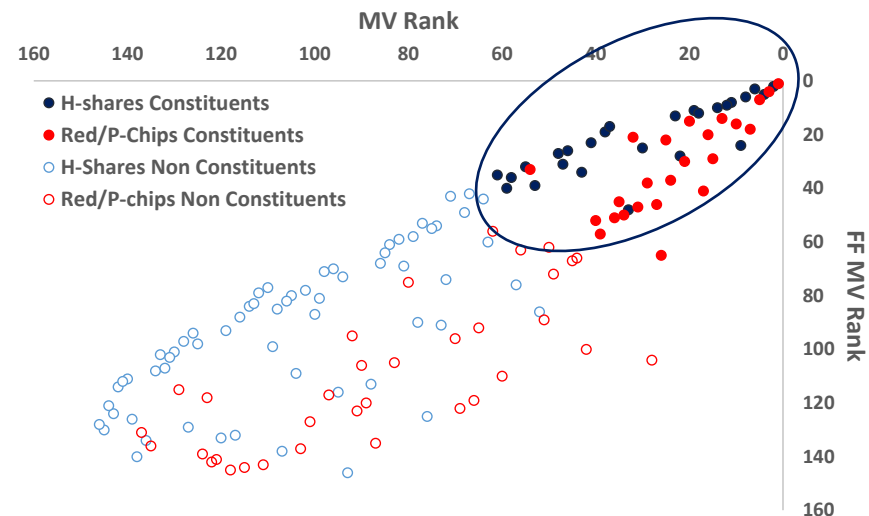
Next Stage: Further Enhance Market Representation of HSCEI

- The current 40:10 split between H-share and Red/P-chip constituents limits the market representation of the HSCEI and compromises the size alignment between the two categories in the index
- The current HSCEI (with 10 Red/P-chip constituents) does not include some sizable Red/P-chips but does include some H-shares with a smaller Market Value (“MV”) and Freefloat-adjusted Market Value (“FFMV”) than a number of current Red/P-chip non-constituents
- Hence, the next step is to remove the fix on the number of Red/P-chip constituents and simply select the largest eligible H-shares/Red/P-chips as index constituents

Constituent Selection (Current)



Constituent Selection (Without fixing number of Red/P-chips)



Estimates based on 2018Q3 review data

Proposed Change 1: Increase Number of Red/P-chips

- Hang Seng Indexes proposes to keep the total number of constituents at 50 and to increase the number of Red/P-chip constituents in the HSCEI
- Hang Seng Indexes proposes to remove the fix on the number of Red/P-chip constituents
- Without fixing the number of Red/P-chips, the MV of H-shares and Red/P-chip constituents in HSCEI will be aligned and the market representation of the index will also be enhanced

Smallest MV of H-shares and Red/P-chips with varying fixed numbers in different share classes

No. of H-shares : No. of Red/P-chips	Smallest MV in each category (HKD Mn)*	
	H-shares	Red/P-chips
40:10	23,617	80,339
35:15	26,154	73,812
30:20	31,104	67,480
Without fixing the numbers on the two categories but maintaining 50 constituents	37,925	42,840

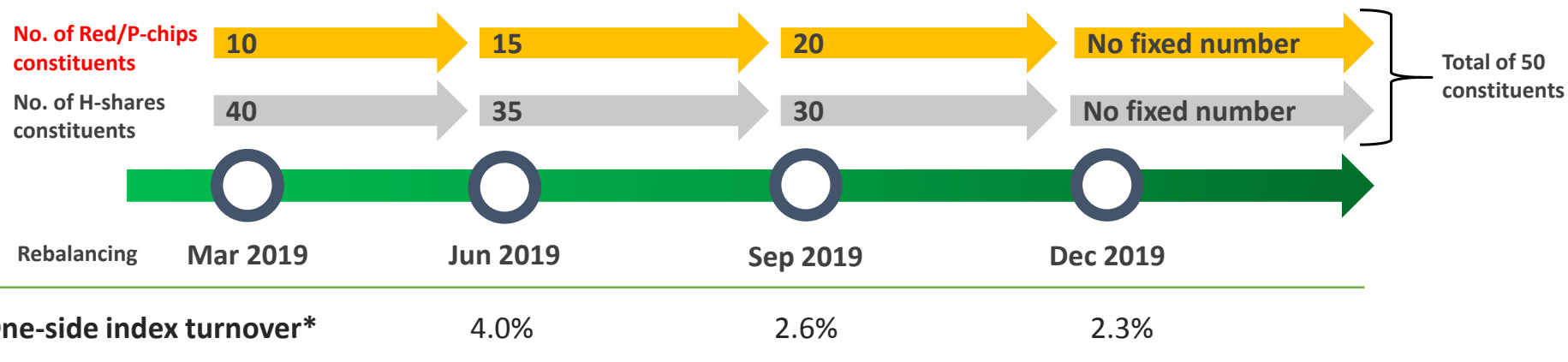
Aligning the size of the two categories

- Subsequent to the removal of the fix on the number of Red/P-chip constituents, the number of Red/P-chip constituents in the index would be around 24[#]

Proposed Change 2: Implement Through Three Rebalancings

- Hang Seng Indexes proposes to implement the enhancement by increasing the number of Red/P-chip constituents in the HSCEI through **three rebalancings**, the first of which will take place in June 2019
- Hang Seng Indexes aims to remove the fix on the number of Red/P-chip constituents in the December 2019 rebalancing

Changes in H-shares and Red/P-chips following the initial transition

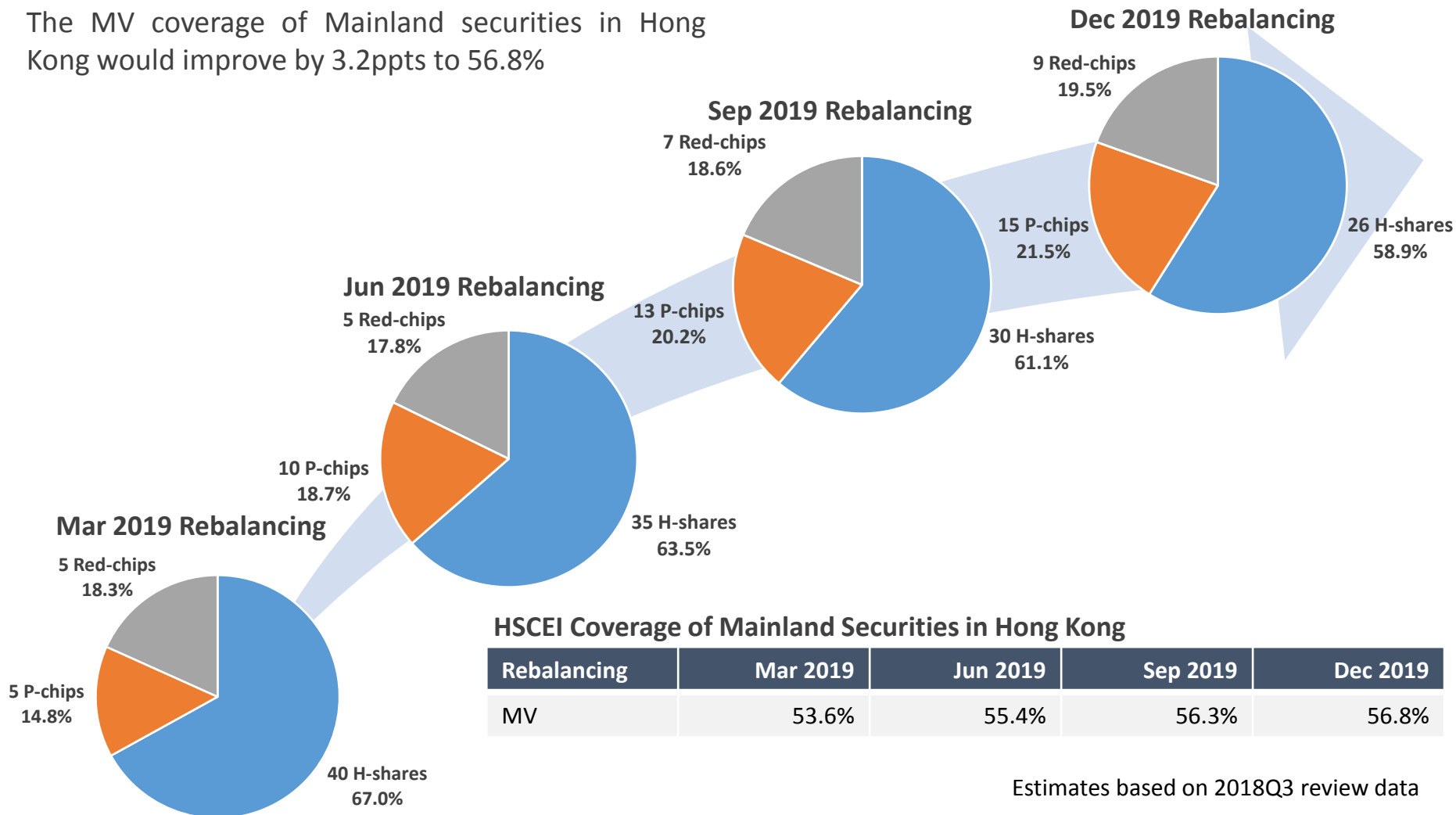


- It is estimated that the index turnover of each round would be around 2% to 4%, which is similar to that of the index turnover during the ongoing transition period of the enhancement
- To avoid unnecessary index turnover during the process (i.e. addition of previously removed Red/P-chip constituents or removal of previously included H-share constituents), Hang Seng Indexes also might consider to widen the buffer zone on a temporary basis

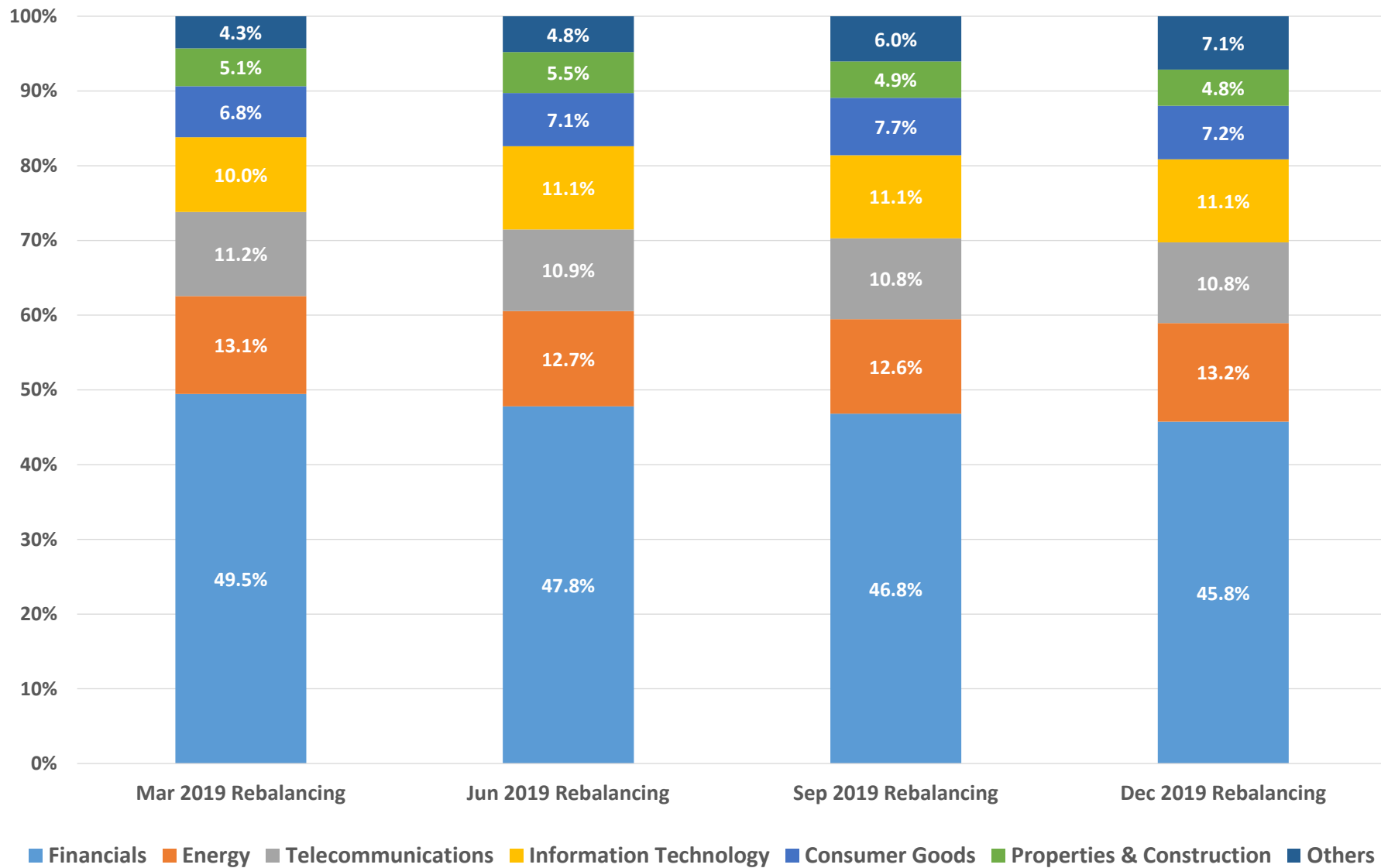
*Estimates based on 2018Q3 review data without applying proposed buffer zone

Indicative Results: Improving Representativeness of HSCEI

- The weighting of Red/P-chip constituents would gradually increase from the current 33% to 41% in December 2019
- The MV coverage of Mainland securities in Hong Kong would improve by 3.2ppts to 56.8%



Indicative Results: More Balanced Industry Distribution



Estimates based on 2018Q3 review data

Existing Eligibility Requirement for Red/P-chips

Listing History:	Price Volatility:	Financial:
IPO: Three years Backdoor listing: Six years	Historical volatilities must be no more than three times of that of HSCEI for the past: <ul style="list-style-type: none">- 1 month- 3 months- 12 months	The following parameters must be positive for the latest three fiscal years: <ul style="list-style-type: none">- Net profit- Net cash generated from operating activities- Cash dividends

- Under the existing requirement, Red/P-chips without a listing history of three years (for IPO) or six years (for backdoor listing) would be ineligible for inclusion regardless of their market status or size
- The more timely addition of sizable Red/P-chips would enhance the representativeness of the HSCEI

Proposed Change 3: Fast Entry Mechanism for Red/P-chips

Proposed Fast Entry Mechanism for Sizable Red/P-chips

MV rank among Mainland Companies	Minimum Listing History	Financial Statement Disclosure Requirement	Financial Requirement
Top 10	One year	<u>One</u> annual report for the <u>latest fiscal year</u> published after the listing date	Net profit, net cash generated from operating activities and cash dividends must be positive for the <u>latest fiscal year</u>
11 - 20	Two years	<u>Two</u> annual reports for the <u>previous two fiscal years</u> published after the listing date	Net profit, net cash generated from operating activities and cash dividends must be positive for the <u>latest two fiscal years</u>

- Hang Seng Indexes proposes a Fast Entry Mechanism that allows for the timely inclusion of significant Red/P-chips to complement the proposed increase of Red/P-chip constituents
- The Fast Entry Mechanism allows for the timely inclusion of Red/P-chips with listing histories of one to two years given sufficient financial statement disclosure
- Hang Seng Indexes proposes specific Disclosure Requirements and Financial Requirements while maintaining the existing Price Volatility Requirements for Red/P-chips eligible for the Fast Entry Mechanism

Proposed Change 1: Increase the number of Red/P-chip constituents in the HSCEI

- Do you agree to the increase in the number of Red/P-chip constituents and the removal of the fix on the number of Red/P-chip constituents in the HSCEI?

Proposed Change 2: Implement the change through THREE rebalancings

- Do you agree to the number of Red/P-chip constituents in the HSCEI being progressively increased through THREE rebalancings?

Proposed Change 3: Introduce Fast Entry Mechanism for sizable Red/P-chips

- Do you agree to the relaxation of listing history requirements for the Top 10 and Top 11-20 Red/P-chips, in terms of full MV, to ONE year and TWO years respectively?

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