



CONSULTATION PAPER

- 1) Eligibility of Foreign Companies to the Hang Seng Index (“HSI”)
- 2) Review Results of the Seven Industry Groups for HSI Constituent Selection and the Number of “HK” Constituents in the HSI

April 2023

(Data as of 31 December 2022 and sourced from Hang Seng Indexes Company Limited unless otherwise specified)

Note:

The information and questions in this document are for the sole purpose of gathering opinions from market participants and various stakeholders. Changes to the relevant indexes, if any, will be announced at a later date.

Responding to the Consultation

Please send us your responses to research@hsi.com.hk by **31 May 2023**. Thank you.

All responses will be kept strictly confidential and used solely for the purposes of internal research and discussion by Hang Seng Indexes Company Limited (“Hang Seng Indexes Company”).

If you wish to provide your responses in hardcopy format, please mail to:

INDEX DEPARTMENT
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83 DES VOEUX ROAD CENTRAL HONG KONG

Respondent Details

In order to better understand your valuable opinions, we may further contact you via e-mail and / or phone for follow-up after you return your responses. Please provide your contact information for this purpose. Failure to provide valid contact details may result in your responses being excluded from this consultation. Thank you.

Name: _____

Job Title: _____

Organisation: _____

Professional Profile:

<input type="checkbox"/> Academic or Institute	<input type="checkbox"/> Asset Owner
<input type="checkbox"/> Broker or Dealer	<input type="checkbox"/> Exchange
<input type="checkbox"/> Individual Investor	<input type="checkbox"/> Investment Manager
<input type="checkbox"/> Passive Fund Manager	<input type="checkbox"/> Regulatory
<input type="checkbox"/> Others (please specify)	_____

Contact Number*: _____

E-mail address*: _____

Date: _____

** Please provide at least one channel through which you can be contacted*

Important Note

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Background

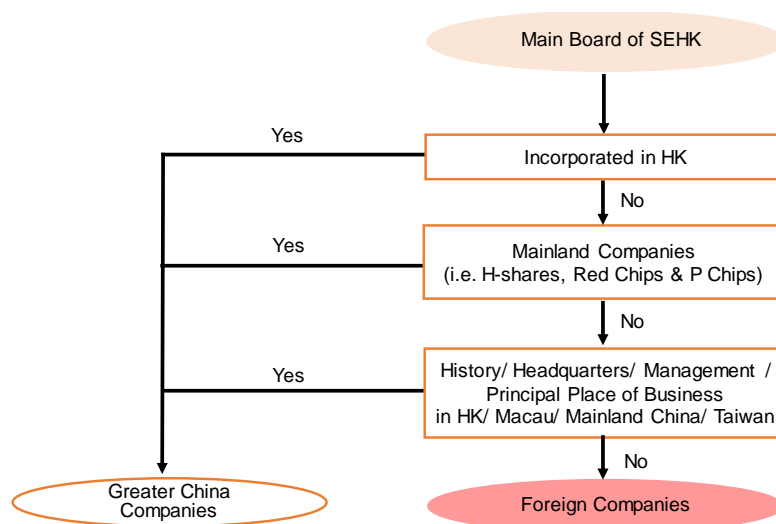
- The HSI is a leading and widely recognised benchmark for the Hong Kong stock market and has been positioned as a representation for the Greater China companies listed on the Stock Exchange of Hong Kong. To be more aligned with the role of Hong Kong as an international financial hub to connect Mainland China and the rest of the world, Hang Seng Indexes Company would like to assess market’s view regarding the eligibility of Foreign Companies for joining the HSI.
- In 2021, after a market consultation, the HSI kicked-off a revamp by increasing its constituent number from 50 to 100 (now 76, still on its way to reach the ultimate 100 constituents). In order to achieve a more balanced sector distribution, the index also began to select constituents by seven industry groups. The number of “HK” constituents was fixed between 20 to 25. The combination of the industry groups and the “HK” constituent number would be reviewed at least every two years.
- To ensure that the HSI can timely reflect changes in the Hong Kong stock market, in this consultation, Hang Seng Indexes Company wishes to solicit market feedback on:
 - 1) The Eligibility of Foreign Companies to the HSI; and
 - 2) The Review Results of the Seven Industry Groups for HSI Constituent Selection and the Number of “HK” Constituents in the HSI

1) Eligibility of Foreign Companies to the HSI

Development of Foreign Companies in Hong Kong Stock Market

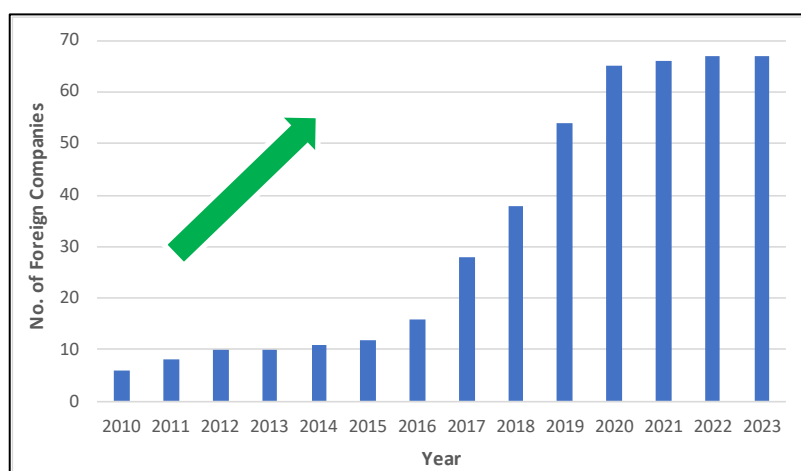
- Hang Seng Indexes Company defines Foreign Companies as companies which are incorporated outside Greater China and have the majority of their business presence outside Greater China (Exhibit 1). Currently, about 68 companies listed on the main board of the Stock Exchange of Hong Kong (“SEHK”) are classified as Foreign Companies.

Exhibit 1: Definition of Foreign Companies



- Exhibit 2 shows the number of Foreign Companies increased from six in 2010 to 68 in 2023, more than 10 times in the past 13 years.

Exhibit 2: Increasing number of Foreign Companies



- Primary-listed Foreign Companies in Hong Kong became eligible for inclusion into the Hang Seng Composite Index (‘HSCI’) starting from 2018Q3 after a market consultation.
- Starting from March 2023, Foreign Companies in the HSCI became eligible for trading under the Stock Connect program.

Positioning of the HSI

- Launched in 1969, the HSI is widely recognised as a benchmark for the performance of the Hong Kong stock market. The HSI is composed of the most representative blue-chip companies listed on the SEHK and is used as a basis for a range of financial products including exchange-traded funds, futures and options as well as other derivatives.
- The positioning of the HSI was discussed in the consultation carried out in 2020 regarding the addition of weighted voting rights ('WVRs') companies into the HSI. At that time, it was decided that the HSI would maintain its positioning to represent the Greater China companies listed in Hong Kong and Foreign Companies would remain ineligible to the HSI.
- As the Hong Kong stock market is targeting to become a financial hub with more multinational listings, Hang Seng Indexes Company would like to revisit this topic to assess the market acceptance of the eligibility of Foreign Companies to the HSI.

The Considerations

- Foreign Companies account for a minor portion, in terms of both market capitalisation and turnover, in the current Hong Kong stock market. As of end March 2023, out of the 527 HSCI constituents, six are Foreign Companies with an aggregate weighting of 0.5%. In 2023 Q1, the HSCI Foreign Companies constituents contributed 0.3% of the overall index traded value.

Exhibit 3: Foreign Companies in the HSCI

Code	Company Name	Place of Incorporation	Market Cap (HK\$bn) (Rank in HSCI)	2023 Q1 Daily Average Turnover (HK\$m)	HSCI Weighting (%)
1913	Prada	Italy	142 (51)	55	0.19
486	Rusal	Russia	59 (106)	2	0.01
3668	Yancoal Aus	Australia	41 (147)	66	0.03
1910	Samsonite	Luxembourg	35 (159)	148	0.18
973	L'Occitane	Luxembourg	29 (187)	26	0.05
3918	Nagacorp	Cayman Islands	27 (198)	10	0.01
				Total	0.46

- The risks of investing in Foreign Companies are different from those of Hong Kong companies as Foreign Companies are subject to different sets of corporate laws governing their affairs including shareholders rights. Hong Kong regulators may not have extra-territorial investigation and enforcement jurisdiction. Instead, reliance has to be placed on the overseas regulatory regimes to enforce against any corporate governance breaches.
- Same HKEX Listing Rules apply to Foreign Companies as to Hong Kong companies, subject to the additional or modified requirements in Chapters 19 and 19C of the Main Board Rules or Chapter 24 of the GEM Rules (where applicable). Starting from 1 January 2022, HKEX introduced a set of 14 core shareholder protection standards to all listed

companies (including Foreign Companies) so that the investor protection requirement from HKEX for Foreign Companies are more aligned.

Approach Taken by Other Index Compilers

- With reference to overseas markets (Exhibit 4), there is no standard treatment among index compilers for handling Foreign Companies. Some local benchmarks, e.g. S&P 500, FTSE 100, etc. have stringent requirements on constituent nationality while others do accept inclusion of the Foreign Companies to the indexes, e.g. NASDAQ 100, DAX, CAC 40, Straits Times Index, etc.

Exhibit 4: Index Eligibility for Foreign Companies in Other Local Flagship Indexes

Market	Index	Foreign Companies Index Eligibility	Examples of Foreign Companies in the index
Australia	S&P ASX 200	Yes	ResMed (US), Meridian Energy (New Zealand)
France	CAC 40	Yes	Airbus (Netherlands), ArcelorMittal (Luxembourg)
Germany	DAX	Yes	Airbus (Netherlands), Linde (Ireland)
Japan	Nikkei 225	No	-
Singapore	Straits Times Index	Yes	Hongkong Land (Hong Kong), Jardine Matheson (Hong Kong)
S. Korea	KOSPI	Yes	LVMC (Vietnam), Prestige Biopharma (Singapore)
UK	FTSE 100	No	-
US	Dow Jones Industrial Average	No	-
	NASDAQ 100	Yes	JD.com (China), Pinduoduo (China)
	S&P 500	No	-

Our Proposal

- Hang Seng Indexes Company suggests expanding the HSI universe to include Primary-listed Foreign Companies in Hong Kong and these companies will be subject to the same set of inclusion requirements as other candidates.
- The expansion would re-position the HSI from being a representation for Greater China companies listed in Hong Kong to a broader representation for the overall Hong Kong stock market. This is also in line with Hong Kong's role as an international financial hub to connect Mainland China and the rest of the world.

Your views:

Question 1:

What do you think the HSI should represent given the significant development and evolution of the Hong Kong stock market over the past 50 years? (Select one answer only)

<input type="checkbox"/>	The overall Hong Kong stock market, regardless the geographical exposure or nationality of the listed companies (i.e. including Foreign Companies)
<input type="checkbox"/>	HK-listed companies from the Greater China region (i.e. Hong Kong, Mainland, Macau and Taiwan)
<input type="checkbox"/>	Others, please specify _____

Please provide your reasons, comments and suggestions

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Question 2:

Do you agree that Foreign Companies should be eligible to the HSI (as long as they can meet the same set of principles as other candidates)? (Select one answer only)

<input type="checkbox"/>	Yes, I agree that Foreign Companies should be subject to the same set of requirements for the HSI as for other candidates.
<input type="checkbox"/>	Yes, Foreign Companies should be eligible to the HSI but there should be additional requirements, for examples higher threshold for (Allow multiple selections) <ul style="list-style-type: none"><input type="checkbox"/> Market capitalisation (e.g. top 10 among HKEX-listed companies)<input type="checkbox"/> Liquidity (e.g. top 10 among HKEX-listed companies)<input type="checkbox"/> Business presence in the Greater China area (e.g. operations, assets, etc.)<input type="checkbox"/> Others, please specify _____
<input type="checkbox"/>	Foreign Companies should not be eligible for the HSI inclusion.

Please provide your reasons, comments and suggestions

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Question 3:

If Foreign Companies are to be included in the HSI, do you think there is any need to have any additional limitation? (Select one answer only)

<input type="checkbox"/>	No, Foreign Companies should be handled the same way as other constituents in the HSI
<input type="checkbox"/>	Yes, I suggest limiting the Foreign Companies constituents in terms of (Allow multiple selections) <ul style="list-style-type: none"> <input type="checkbox"/> Total number of constituents (please suggest _____) <input type="checkbox"/> Aggregate weighting in the HSI (please suggest _____) <input type="checkbox"/> Discounted market capitalisation for weighting calculation (please suggest the discount factor _____) <input type="checkbox"/> Lower the cap level on individual constituent weighting (please suggest the cap level _____) <input type="checkbox"/> Others, please specify _____

Please provide your reasons, comments and suggestions

Question 4:

If you agree that Foreign Companies could be eligible to the HSI, would you also agree the same to be applied to the HSTECH? (Select one answer only)

<input type="checkbox"/>	Yes, I agree that Foreign Companies should also be eligible to the HSTECH and subject to the same set of additional requirements and limitations
<input type="checkbox"/>	Yes, I agree that Foreign Companies should also be eligible to the HSTECH, but they should be subject to a different set of additional requirements and limitations (please suggest _____)
<input type="checkbox"/>	No, Foreign Companies should not be eligible for HSTECH inclusion

Please provide your reasons, comments and suggestions

2) Review Results of the Seven Industry Groups for HSI Constituent Selection and the Number of “HK” Constituents in the HSI

The HSI Revamp in 2021

- To achieve a better sector representation of the overall Hong Kong stock market, the HSI began to select constituents from seven industry groups starting from May 2021. The seven industry groups are formed by grouping the 12 Industries under the Hang Seng Industry Classification System (‘HSICS’). The HSI constituent number would be doubled from 50 to 100 (target). The number of “HK” constituents is also fixed between 20 to 25. The combination of the industry groups and the “HK” constituent number would be reviewed at least every two years.

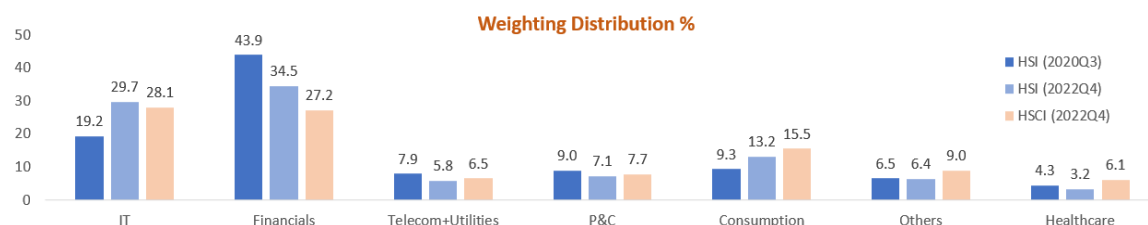
(Note: “HK” constituents refer to non-Mainland constituents, i.e. non-H-shares, non-Red-chips and non-P-chips)

- The existing seven industry groups are (1) Financials, (2) Information Technology, (3) Properties & Construction, (4) Healthcare, (5) Consumer Discretionary and Consumer Staples, (6) Telecommunications and Utilities, and (7) Energy, Materials, Industrials and Conglomerates.

The Review of the Industry Groups

- Exhibit 5 compares the latest HSI weighting distribution by the seven industry groups against that as of 2020Q3 (when the HSI was still composed of 50 constituents). As shown, the weighting distribution of the HSI has become more converged to that of the HSCI (a broad-based benchmark for the Hong Kong stock market).

Exhibit 5: Improvement in the HSI Weighting Distribution after the 2021 Revamp



- The current grouping of the seven industry groups remains valid as individual industry group continues to make a meaningful representation for the core segments of the Hong Kong stock market.

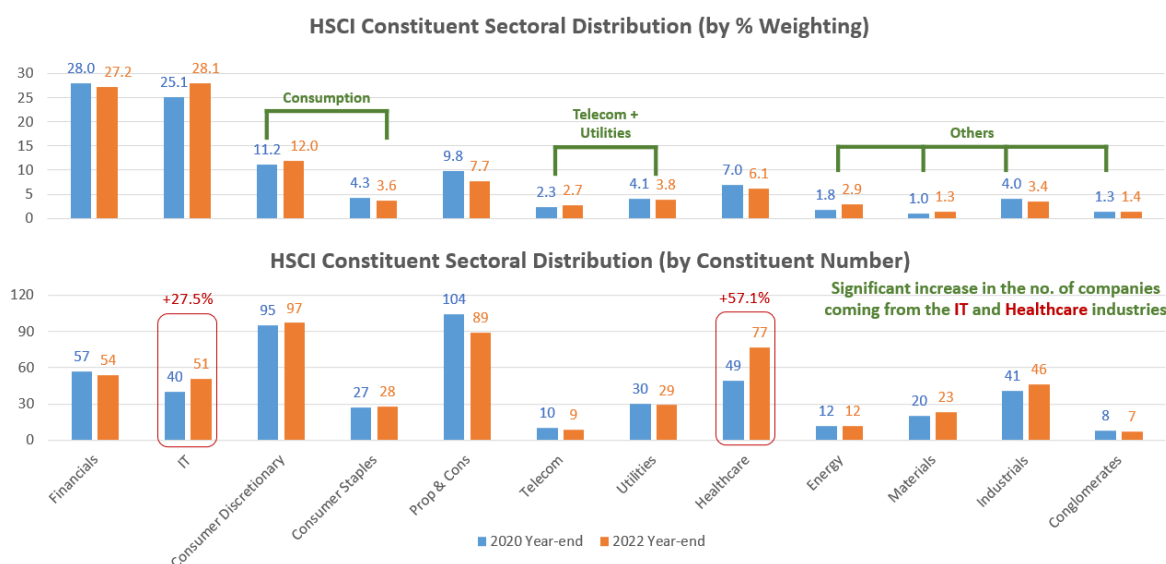
Exhibit 6: HSCI constituent weighting by 12 HSICS Industries (As of 2022 Year-end)

Industry Group	HSICS Industry	Weighting (%)	Rationale
1	Financials	27.2	Major Industries account for significant portion in the HSCI
2	Information Technology	28.1	
3	Properties & Construction	7.7	

Industry Group	HSICS Industry	Weighting (%)	Rationale
4	Healthcare	6.1	
5	Consumer Discretionary	12.0	15.6
	Consumer Staples	3.6	
6	Telecommunications	2.7	6.5
	Utilities	3.8	
7	Energy	2.9	9.0
	Materials	1.3	
	Industrials	3.4	
	Conglomerates	1.4	

- Exhibit 7 shows there have not been significant changes in the sectoral distribution in the Hong Kong stock market since 2020.

Exhibit 7: Comparing the HSCI Structure by the 12 HSICS Industries in 2020 and 2022



The Review of the “HK” Constituent Number

- As the HSI expands its constituent number, more Mainland China companies have been added and the weighting of “HK” constituents has been dropped from 42.7% to 34.7%.
- One “HK” company has been added to the HSI after the revamp and the number of “HK” constituents has already reached 25.

Our Proposal

- Hang Seng Indexes Company proposes no change to the existing seven industry groups as the market structure did not experience any significant changes in the past two years and the existing grouping is still appropriate.
- The original purpose of fixing a range of “HK” constituent number (20 to 25) was to ensure sufficient “HK” representation in the HSI. Capping the “HK” constituent number is unnecessary and thus the removal of the upper limit of the “HK” constituent number is suggested.

Your views:

Question 5:

Do you agree with the review results and the No Change proposal of the HSI seven industry groups? (Select one answer only)

<input type="checkbox"/>	Yes, I agree
<input type="checkbox"/>	No, there should be changes to the industry groups (please provide your suggestions and reasons _____)

Please provide your reasons, comments and suggestions

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Question 6:

Do you agree to remove the upper limit of “HK” constituent number in the HSI? (Select one answer only)

<input type="checkbox"/>	Yes, I agree
<input type="checkbox"/>	No, I support capping the “HK” constituent number in the HSI (please provide your suggestions and reasons: _____)

Please provide your reasons, comments and suggestions

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~ Thank you ~

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