UPGRADING VIETNAMESE STOCK MARKET USING MSCI CRITERIA

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Abstract: ***After 22 years of establishment and development, Vietnamese stock market has proved its functions to the economy. However, the limitations that hinder the development of the market still exist. Market upgrading is not only a way to build an image for the national financial market, but it also has a direct impact on the ability to attract foreign capital flows. Not only Vietnam but many other frontier markets are also trying to be upgraded to Emerging market. Currently, Vietnamese stock market is rated as a frontier market by MSCI (Morgan Stanley Capital International). In terms of MSCI's quantitative criteria, Vietnamese stock market has reached the emerging market level, but there are still many qualitative criteria that Vietnamese stock market has not yet satisfied.***

• Keywords: *market upgrade, MSCI, stock market.*

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Tóm tắt: *Thị trường chứng khoán Việt Nam từ khi thành lập đến nay sau 22 năm hình thành và phát triển đã phát huy được chức năng của mình đối với nền kinh tế. Tuy nhiên, bên cạnh đó vẫn còn tồn tại những hạn chế gây kiềm hãm sự phát triển của thị trường. Nâng hạng thị trường không chỉ là cách xây dựng hình ảnh cho thị trường tài chính quốc gia mà nó còn tác động trực tiếp lên khả năng thu hút dòng vốn nước ngoài. Không chỉ riêng Việt Nam mà nhiều thị trường cận biên (Frontier market) khác cũng đang nỗ lực để được nâng hạng lên thành thị trường mới nổi (Emerging market). Hiện tại, TTCK Việt Nam đang được MSCI (Morgan Stanley Capital International) xếp hạng là thị trường cận biên. Xét về tiêu chí định lượng của MSCI, TTCK Việt Nam đã đạt được mức thị trường mới nổi, tuy nhiên vẫn còn nhiều tiêu chí định tính mà TTCK Việt Nam vẫn chưa đáp ứng được.*

• Từ khóa: *nâng hạng thị trường, MSCI, thị trường chứng khoán.*

1. Introduction

MSCI has just announced the results of periodic market classification for 84 stock markets in the world, in which Vietnam continues to be absent from the list of consideration to be upgraded from a frontier market to an emerging market. Previously, MSCI gave new but less positive assessments about Vietnamese market. Specifically, MSCI believed that foreign room issues were affecting more than 10% of stocks in Vietnamese stock market.

At the same time, MSCI also labeled "-" with 9 quantitative criteria including: foreign ownership limit; the remaining foreign room; equal rights of foreign investors; degree of freedom in the foreign exchange market; investment registration and account opening; market regulations; information flow; Clearing; transferability. Previously, in 2021, when the above 9 criteria did not have enough information to evaluate, MSCI assigned the level "-/?". But now, this agency has officially labeled "-", which means not meeting the requirements.

2. Literature review

There are many research papers on stock market upgrading in the world and Vietnam such as:

Research: "Are investors interested in upgrading the stock market? Evidence from the multivariate analysis" by BanaAbuzayed and Nedal Al-Fayoumi (2016) tested the profitability and volatility of the stock market against the announcements of market upgrade. It measures the direct effects of MSCI's upgrade of the Qatar, Dubai and Abu Dhabi from FM to EM by studying the non-traditional marginal events,

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through the multivariate model BEKK and DCC OARCH. Its results clearly contradict the free information hypothesis and supports the price hypothesis. Initially, MSCI's upgrade led to positive investors' feedback, which will attract foreign investors who play a key role in improving market performance. In Vietnam: At present, the goal of "Upgrading Vietnamese stock market" is the central task that the Government has assigned to state management agencies to focus on in the coming years. So far, there is only one scientific research topic at the committee level by Nguyen Quang Long from the Department of Fund Management and Investment Company under the State Securities Commission with the topic "Stock market rating and solutions to upgrade Vietnam stock market" completed in 2015 which has the same subject of research with this topic. Therefore, this is the only master thesis up to now studying the topic "Upgrading Vietnamese stock market".

In his research, Nguyen Quang Long analyzed the upgrading criteria of all 3 stock market rating agencies in the world (MSCI, FTSE RUSELL, S&P Down Jones) instead of focusing on analyzing MSCI's upgrade criteria for Vietnam's stock market only like in this topic. Therefore, this topic goes deeper into the unsatisfactory criteria of the Vietnamese stock market, thereby offering highly feasible solutions. Besides, Nguyen Quang Long's research project completed in 2015, since then Vietnamese stock market has changed both intensively and extensively leading to changes in MSCI's evaluation report about Vietnam's stock market. This is the research gap that this study focuses on for in-depth analysis and evaluation. Therefore, this topic is more contemporary due to the latest update of the Vietnamese stock market rating from MSCI.

3. Research results

Stock market upgrade is the process by which a national stock market is upgraded by stock market rating organization from an independent market to a marginal market or from a marginal market to an emerging market or from an emerging market to a developed market based on its set of criteria for ranking the stock market.

3.1. The need to upgrade the stock market

Market upgrading is not only a way to build an image for the national financial market, but it also has a direct impact on the ability to attract capital flows from abroad. Not only Vietnam but many other frontier markets are also making efforts to be upgraded to emerging markets for the following reasons:

Firstly, emerging markets are larger in size and of better quality than marginal markets, while the growth potential is higher than marginal markets. The capital flows attracted by emerging markets are more stable, compared to those that invest in frontier markets. Passive funds, such as exchange-traded funds (ETFs), that currently focus on investing in emerging markets, will also automatically allocate a portion of their capital to newly upgraded emerging markets.

Secondly, in order to meet the standards of upgrading to an emerging market, in addition to increasing the size, liquidity or accessibility of foreign investors, national stock markets also have pressure to improve trading conditions such as operating system, institutional framework, information transparency. During the review process, ranking agencies also proactively assist countries in understanding the current situation and the standards to be met so that they can make appropriate changes. This process is the main driver that helps marginal markets benefit from the upgrade, while the decision to upgrade serves only as confirmation of the above conditions.

3.2. Stock market rating agencies and criteria

Credit rating organizations provide information to individuals and institutional investors to assist them in determining the solvency of issuers for debt obligations and fixed income securities. Credit rating agencies also provide objective analysis and independent reviews of companies and countries that issue securities. The globalization of the investment market together with the diversification of types and quantities of issued securities poses a challenge to individuals and investment institutions. They must analyze the risks associated with both domestic and foreign investments. The historical information and analysis of the three companies below will facilitate the reader to better understand the function and development of credit rating agencies.

3.2.1. Introduction to MSCI and MSCI ranking criteria

a. About MSCI

MSCI is a company based in New York (USA) specializing in providing tools to support institutional investors in making investment decisions, mainly pension funds and hedging funds. MSCI designs different types of indexes to serve the needs of each customer group. To date, MSCI has had a wide range of index products, however, MSCI's most prominent products are the sets of indexes such as the MSCI Developed Markets Index, the MSCI Emerging Markets Index and the MSCI Frontier Markets Index. MSCI focuses on reflecting the views and experiences of the international investment community based on a set of principles that seek to find a balance between a country's economic development and its market access. The MSCI Market Classification Framework (MSCI Market Classification Framework) consists of 15 principles focusing on the following major criteria:

1) The economic development of a country;

2) Size and liquidity of stock market and representative shares;

3) Criteria on market accessibility of foreign investors.

The rating criteria also include macroeconomic conditions, political stability, property rights and procedures, and transaction and payment conditions and procedures. MSCI also reflects the views and experiences of institutional investors in deciding whether to rate a market as developed, emerging or marginal.

b. MSCI's stock market rating criteria

MSCI uses two types of standards to classify stock markets. One is a quantitative standard that includes the levels of economic development, size and liquidity of the stock market. The second is qualitative criteria which is to consider market accessibility. Based on how well these standards are met, MSCI classifies the stock market into four categories, in order from highest to lowest: developed, emerging, frontier, and unclassified.

Quantitative standards

+ The level of economic development.

According to the market classification framework of MSCI, this criterion only applies to developed markets, while there is no difference for the other two types of markets. For a stock market to be classified as a developed market, the gross national income (GNI) must be 25% higher than the World Bank high-income benchmark for three consecutive years.

+ Size and liquidity.

This criterion requires that the minimum number of shares in the stock market must satisfy requirements as below:

• For developed markets: at least 5 stocks that meet the market capitalization requirement of USD 3,187 million, of which free capitalization is USD 1,594 million. Regarding liquidity, the annual traded value to market capitalization ratio (ATVR) of that stock must be at least 20%.

• For emerging markets: at least 3 stocks that meet the market capitalization requirement of USD 1,594 million, of which free market capitalization is USD 797 million and ATVR must reach 15%.

• For the marginal market: at least 2 stocks that meet the market capitalization requirement of 797 million USD, of which free market capitalization is 71 million USD and ATVR must be from 2.5%.

Table 1.1. Quantitative criteria for market rating

Criteria	Frontier market	Emerging market	Developed market
A. Economic Development A.1. The sustainability of economic development	No requirement	No requirement	Country GNI per capita 25% above the World Bank high income threshold (*) for 3 consecutive years
B. Size and Liquidity Requirements			
B.1. Number of companies meeting the following Standard Index criteria	2	3	5

Criteria		Frontier market	Emerging market	Developed market
Company size (full market cap (**)		USD 797 mm	USD 1,594 mm	USD 3,187 mm
Security size (float market cap (**)		USD 71 mm	USD 797 mm	USD 1,594 mm
Security liquidity		2.5% ATVR	15% ATVR	20% ATVR
C. Market Accessibility Criteria				
C.1	Openness to foreign ownership	At least some	Significant	Very high
C.2	Ease of capital inflows / outflows	At least partial	Significant	Very high
C.3	Efficiency of operational framework	Modest	Good and tested	Very high
C.4	Competitive landscape	High	High	Unrestricted
C.5	Stability of the institutional framework	Modest	Modest	Very high

(*): High income threshold for 2017: GNI per capita of USD 12,235 (World Bank, Atlas method)

(**): Minimum in use for the May 2018 Semi-Annual Index Review, updated on a semi-annual basis

Source: MSCI Global Market Accessibility Review-June 2018,

Qualitative standards

This standard reflects the experience of foreign investors on their probability to invest in a market, which consists of five sub-criteria: i) openness to foreign investors, ii) the ability to navigate capital flow into/out of the market, iii) efficiency of the operating system, iv) competitiveness of the business environment, v) stability of the institutional framework. These five benchmarks show that foreign investors focus on investor equality, free flow of capital, investment potential, competitiveness, and country risks. MSCI uses 18 criteria to evaluate these five standards. The evaluation is mainly based on the feedback of many types of investors across all markets, including financial managers, brokers, market monitors, operators. Results are announced in June each year.

1. Openness to foreign investors:

One of the most attractive features to foreign investors about a market is when they do not perceive any distinction between domestic and international investors. To assess this degree of discrimination, MSCI analyzed four criteria:

a. Standard requirements for foreign investors

The Qualified Foreign Institutional Investor (QFII) system poses great difficulty because it makes a distinction not only between domestic investors and foreign investors, but also among different foreign investors. Markets that require QFII will receive a low rating from investors.

b. Ownership limit for foreign investors

International investors expect no discrimination in the opportunities presented to them and to domestic investors. Restrictions on foreign ownership in all industries or within a specific group of industries can cause a significant bias, leading to a negative market assessment.

c. Room left for foreign investors

When a market has a limit on ownership for foreign investors, the criterion of remaining room for foreign investors is taken into consideration. Ownership limit reaching the specified threshold will result in injustice to the investors who bought and other investors who want to buy. In some cases, investors who have just bought in will be forced to sell.

d. Equality for foreign investors

Foreigner restrictions can take the form of a classified stock that reduces the voting rights of foreign investors. International investors want to be treated equally in terms of economic rights and voting rights, they need access to information in English. Restrictions on ownership limits, discriminatory voting rights, and limited access to information will lead to a low rating for this criterion.

2. The ability to navigate capital flow into/out of the market

This is about whether the capital flow can go into and out of a market easily, uninterruptedly, and cost-effectively. MSCI evaluates this standard through two criteria:

a. The degree of capital flow restriction

A country is rated badly if there are controls on the capital inflow into/outflow from its stock market.

b. Degree of liberalization in the foreign exchange market

If a country does not have an overseas foreign exchange market, foreign investors are forced to conduct transactions in the domestic market at high costs and often have little choice of intermediaries, thus being poorly rated. Lack of foreign currency is also an important issue.

3. Efficiency of the operating system

This standard is designed to reflect the views of foreign investors as they want to ensure their ownership is accurately recorded and closely protected; operational risks are minimized and the transaction, settlement, clearing and custody of those operations are carried out smoothly and economically. MSCI evaluates this standard based on nine criteria:

a. Registration and account opening for foreign investors

The number and type of documents required, along with the time it takes to complete the application, are considered for this criterion. Documentation preparation time is also included in the registration completion time.

b. Market regulations

Easy market access (including information in English), clear policies, strict law enforcement and regulations are highly appreciated. Inconsistencies and unexpected changes, especially when targeting foreign investors, are poorly rated.

c. Information flow

Good information flow is essential for protecting shareholder interests. Quality, time, English-language information, and affordable access fees are all considered. In addition, investors also take into account the quality of the domestic accounting system, for example, if the international accounting standards IFRS is applied, it will be highly regarded.

d. Payment and clearing system

A well-functioning clearing and settlement system is evaluated based on the framework prescribed by the Bank for International Settlements, including: the securities payment principles DVP - Delivery Versus Payment, no advance payment required for transactions, the ability to use overdrafts and the availability of overarching structures.

e. Depository system

An efficient market needs a mechanism that prevents brokers from having unlimited access to an investor's account and ensures the safety of an investor's assets. The degree of competition among depository banks in each market is measured by the number of custodial banks present as well as the presence of global depository banks.

f. Registration system

Central registries or independent registries and central depository are important characteristics for evaluating a registration system. A depository center acting as a registry is also considered a standard feature.

g. Transaction

An important desirable feature is the ability of a fund manager to do group trades at the same price for different accounts. The level of competition among brokers is also measured by the number of active brokers.

h. Ability to convert

The ability to trade foreign exchange and make wire transfers in kind creates significant cost savings and increased operational efficiency. These are important in the case of management transitions, mergers of funds, and in the creation and redemption of ETFs shares.

i. Securities lending and short selling

Securities lending and short selling are recognized as important components in an efficient market, as they allow arbitrage between different instruments. But the presence of these activities is not enough to assess the market, they need to be implemented effectively and reviewed.

4. Competitiveness of the business environment

When non-compete clauses in the provision of stock market data are imposed, legal or natural monopolies would be underestimated. These non-compete provisions limit investors' access to information, data, and investment products. The imposition of non-compete practices leads to a negative rating.

5. The stability of the institutional framework.

Government intervention and restrictions on foreign investors are used to gauge the stability of the free market mechanism. This criterion considers past cases to assess the potential risk that foreign investors may be exposed to by discriminatory measures during crises.

3.2.2. Vietnam's choices

Although the stock market rating criteria of the 3 international rating organizations above (MSCI, FTSE, S&P Dow Jones) have differences in a few small criteria, these criteria are basically all evaluate the economic and stock market development of that country. Therefore, Vietnam getting upgraded by one of these three organizations to the emerging market is a great success for the securities industry in particular and Vietnamese economy in general. However, when making more thorough analysis of specific criteria of all 3 rating agencies, the writer finds that there are criteria directly related to the stock market but also many other criteria mainly related to macroeconomics and the economic development. Of the three organizations above, the ranking criteria of S&P Dow Jones are mainly related to the economy, not many criteria are directly related to the stock market. Therefore, the writer believes that it is necessary to further analyze the other two major rating agencies, MSCI and FTSE. Comparing the ranking criteria of MSCI and FTSE, the criteria of MSCI are more quantitative and directly related to the stock market than those of FTSE. At the same time, the number of asset investment funds using MSCI's rating classification is much higher than that of FTSE, therefore the amount of capital poured into Vietnam if the stock market is upgraded to emerging status of MSCI will also be higher. Specifically, according to estimates of Bao Viet Securities Joint Stock Company (BVSC), capital inflows into Vietnamese stock market when upgraded by FTSE will increase from $709.46 million to $1.16 billion. Meanwhile, if Vietnam's stock market is upgraded to emerging market by MSCI, it will attract a total of 991.44 million USD - 1.68 billion USD from investment funds using the results of MSCI's ratings.

Table 1.2. Capital inflows when Vietnamese stock market gets upgraded

FTSE	ETFs	Active funds	Total
Number of funds using the FTSE Emerging Markets index as a reference	25	22	47
Total capital under management	81,58 billion USD	368,22 billion USD	449,81 billion USD
Capital inflow into Vietnam (estimated)	347,91 - 566.73 million USD	361,55 - 588,94 million USD	709,46 million USD - 1,16 billion USD
MSCI			
Number of funds using the MSCI Emerging Markets index as a reference	104	301	404
Total capital under management	175,32 billion USD	124,23 billion USD	299,71 billion USD
Capital inflow into Vietnam (estimated)	571,41 - 966,31 million USD	420,03 - 710,30 million USD	991,44 million USD - 1,68 billion USD
Source: BVSC			

Therefore, from the writer's opinion, Vietnam should aim to be upgraded by MSCI to an emerging market and this topic only focuses on studying the MSCI's rating criteria for Vietnam's stock market.

4. The evaluation of MSCI on Vietnamese stock market

Evaluating Vietnamese stock market, MSCI reports are as follows:

Regarding foreign ownership limit: Companies in some sensitive industries and sectors are still limited in foreign ownership from 0% to 51%. These limits still affect more than 10% of stocks on the Vietnamese stock market.

The remaining foreign room for foreign investors: The stock market is heavily influenced by the foreign room. More than 1% of the MSCI

Vietnam IMI index is affected by low foreign room.

Equality for foreign investors: Some business information is still not available in English. In addition, the interests of foreign investors are limited due to strict foreign ownership limits applied to the total foreign ownership ratio in general and each investor's ownership in particular.

Degree of liberalization in the foreign exchange market: Currently, there is no foreign currency trading market and the domestic market is still limited (foreign currency transactions must be related to securities transactions). Investment registration and account opening: Trading registration is required and the account opening needs to be approved by VSD. Market regulations: Market regulations are not fully available in English. Information flow: Information about the stock market is often not available in English or is not detailed enough. Payment and clearing: There is no overdraft facility and the transaction requires an advance. Transferability: Some off-exchange transactions and in-kind transfers need to be approved by the SSC.

According to the MSCI Frontier Market Index report on May 31, 2022, Vietnam still ranked top at the frontier market basket with a point of 28.45%. Currently, MSCI has initiated consultations on the proposal to move the MSCI Nigeria Index from the frontier market to the independent market. If this happens, Vietnamese point may be raised to 34.3% but the number of Vietnamese shares will remain unchanged at 28 shares. Recently, the issue of upgrading the market has also attracted the attention of the Government. Currently, the Government has also made efforts to promote this upgrade process.

In some ways Vietnamese stock market is like a heavyweight boxer competing in lightweight, the scale of lightweight is currently about 95 billion USD. And in that basket, funds are recommended by MSCI to allocate about 30% to the Vietnamese market, of course the funds will not allocate all of that 30% because the market is still lightweight. If Vietnam competes in the emerging middle class, the size of this class is 6.8 trillion USD and only 1% of the allocation is enough to have 68 billion USD into the market. Usually, cash flows into the market before the upgrade is announced, as has happened in Pakistan, in Saudi Arabia or Kuwait.

It can be seen that over the past few years, the role of fund management companies in Vietnam has matured rapidly and achieved many important milestones to contribute to the sustainable development of Vietnam's stock market in many ways.

5. Conclusion

In the process of establishment and development, Vietnamese stock market has experienced the inevitable ups and downs of a newly integrated economy. This is a natural and self-screening process in accordance with the rules of a free market. State management agencies have contributed greatly in orienting and creating a legal corridor for the market to develop dramatically as it is now. The efforts of regulators, market participants and investors are objectively recognized by international investors. So far, Vietnamese stock market has been joined by experienced investors, securities trading organizations competent enough to overcome shocks, the listed companies willing to change to adapt to international standards and meet the expectations of domestic and foreign investors. This is the collective achievement of the whole market.

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