

CONSULTATION ON A MARKET RECLASSIFICATION PROPOSAL FOR THE MSCI SAUDI ARABIA INDEX

Potential Reclassification from Standalone to
Emerging Markets

June 2017

RECLASSIFICATION PROPOSAL

- MSCI proposes to reclassify the MSCI Saudi Arabia Index from Standalone Market to Emerging Markets status
 - The proposed reclassification would be reflected in all relevant global and regional composite indexes
 - The proposal is to implement the potential reclassification in two steps coinciding with the May 2019 Semi-Annual and the August 2019 Quarterly Index Reviews
- MSCI will consult with market participants on this reclassification proposal as part of the 2018 Annual Market Classification Review
 - MSCI will announce its decision in June 2018
- Please note that this proposal may or may not lead to any changes to the MSCI Indexes

BACKGROUND

- The Saudi Arabia equity market opened up to foreign direct investments in June 2015 through a Qualified Foreign Investor (QFI) program
- Since September 2016, a number of positive market reforms were implemented. Changes include among others:

	Previous situation	Current situation
Foreign Ownership Limits	20% limit applicable to QFIs	49% limit applicable to all foreign investors (including QFIs)
QFI registration rules	<ul style="list-style-type: none"> • Reduction in the minimum AuM for QFIs from USD 5B to USD 1B • Addition of new types of eligible QFIs such as sovereign wealth funds and university endowments • Streamlining of the registration process 	
Clearing and settlement	<ul style="list-style-type: none"> • T+0 settlement cycle • No DVP model • Cash pre-funding 	<ul style="list-style-type: none"> • T+2 settlement cycle • DVP model with proper fail trade management • No cash pre-funding
Securities lending	Not allowed	Allowed (bilateral basis)
Short selling	Not allowed	Allowed

MARKET ACCESSIBILITY REVIEW 2017

Market Accessibility Assessment	SA
Openness to foreign ownership	
Investor qualification requirement	+
Foreign ownership limit (FOL) level	-/?
Foreign room level	-/?
Equal rights to foreign investors	-/?
Ease of capital inflows / outflows	
Capital flow restriction level	++
Foreign exchange market liberalization level	++
Efficiency of the operational framework	
Market entry	
Investor registration & account set up	-/?
Market organization	
Market regulations	+
Competitive Landscape	+
Information flow	+
Market infrastructure	
Clearing and settlement	+
Custody	+
Registry / Depository	++
Trading	++
Transferability	-/?
Stock lending	-/?
Short selling	-/?
Stability of institutional framework	+

Note: ++: No Issue; +: No Major Issues, improvements possible; -/? : Improvements needed / extent to be assessed

- **Investor Qualification Requirement:** The QFI program is open to selected types of investors with appropriate size and with sufficient track records. Investors from GCC countries are not subject to any qualification requirements.
- **Foreign Ownership Limits:** A 49% limit applies. A few companies are fully closed to foreign investors.
- **Investor Registration & Account Setup:** Registration is mandatory. The ease and time required for QFIs to register and set up local accounts still needs to be assessed.
- **Information Flow: “-/?” to “+”:** The use of IFRS will be enforced for all listed companies beginning January 2017. Some information is still available only in Arabic.
- **Clearing and Settlement: “-/?” to “+”:** Effective April 2017, the settlement cycle moved from T+0 to T+2, and pre-funding requirement was eliminated. There is no nominee status and omnibus structures are not available.
- **Custody: “-/?” to “+”:** Under the “Securities Independent Custody Model”, custodians can now participate in the market settlement process and have greater control over client assets.
- **Transferability:** In-kind transfers and off-exchange transactions are prohibited.
- **Stock lending / Short selling:** Have recently been allowed but have not been tested yet.

CURRENT CONSTITUENTS OF MSCI SAUDI ARABIA INDEX

Company	Full Mcap*	FIF Mcap*	FIF**
SAUDI BASIC IND CORP	79,216	19,804	0.25
SAUDI TELECOM CO	37,180	7,436	0.2
AL RAJHI BANKING & INV	26,799	13,131	0.49
SAUDI ELECTRICITY CO	23,886	4,777	0.2
NATIONAL COMM BANK	22,771	9,108	0.4
ALMARAI CO	17,585	7,034	0.4
SAUDI ARABIAN MINING CO	12,764	4,467	0.35
SAMBA FINANCIAL GROUP	11,972	5,866	0.49
SAUDI BRITISH BANK	9,039	1,356	0.15
BANQUE SAUDI FRANSI	8,626	2,588	0.3
YANBU NATL PETROCHEMICAL	8,255	3,302	0.4
RIYAD BANK	8,223	3,289	0.4
SAUDI ARAB FERTILIZER	6,776	3,049	0.45
SAVOLA	6,568	3,218	0.49
ALINMA BANK	5,687	2,787	0.49
ARAB NATIONAL BANK	5,255	1,839	0.35

Company	Full Mcap*	FIF Mcap*	FIF**
ETIHAD ETISALAT CO	4,168	2,042	0.49
JARIR MARKETING CO	3,336	1,635	0.49
SAUDI KAYAN PETROCHEM	3,276	1,605	0.49
CO FOR COOPERATIVE INS	3,081	1,510	0.49
EMAAR ECONOMIC CITY	2,910	1,426	0.49
BANK ALBILAD	2,878	1,410	0.49
RABIGH REFINING & PETRO	2,663	666	0.25
SAUDI INVESTMENT BANK	2,506	1,228	0.49
BUPA ARABIA FOR COPR INS	2,398	1,175	0.49
NATL INDUSTRIALIZATION	2,320	1,137	0.49
ADVANCED PETROCHEMICALS	2,293	1,124	0.49
SAUDI INDL INV GROUP	2,287	1,121	0.49
SAUDI CEMENT	2,050	1,004	0.49
SOUTHERN PROVINCE CEMENT	1,853	834	0.45
SAUDI AIRLINES CATERING	1,784	803	0.45
AL TAYYAR TRAVEL GROUP	1,559	764	0.49

Data as of June 12, 2017

* USD million

** Foreign Inclusion Factor

- The MSCI Saudi Arabia Index is already maintained using the Emerging Markets size and liquidity requirements
- Therefore, there would be no changes in the index maintenance rules for the MSCI Saudi Arabia Index in case of reclassification to Emerging Markets

KEY STATISTICS FOR THE MSCI SAUDI ARABIA INDEXES

	Large Cap*	Mid Cap*	Standard	Small Cap	IMI
Number of Constituents	16	16	32	39	71
Free Float Market Cap (USD million)	93,256	19,280	112,536	14,627	127,163

Data as of June 12, 2017

* The Large Cap / Mid Cap size segmentation is currently not available for the MSCI Saudi Arabia Indexes

- The MSCI Saudi Arabia Index would have 32 constituents under Emerging Markets, and a free float-adjusted market capitalization of USD 112.5 billion
- The MSCI Saudi Arabia Small Cap Index would have 39 constituents under Emerging Markets, and a free float-adjusted market capitalization of USD 14.6 billion

SIMULATED IMPACT ON THE MSCI EMERGING MARKETS INDEX

Simulated Standard Index			
	Index Market Cap	Weight	# Sec.
EM	4,781,490	100.0%	877
EM Asia	3,403,518	71.2%	567
China	1,301,932	27.2%	152
Korea	725,668	15.2%	112
Taiwan	568,864	11.9%	89
India	417,796	8.7%	77
Malaysia	113,903	2.4%	41
Indonesia	112,074	2.3%	31
Thailand	99,798	2.1%	36
Philippines	57,450	1.2%	23
Pakistan	6,033	0.1%	6
EM EMEA	809,907	16.9%	195
South Africa	315,674	6.6%	53
Russia	153,223	3.2%	22
Saudi Arabia	112,536	2.4%	32
Poland	59,974	1.3%	22
Turkey	54,445	1.1%	25
United Arab Emirates	35,244	0.7%	10
Qatar	31,471	0.7%	12
Greece	17,565	0.4%	9
Hungary	15,054	0.3%	3
Czech Republic	8,521	0.2%	4
Egypt	6,200	0.1%	3
EM Latin America	568,066	11.9%	115
Brazil	305,518	6.4%	57
Mexico	169,249	3.5%	27
Chile	54,768	1.1%	19
Colombia	21,619	0.5%	9
Peru	16,912	0.4%	3

Note: All market caps are in USD millions. Data as of the close of June 12, 2017

- The MSCI Saudi Arabia Index would have a potential weight of 2.4% in the MSCI Emerging Markets Index

KEY QUESTIONS

- Is the current level of opening of the Saudi Arabia equity market to foreign investors sufficient to warrant a reclassification of the MSCI Saudi Arabia Index to Emerging Markets?
- Should MSCI give more time before the reclassification in order for market participants to fully absorb the changes that have been implemented in the market?
- Are there any remaining market accessibility concerns that should prevent the reclassification?
- What is your effective experience, if any, of investing in Saudi Arabian equities through the QFI scheme?

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