

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

Potential Reclassification from Standalone to Emerging Markets

February 2018

# 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	Implementation date of the changes
Foreign Ownership Limits	20% limit applicable to QFIs	49% limit applicable to all foreign investors (including QFIs)	Sep. 2016 (QFI rules version 2)
QFI registration rules	<ul style="list-style-type: none"> <li>• Reduction in the minimum AuM for QFIs from USD 5B to USD 500M</li> <li>• New eligible QFIs (e.g. sovereign wealth funds and university endowments)</li> <li>• Improvements in registration process and process for applying for QFI license</li> </ul>		Sep. 2016 / Jan. 2018 (QFI rules versions 2 and 3)*
Clearing and settlement	<ul style="list-style-type: none"> <li>• T+0 settlement cycle</li> <li>• No DVP model</li> <li>• Cash pre-funding</li> </ul>	<ul style="list-style-type: none"> <li>• T+2 settlement cycle</li> <li>• DVP model with fail trade management</li> <li>• No cash pre-funding</li> </ul>	Apr. 2017 (Tadawul's new operating model)
	<ul style="list-style-type: none"> <li>• Omnibus facilities not available</li> </ul>	<ul style="list-style-type: none"> <li>• «Omnibus like» facilities available</li> </ul>	Jan. 2018 (amended Market Conduct Regulations)
Securities lending / Short selling	Not allowed	Allowed	Apr. 2017 (Tadawul's new operating model)

\* The 3rd version of the QFI rules (Jan 2018) includes a significant reduction in the number of qualification requirements and a significant improvement in the registration process and the process for applying for a QFI license.

# 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 has been 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<sup>1</sup>.
- **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 for all listed securities but have not been tested yet.

<sup>1</sup>«Omnibus like» facilities have been available since January 2018

# CURRENT CONSTITUENTS OF MSCI SAUDI ARABIA INDEX

Company	Full Mcap*	FIF Mcap*	FIF**
ADVANCED PETROCHEMICALS	2,231	1,093	0.49
AL RAJHI BANKING & INV	30,761	15,073	0.49
AL TAYYAR TRAVEL GROUP	1,495	733	0.49
ALINMA BANK	7,964	3,902	0.49
ALMARAI CO	13,538	6,092	0.45
ARAB NATIONAL BANK	7,061	2,471	0.35
BANK ALBILAD	3,414	1,673	0.49
BANQUE SAUDI FRANSI	9,639	2,892	0.3
BUPA ARABIA FOR COPR INS	1,832	458	0.25
CO FOR COOPERATIVE INS	2,605	1,276	0.49
DAR AL ARKAN REAL ESTATE	2,782	1,363	0.49
EMAAR ECONOMIC CITY	3,021	1,480	0.49
ETIHAD ETISALAT CO	3,234	1,585	0.49
JARIR MARKETING CO	3,959	1,940	0.49
NATIONAL COMM BANK	30,910	12,364	0.4
NATL INDUSTRIALIZATION	2,882	1,412	0.49

Company	Full Mcap*	FIF Mcap*	FIF**
RABIGH REFINING & PETRO	5,085	1,271	0.25
RIYAD BANK	10,831	4,333	0.4
SAMBA FINANCIAL GROUP	13,066	6,402	0.49
SAUDI AIRLINES CATERING	1,755	790	0.45
SAUDI ARAB FERTILIZER	7,358	3,311	0.45
SAUDI ARABIAN MINING CO	15,871	5,555	0.35
SAUDI BASIC IND CORP	83,276	20,819	0.25
SAUDI BRITISH BANK	11,599	1,740	0.15
SAUDI CEMENT	2,046	1,003	0.49
SAUDI ELECTRICITY CO	22,332	4,466	0.2
SAUDI INDL INV GROUP	2,511	1,231	0.49
SAUDI KAYAN PETROCHEM	4,800	2,352	0.49
SAUDI TELECOM CO	38,798	7,760	0.2
SAVOLA	5,372	2,632	0.49
SOUTHERN PROVINCE CEMENT	1,858	836	0.45
YANBU NATL PETROCHEMICAL	9,524	3,810	0.4

Pro forma data as of February 9, 2018 reflecting the changes due to the February 2018 Quarterly Index Review

\* 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	42	74
Free Float Market Cap (USD million)	103,622	20,495	124,117	16,709	140,827

Pro forma data as of February 9, 2018 reflecting the changes due to the February 2018 Quarterly Index Review

\* 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 124.1 billion
- The MSCI Saudi Arabia Small Cap Index would have 42 constituents under Emerging Markets, and a free float-adjusted market capitalization of USD 16.7 billion

# SIMULATED IMPACT ON THE MSCI EMERGING MARKETS INDEX

	Simulated Standard Index		
	Index Market Cap	Weight	# Sec.
<b>EM</b>	<b>5,499,620</b>	<b>100.0%</b>	<b>879</b>
<b>EM Asia</b>	<b>3,904,570</b>	<b>71.0%</b>	<b>573</b>
China	1,604,848	29.2%	153
Korea	776,047	14.1%	113
Taiwan	609,549	11.1%	90
India	466,557	8.5%	79
Malaysia	133,041	2.4%	46
Indonesia	122,398	2.2%	29
Thailand	128,840	2.3%	35
Philippines	58,849	1.1%	23
Pakistan	4,439	0.1%	5
<b>EM EMEA</b>	<b>927,580</b>	<b>16.9%</b>	<b>196</b>
South Africa	367,651	6.7%	52
Russia	188,328	3.4%	22
Saudi Arabia	124,117	2.3%	32
Poland	71,517	1.3%	23
Turkey	56,748	1.0%	25
United Arab Emirates	35,564	0.6%	11
Qatar	30,414	0.6%	12
Greece	18,758	0.3%	9
Hungary	17,870	0.3%	3
Czech Republic	10,167	0.2%	4
Egypt	6,446	0.1%	3
<b>EM Latin America</b>	<b>667,470</b>	<b>12.1%</b>	<b>110</b>
Brazil	395,345	7.2%	53
Mexico	160,736	2.9%	26
Chile	67,411	1.2%	19
Colombia	23,025	0.4%	9
Peru	20,953	0.4%	3

Note: All market caps are in USD millions. Pro forma data as of the close of February 9, 2018

- The MSCI Saudi Arabia Index would have a potential weight of 2.3% in the MSCI Emerging Markets Index
- The size of the Saudi Arabian equity market is expected to increase further with the Saudi Aramco IPO which is planned for the second half of 2018 (\*)

(\*) As per the MSCI Global Investable Market Indexes methodology, Saudi Aramco will be included in the MSCI Saudi Arabia Index at the time of the IPO as long as it fulfills all eligibility criteria, including the listing of the company's shares on an eligible stock exchange and related market segment, e.g., Tadawul's Main Market

# KEY QUESTIONS

- Is the level of accessibility of the Saudi Arabia equity market to foreign investors (including the recent developments highlighted in this document) 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?



# ABOUT MSCI

For more than 40 years, MSCI's research-based indexes and analytics have helped the world's leading investors build and manage better portfolios. Clients rely on our offerings for deeper insights into the drivers of performance and risk in their portfolios, broad asset class coverage and innovative research.

Our line of products and services includes indexes, analytical models, data, real estate benchmarks and ESG research.

MSCI serves 99 of the top 100 largest money managers, according to the most recent P&I ranking.

For more information, visit us at [www.msci.com](http://www.msci.com).

# NOTICE AND DISCLAIMER

This document and all of the information contained in it, including without limitation all text, data, graphs, charts (collectively, the “Information”) is the property of MSCI Inc. or its subsidiaries (collectively, “MSCI”), or MSCI’s licensors, direct or indirect suppliers or any third party involved in making or compiling any Information (collectively, with MSCI, the “Information Providers”) and is provided for informational purposes only. The Information may not be modified, reverse-engineered, reproduced or disseminated in whole or in part without prior written permission from MSCI.

The Information may not be used to create derivative works or to verify or correct other data or information. For example (but without limitation), the Information may not be used to create indexes, databases, risk models, analytics, software, or in connection with the issuing, offering, sponsoring, managing or marketing of any securities, portfolios, financial products or other investment vehicles utilizing or based on, linked to, tracking or otherwise derived from the Information or any other MSCI data, information, products or services.

The user of the Information assumes the entire risk of any use it may make or permit to be made of the Information. NONE OF THE INFORMATION PROVIDERS MAKES ANY EXPRESS OR IMPLIED WARRANTIES OR REPRESENTATIONS WITH RESPECT TO THE INFORMATION (OR THE RESULTS TO BE OBTAINED BY THE USE THEREOF), AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, EACH INFORMATION PROVIDER EXPRESSLY DISCLAIMS ALL IMPLIED WARRANTIES (INCLUDING, WITHOUT LIMITATION, ANY IMPLIED WARRANTIES OF ORIGINALITY, ACCURACY, TIMELINESS, NON-INFRINGEMENT, COMPLETENESS, MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE) WITH RESPECT TO ANY OF THE INFORMATION.

Without limiting any of the foregoing and to the maximum extent permitted by applicable law, in no event shall any Information Provider have any liability regarding any of the Information for any direct, indirect, special, punitive, consequential (including lost profits) or any other damages even if notified of the possibility of such damages. The foregoing shall not exclude or limit any liability that may not by applicable law be excluded or limited, including without limitation (as applicable), any liability for death or personal injury to the extent that such injury results from the negligence or willful default of itself, its servants, agents or sub-contractors.

Information containing any historical information, data or analysis should not be taken as an indication or guarantee of any future performance, analysis, forecast or prediction. Past performance does not guarantee future results.

The Information should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. All Information is impersonal and not tailored to the needs of any person, entity or group of persons.

None of the Information constitutes an offer to sell (or a solicitation of an offer to buy), any security, financial product or other investment vehicle or any trading strategy.

It is not possible to invest directly in an index. Exposure to an asset class or trading strategy or other category represented by an index is only available through third party investable instruments (if any) based on that index. MSCI does not issue, sponsor, endorse, market, offer, review or otherwise express any opinion regarding any fund, ETF, derivative or other security, investment, financial product or trading strategy that is based on, linked to or seeks to provide an investment return related to the performance of any MSCI index (collectively, “Index Linked Investments”). MSCI makes no assurance that any Index Linked Investments will accurately track index performance or provide positive investment returns. MSCI Inc. is not an investment adviser or fiduciary and MSCI makes no representation regarding the advisability of investing in any Index Linked Investments.

Index returns do not represent the results of actual trading of investable assets/securities. MSCI maintains and calculates indexes, but does not manage actual assets. Index returns do not reflect payment of any sales charges or fees an investor may pay to purchase the securities underlying the index or Index Linked Investments. The imposition of these fees and charges would cause the performance of an Index Linked Investment to be different than the MSCI index performance.

The Information may contain back tested data. Back-tested performance is not actual performance, but is hypothetical. There are frequently material differences between back tested performance results and actual results subsequently achieved by any investment strategy.

Constituents of MSCI equity indexes are listed companies, which are included in or excluded from the indexes according to the application of the relevant index methodologies. Accordingly, constituents in MSCI equity indexes may include MSCI Inc., clients of MSCI or suppliers to MSCI. Inclusion of a security within an MSCI index is not a recommendation by MSCI to buy, sell, or hold such security, nor is it considered to be investment advice.

Data and information produced by various affiliates of MSCI Inc., including MSCI ESG Research LLC and Barra LLC, may be used in calculating certain MSCI indexes. More information can be found in the relevant index methodologies on [www.msci.com](http://www.msci.com).

MSCI receives compensation in connection with licensing its indexes to third parties. MSCI Inc.’s revenue includes fees based on assets in Index Linked Investments. Information can be found in MSCI Inc.’s company filings on the Investor Relations section of [www.msci.com](http://www.msci.com).

MSCI ESG Research LLC is a Registered Investment Adviser under the Investment Advisers Act of 1940 and a subsidiary of MSCI Inc. Except with respect to any applicable products or services from MSCI ESG Research, neither MSCI nor any of its products or services recommends, endorses, approves or otherwise expresses any opinion regarding any issuer, securities, financial products or instruments or trading strategies and MSCI’s products or services are not intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Issuers mentioned or included in any MSCI ESG Research materials may include MSCI Inc., clients of MSCI or suppliers to MSCI, and may also purchase research or other products or services from MSCI ESG Research. MSCI ESG Research materials, including materials utilized in any MSCI ESG Indexes or other products, have not been submitted to, nor received approval from, the United States Securities and Exchange Commission or any other regulatory body.

Any use of or access to products, services or information of MSCI requires a license from MSCI. MSCI, Barra, RiskMetrics, IPD, FEA, InvestorForce, and other MSCI brands and product names are the trademarks, service marks, or registered trademarks of MSCI or its subsidiaries in the United States and other jurisdictions. The Global Industry Classification Standard (GICS) was developed by and is the exclusive property of MSCI and Standard & Poor’s. “Global Industry Classification Standard (GICS)” is a service mark of MSCI and Standard & Poor’s.