OPENING OF THE SAUDI MARKET AND RESULTING IMPACT ON TRANSPARENCY

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The S&P/Hawkamah ESG Pan Arab Index has been created by S&P Dow Jones Indices and Hawkamah. The International Finance Corporation has partly funded this work. The ESG research is carried out by Hawkamah; S&P Dow Jones Indices provides the methodology for defining ESG criteria, and developed and calculates the index.

The S&P/Hawkamah ESG Pan Arab Index is the first Pan Arab Index of its kind. It is an index based primarily on quantitative factors, with subjective overlay, if needed. For the first time, environmental, social and corporate governing factors have been extensively quantified and translated into a series of scores measuring securities in the universe of publicly traded Pan Arab companies. This index not only ensures a selection of environmentally, socially and corporate governance responsible companies, but also securities which are representative of the Pan Arab equity markets based on size and liquidity.

Linking stock market performance to ESG is, perhaps, the most effective way to highlight the concept of ESG. Indices are being used more and more to create derivative products, exchange traded funds (ETFs), OTC products, and structured products, all of which provide liquidity and investability to specific market segments. Investors, in turn, have access to an investable tool which matches their investment preferences.

For more information, please refer to the S&P/Hawkamah ESG Pan Arab Index methodology at www.spdji.com.

Transparency and disclosure by companies about their finances, management and policies have increasingly become critical parameters in how investors invest globally. Environmental, Social and Governance or ESG as it is popularly called, once a niche domain of some so called ‘do gooders’ has morphed into a theme that is playing out repeatedly across the corporate world, resonating in board rooms and asset management strategies alike. Stakeholder engagement now drives transparency and good governance, and companies have slowly become aware of the fact that stakeholder engagement is not about anti-business sentiment getting a free run, rather it is about all stakeholders - investors, management, employees together working to make the company a wholesome and profitable enterprise.

Changing societal expectations around the world are now driving an agenda where all stakeholders have complete information about the company policies and implementations. Complete stakeholder engagement helps the board to understand the global environment and how best to prepare for it. Too often in the past the board would be sitting in isolation, snug in its belief that the company is on track, and then would be caught by surprise about some negative publicity about their behavior. To avoid any ‘surprises’ whether about specific business activities or their performance in general, it has become critically important to have full stakeholder engagement. Effective corporate leadership needs full

Exhibit 1:Qatar Scores

Year	Governance	Environmental & Social	Total Score
2014	933	178	1111
2013	920	177	1097
2012	748	126	874
2011	665	76	741
2010	649	85	734
2009	533	53	586
2008	475	40	515
2007	441	24	465

Source: S&P Dow Jones Indices LLC and Hawkamah UAE. Data from 2007 through 2014. Table is provided for illustrative purposes.

Exhibit 2: UAE Scores

Year	Governance	Environmental & Social	Total Score
2014	831	168	999
2013	820	163	983
2012	654	150	804
2011	627	122	749
2010	518	97	615
2009	449	69	518
2008	378	60	438
2007	359	40	399

Source: S&P Dow Jones Indices LLC and Hawkamah UAE. Data from 2007 through 2014. Table is provided for illustrative purposes.

Exhibit 3: Saudi Arabia Scores

Year	Governance	Environmental & Social	Total Score
2014	3337	617	3954
2013	3397	600	3997
2012	2643	510	3153
2011	2590	460	3050
2010	2052	310	2362
2009	1950	254	2204
2008	1629	214	1843
2007	1399	140	1539

Source: S&P Dow Jones Indices LLC and Hawkamah UAE. Data from 2007 through 2014. Table is provided for illustrative purposes.

Exhibits 1, 2, and 3 show the Goverance and Environmental and Social scores of companies in the S&P/Hawkamah ESG Pan Arab Index from the Qatar, UAE, and Saudi Arabia markets.

Further Exhibits 4, 5, and 6 compute the percentage difference in scores year over year for each of the markets. The striking improvement in transparency and disclosure in all markets from 2007 through 2014 stands out immediately. On an average both categories of scores and the total scores have more than doubled. The Environmental and Social scores have shown the maximum improvement. This is not surprising since they have come up from a very low base. Environmental and stakeholder engagement for policy setting, accounting and management and executive management selection.

As the Saudi Arabian equity market gears up for more accessibility and investability by global investors, it offers an exciting opportunity to increase the pace of stakeholder engagement and transparency. Global investors bring in large fund flows to the market and its listed stocks but also demand more say in corporate management. Corporate responsibility exhibited by a company actually encourages, besides increased investments, long term customer loyalty and employee longevity. Globally it is increasingly accepted that shareholders are the owners of the company and the board and management have a fiduciary responsibility to the shareholders as true owners. Shareholders have the right to vote in the decision making of the company, receive dividend distribution and sell their ownership stake as per their choice. Stakeholder engagement helps companies understand the important issues and concerns of different stakeholders and address them before they become major risk factors.

The question is then does market opening and global fund flows help companies to become more transparent and encourage stakeholder engagement. We looked at the data around S&P's ESG indices in the Pan Arab region to give us some answers.

Let us see how scores change over time in response to market openings giving more investor say in how companies are run and managed. Both UAE and Qatar entered global emerging markets benchmarks in 2014. However, they were under review for such a change since 2008. Corporate governance standards and operational ease of access and transparency had to improve considerably for them to qualify for global investment portfolios. If we look at improvement in scores during the 2008- 2010 period, for both markets, though the pattern is uneven, however there is an overall improvement in both corporate governance and environmental scores. In

Exhibit 4: Saudi Arabia Score Change

Year	Governance (%)	Environmental (%)	Total Score (%)
2014	-1.77	2.83	-1.08
2013	28.53	17.65	26.77
2012	2.05	10.87	3.38
2011	26.22	48.39	29.13
2010	5.23	22.05	7.17
2009	19.71	18.69	19.59
2008	16.44	52.86	19.75
2007	-	-	-

Source: S&P Dow Jones Indices LLC and Hawkamah UAE. Data from 2007 through 2014. Table is provided for illustrative purposes.

Exhibit 5: Qatar Score Change

Year	Governance (%)	Environmental (%)	Total Score (%)
2014	1.41	0.56	1.28
2013	22.99	40.48	25.51
2012	12.48	65.79	17.95
2011	2.47	-10.59	0.95
2010	21.76	60.38	25.26
2009	12.21	32.50	13.79
2008	7.71	66.67	10.75
2007	-	-	-

Source: S&P Dow Jones Indices LLC and Hawkamah UAE. Data from 2007 through 2014. Table is provided for illustrative purposes.

Exhibit 6: UAE Score Change

Year	Governance (%)	Environmental (%)	Total Score (%)
2014	1.34	3.07	1.63
2013	25.38	8.67	22.26
2012	4.31	22.95	7.34
2011	21.04	25.77	21.79
2010	15.37	40.58	18.73
2009	18.78	15.00	18.26
2008	5.29	50.00	9.77
2007	-	-	-

Source: S&P Dow Jones Indices LLC and Hawkamah UAE. Data from 2007 through 2014. Table is provided for illustrative purposes.

2013 when the announcement for inclusions went out for implementation in 2014, the markets gathered pace with their reforms and the companies worked hard to be relevant for global investors. Interestingly 2014 when the actual inclusion occurred there is a very small change in scores for both markets. This could be because these companies knew that they were 'good enough' now and there was no immediate need for improvement or because they were comfortable that they had reached a certain acceptable standard and were comfortable in this space.

Saudi Arabian markets first permitted access to global investors in 2008 via P notes. We see a similar pattern of improvement though a little more uneven than the UAE and Qatar. In January 2012 the market regulators published their first draft of QFII rules for more global accessibility, and the final rules were published in 2014 with implementation in 2015. Hence we see a big jump in 2013 when the companies start expecting a favorable outcome of more global investors and make a big effort in bringing their standards up to speed. Interestingly, 2014 was a very lackluster year with slightly negative results. There could be several reasons for this – companies felt that enough had been done and there was no need to do more, or they felt that the changes themselves would take some time before actual investments were going to come in and there was time to step back, ponder and decide the best way forward over the next few years, or simply there was a fatigue about disclosure changes for now.

Whatever the reason may be, it is heartening to note the steady march of Saudi Arabia and other GCC markets towards higher ESG standards. The change is well in motion and we can only expect that as more global investors put their spotlight on GCC markets and Saudi Arabia in particular, this can only result in more stakeholder engagement and better understanding of the importance of ESG norms for the corporate community in these markets.

Global investing norms are changing rapidly and ESG which had been a fringe player even in developed markets until very recently has now taken center stage. Increasingly pension funds and sovereign funds are being asked to include ESG as part of their fiduciary responsibility along with investor returns. With this kind of a global momentum in place, it will be hard for GCC markets to remain immune to it, and we can only expect that ESG standards go up and up.