

# FTSE Saudi Arabia Inclusion Index Series

Your keys to the kingdom

## Introduction

On October 29, 2017 FTSE Russell launched the FTSE Saudi Arabia Inclusion Index Series, a comprehensive series of global, regional and country-level indexes which can be used as a transitional tool in preparation for the potential inclusion of Saudi Arabia in the widely-followed FTSE Global Equity Index Series (FTSE GEIS). The indexes were designed to support domestic and international investors in response to regional growth and the opening of the Saudi Arabia capital market to Qualified Foreign Investors (QFI), which was announced in 2015.

The QFI program, along with a series of additional market reforms, supports “Vision 2030”, the Kingdom of Saudi Arabia’s plan for economic transformation. The plan aims to boost and diversify the Kingdom’s economy by increasing foreign investment and developing the private sector to increase non-oil revenue. A vital portion of the plan attracting global attention includes the potential sale of up to 5% of the government-owned oil company, Aramco, the largest oil company in the world and likely the largest initial public offering (IPO) in history.

Saudi Arabia was added to the FTSE Watch List for possible inclusion as a Secondary Emerging market within FTSE GEIS in September 2015. As per FTSE’s Annual Country Classification announcement on September 29, 2017, it is retained on the Watch List for possible inclusion, and its status will be reviewed as part the interim country classification review in March 2018.

To support growing demand, FTSE Russell offers market participants the FTSE Saudi Arabia Inclusion Index Series, a global index series that combines the constituents of stand-alone FTSE Saudi Arabia Indexes with various regional and global FTSE indexes.

## Saudi Arabia and Vision 2030

Saudi Arabia is the world's second largest producer of oil, second only to Russia as of the end of 2016<sup>1</sup> and the world's largest oil exporter.<sup>2</sup> It also holds the world's second largest oil reserves.<sup>3</sup> It's no surprise that the economy has been heavily dependent upon oil, as the petroleum sector accounts for roughly 87% of budget revenues, 42% of GDP and 90% of export earnings.<sup>4</sup>

In an environment of sustained low oil prices, the Kingdom posted a record-high fiscal deficit in 2015.<sup>5</sup> In response, the Crown Prince and Chairman of the Council of Economic and Development Affairs, Mohammad bin Salman bin Abdulaziz Al Saud announced "Vision 2030" in 2016, a comprehensive plan for national transformation built around three key themes: A vibrant society, a thriving economy and an ambitious nation.<sup>6</sup> Under each theme, the plan outlines several commitments and key targets for the coming years, most of which can be tied back to the key objectives of modernizing and diversifying the economy away from oil revenue, attracting foreign investors, and privatizing government services.

Key targets of Vision 2030 include:

- Increase non-oil export contribution to GDP from 16% to 50%
- Increase the private sector contribution to GDP from 40% to 65%
- Increase foreign direct investment from 3.8% to 5.7% of GDP
- Increase small to medium enterprise (SME) contribution to GDP from 20% to 35%
- Lower the rate of unemployment from 11.6% to 7% while increasing the participation of women in the labor market from 22% to 30%

## Diversification and growth opportunities

As the Kingdom seeks to increase foreign investment and create alternative revenue streams, market participants will be attracted to a variety of related growth and diversification opportunities. The Kingdom identifies in Vision 2030 numerous sector-specific growth initiatives it plans to support in the coming years, including the following:

**Industrials:** The industrial equipment manufacturing sector will benefit from the plan's aim to bring 50% of the Kingdom's military equipment spending in house. As the world's fourth biggest military spender<sup>7</sup>, and with only 2% of its spending occurring within the Kingdom, achievement of this goal would result in a substantial amount of capital being invested locally, creating more job opportunities for local citizens and stimulating the growth of supporting sectors such as communications and technology.

**Travel & Tourism:** The Kingdom's plans for its tourism and leisure sector include creating new attractions, developing historical sites and improving visa procedures. As Saudi Arabia is home to two of Earth's most sacred sites to Muslims, it plans to increase its capacity to accommodate annual pilgrimage visitors from 8 million to 20 million by 2030.

**Technology:** The Kingdom plans to partner with the private sector to further develop its telecommunications and information technology infrastructure. Goals specific to expanding high-speed

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<sup>1</sup> Source: <https://www.bloomberg.com/news/articles/2017-02-20/russia-overtakes-saudi-arabia-as-world-s-largest-crude-producer>

<sup>2</sup> Source: <http://www.worldstopexports.com/worlds-top-oil-exports-country>

<sup>3</sup> Source: <https://www.cia.gov/library/publications/the-world-factbook/rankorder/2244rank.html>

<sup>4</sup> Source: [https://www.cia.gov/library/publications/the-world-factbook/geos/print\\_sa.html](https://www.cia.gov/library/publications/the-world-factbook/geos/print_sa.html)

<sup>5</sup> Source: <https://www.mof.gov.sa>

<sup>6</sup> Source: <http://vision2030.gov.sa/en>

<sup>7</sup> Source: Stockholm International Peace Research Institute. Measured as % of 2016 GDP.

broadband coverage and capacity include exceeding 90% coverage in densely populated cities and 66% coverage in other urban zones.

**Mining:** Plans to invest in mining and further explore the Kingdom's mineral resources, including expanding into gold, uranium and phosphate mining are underway. Vision 2030 aims to increase this sector's contribution to GDP and create 90,000 related jobs.

**Education:** Aimed at attracting significant private sector participation in this sector, the Kingdom plans to have at least five Saudi universities among the top 200 universities globally.

**Energy:** Plans to continue to build upon the strength of the oil and gas sector include creating a new city dedicated to energy, constructing a natural gas distribution network, and doubling gas production.

**Renewable Energy:** Local energy consumption is expected to triple by 2030 and the Kingdom plans to build a competitive renewable energy sector. As such, it has allocated \$1.33 billion for the construction of the King Abdallah City for Atomic and Renewable Energy and plans to review the regulatory framework that allows private sector investment in this sector.

**Real Estate:** The Capital Market Authority (CMA) recently approved rules governing the listing of real estate investment trusts (REITs)<sup>8</sup> on the Saudi market with the aim of boosting local and foreign investment in the Kingdom's real estate sector. Also, plans for real estate involve allowing non-Saudis living and working in the Kingdom to own real estate in certain areas. The Kingdom also plans to introduce regulations that will encourage private sector involvement in building and providing funding for housing.

## Aramco and the Public Investment Fund

A vital part of the Kingdom's Vision 2030 plan is to publicly list up to 5% of its shares of the state-owned petroleum company, Saudi Aramco, in an effort to broaden outside investment and generate revenue. This could happen as soon as 2018, and it has potential to be the largest IPO in history with its estimated market cap of \$2 trillion<sup>9</sup> — a 5% sale of a company of this size would result in an IPO valued at \$100 billion. Proceeds of the Aramco IPO will be invested to develop and diversify the economy and support further privatization of government assets and functions. The remaining state-owned shares will be given to the Public Investment Fund, the expanding role of which will make it the largest sovereign wealth fund in the world. Improvement plans currently underway for the fund include restructuring its investment processes to manage its current and future portfolios to improve its return on investment.

## Saudi Arabia's stock market

Saudi Arabia's stock market, called Tadawul (which means "trading" in Arabic), is the largest in the Middle East both by size (\$457.6 billion) and by total number of companies listed (171) as of August 30, 2017.<sup>10</sup> It is also home to some of the largest companies in the region, including Saudi Basic Industries Corporation (SABIC), a chemicals manufacturing corporation; Saudi Telecom Company; and Al Rajhi Banking and Investment Corporation. Five of the ten largest companies in the GCC region are listed on Tadawul.<sup>11</sup>

Much of the Kingdom's ability to succeed in diversifying its oil export-dependent economy relies heavily on its ability to attract foreign capital, but Tadawul has historically been closed to foreign investors. As of June 2015, Qualified Foreign Investors QFIs could directly invest in Tadawul-listed companies for the first time in the market's history, albeit with strict guidelines. Prior to this, the only way non-GCC investors could invest in the

<sup>8</sup> <https://cma.org.sa/en/MediaCenter/PR/Pages/REIT.aspx>

<sup>9</sup> <http://fortune.com/2017/03/28/saudi-arabia-aramco-ipo-tax/>

<sup>10</sup> Source: Tadawul.com

<sup>11</sup> As of August 31 2017. Based on FTSE GCC Saudi Arabia Inclusion Index gross market capitalization.

Saudi stock market was through participatory notes and swap agreements. The initial QFI program permitted a maximum of 5% of issued shares of a listed company to be held by an individual foreign investor, and to qualify, investors were required to have at least \$5 billion in AUM. Additionally, only banks, insurance companies, fund managers and brokerages could participate. In total QFIs were only permitted to hold 20% of a local Saudi company.

In 2016, the QFI regulations were adjusted, decreasing the AUM requirement from \$5 billion to \$1 billion, increasing the company-specific limit on foreign-owned shares from 5% to 10%, and accepting investments by additional investor-types including sovereign wealth funds and university endowments. A limit on total foreign ownership in any single company to a maximum of 49% was also introduced. As of September 14, 2017, foreign investors, including foreign residents and strategic partners, own 4.6% of the total market capitalization of Tadawul-listed companies, with only 0.4% owned as part of the QFI program.<sup>12</sup>

## Saudi Arabia market status

The FTSE Country Classification scheme<sup>13</sup> classifies markets contained in its global benchmarks as either Developed, Advanced Emerging, Secondary Emerging or Frontier. Markets are assessed against twenty-one criteria (referred to as FTSE Quality of Markets criteria) which were developed in conjunction with international investors. The economic status of a country is measured using gross national income (GNI) per capita. The process is overseen by an independent advisory committee consisting of senior market participants with technical expertise in trading, portfolio management and custody services.

To ensure that the potential reclassification of markets is transparent to investors, FTSE Russell publishes a Watch List containing markets under consideration for a possible change in their country classification. The FTSE Russell approach is to engage with the domestic market authorities, and with the support of the independent advisory committee, work with the domestic market to address any hurdles to reclassification. The Annual Country Classification announcement is published each September, and FTSE Russell provides an interim update on the status of the Watch List markets each March.

In September 2015, Saudi Arabia was added to the Watch List for potential inclusion in FTSE GEIS as a Secondary Emerging market. Since then, the annual and interim updates have reported Saudi Arabia's continued progress toward achieving Secondary Emerging market status, with developments in the areas of relaxed foreign ownership restrictions, improved custodian and brokerage services, and enhanced settlement cycle and delivery versus payment processes. Specific changes recently made by the Capital Market Authority (CMA) and Tadawul to bring the market in line with international standards include:

- The introduction of Real Estate Investment Trust (REIT) regulations to further diversify the availability of investment vehicles and promote investment in real estate in late 2016
- Qualified Foreign Investors (QFIs) were allowed to participate in IPOs as of January 2017
- Tadawul launched a parallel market called Nomu, which means "growth" in Arabic, in February 2017 to stimulate economic growth by attracting additional sources of capital for smaller companies
- Tadawul adopted the new Tadawul Corporate Governance rules in February 2017
- The settlement period was amended from T+0 to T+2 in April 2017
- Securities lending and short selling were authorized in April 2017
- An independent custody model, which enables custodians to reject trades and passes settlement responsibility to the broker, is scheduled to be introduced in January 2018

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<sup>12</sup> Source: Tadawul.com

<sup>13</sup> As of August 31 2017. Based on FTSE GCC Saudi Arabia Inclusion Index gross market capitalization.

When the promotion of Saudi Arabia to Secondary Emerging does occur, timing of when it will officially be added to the FTSE Global Equity Index Series will be carefully considered. FTSE Russell provides a minimum of six months of notice before a country's market status is reflected within its indexes.

## FTSE Saudi Arabia Inclusion Index Series

As Tadawul and the Capital Market Authority continue to implement new regulations and market reforms to help boost foreign investments and earn Secondary Emerging market status, investors closely tied to the FTSE Global Equity Index Series are preparing for what could be a change to their emerging markets allocations. To facilitate a smooth transition, and to address the demand from international investors for indexes that measure the performance of the Saudi Arabia market and its market segments, FTSE Russell launched the FTSE Saudi Arabia Inclusion Index Series on October 29, 2017. The index series includes Saudi Arabia country-level indexes, which cover companies listed on Tadawul (based on FTSE GEIS eligibility criteria),<sup>14</sup> as well as regional and global inclusion indexes that combine the constituents of the FTSE Saudi Arabia Indexes with various FTSE indexes. The inclusion indexes incorporate the foreign ownership limits (FOL) that apply to international investors. Large, mid, and small cap indexes are available, as are ICB<sup>®</sup> Industry and Sector variations. A list of the key FTSE Saudi Arabia Inclusion Indexes, their underlying FTSE index universes, and the Saudi Arabia component indexes are included in Figure 1.

**Figure 1. FTSE Saudi Arabia Inclusion Index Series**

| Country-level Indexes   |
|---|
| FTSE Saudi Arabia Index   |
| FTSE Saudi Arabia Capped Index  |
| FTSE Saudi Arabia All Cap Index   |
| FTSE Saudi Arabia All Cap Capped Index                                      |
| Regional Inclusion Indexes  |
| FTSE GCC Saudi Arabia Inclusion Index                                       |
| FTSE GCC Saudi Arabia Capped Inclusion Index                                |
| FTSE GCC Saudi Arabia All Cap Inclusion Index                               |
| FTSE GCC Saudi Arabia All Cap Capped Inclusion Index                        |
| FTSE Middle East & Africa Saudi Arabia Inclusion Index                      |
| FTSE Middle East & Africa All Cap Saudi Arabia Inclusion Index              |
| FTSE Middle East & North Africa (MENA) Saudi Arabia Inclusion Index         |
| FTSE Middle East & North Africa (MENA) All Cap Saudi Arabia Inclusion Index |
| Global Inclusion Indexes  |
| FTSE All-World <sup>®</sup> Saudi Arabia Inclusion Index                    |
| FTSE Global All Cap Saudi Arabia Inclusion Index                            |
| FTSE Emerging Saudi Arabia Inclusion Index                                  |
| FTSE Emerging All Cap Saudi Arabia Inclusion Index                          |

The size of Saudi Arabia's market relative to its regional peers is shown in Figure 2, which compares the country weights of the FTSE GCC Saudi Arabia Inclusion Indexes to the country weights of the standard FTSE GEIS equivalent index. In the case of the all cap version of the FTSE GCC Saudi Arabia Inclusion

<sup>14</sup> The FTSE Saudi Arabia Indexes are reviewed as part of the FTSE GEIS Middle East and Africa region. For additional details on the free-float, liquidity and size screens applied, please refer to the [FTSE Saudi Arabia Inclusion Index Series Ground Rules](#).

Index, Saudi Arabia represents over 60% of the index's weight. The inclusion of Saudi Arabia in the GCC regional index shifts UAE's representation from 52% to under 21%. Results are similar in the MENA regional index (not shown).

Given the significant influence Saudi Arabia's large market size has on the weights of its regional peers, capped versions of the GCC inclusion indexes are available. The capped index constrains individual country weights to 40% and individual company weights to 10% on a semi-annual basis. Weights after the capping methodology<sup>15</sup> has been applied are also exhibited in Figure 2.

**Figure 2. GCC standard and inclusion index country weights comparison as of September 29, 2017**

| Country      | FTSE GCC All Cap Index (%) | FTSE GCC All Cap Saudi Arabia Inclusion Index (%) | FTSE GCC All Cap Saudi Arabia Inclusion Capped Index (%) |
|--------------|----------------------------|---|--|
| Bahrain      | 0.0                        | 0.0   | 0.0  |
| Kuwait       | 6.2                        | 2.5   | 3.7  |
| Oman         | 6.1                        | 2.4   | 3.6  |
| Qatar        | 35.6                       | 14.2  | 21.3   |
| Saudi Arabia | n/a                        | 60.1  | 40.2 <sup>16</sup>                                       |
| UAE          | 52.1                       | 20.8  | 31.1   |

Source: FTSE Russell.

Viewing the impact of including Saudi Arabia on a larger scale, Figure 3 lists the ten largest countries by weight in the FTSE Emerging Saudi Arabia Inclusion Index. Saudi Arabia ranks tenth in size out of twenty-four emerging market countries.

**Figure 3. FTSE Emerging Saudi Arabia Inclusion Index country weights as of September 29, 2017**

| Country      | FTSE Emerging Saudi Arabia Inclusion Index (%) |
|--------------|--|
| China        | 28.0   |
| Taiwan       | 13.3   |
| India        | 11.3   |
| Brazil       | 9.1  |
| South Africa | 7.9  |
| Russia       | 4.3  |
| Mexico       | 4.3  |
| Thailand     | 3.5  |
| Malaysia     | 3.2  |
| Saudi Arabia | 2.8  |
| Other        | 12.3   |

Source: FTSE Russell.

<sup>15</sup> Please refer to the [FTSE Saudi Arabia Inclusion Index Series Ground Rules](#) for details on the capping methodology applied.

<sup>16</sup> Weights are allowed to drift above 40% intra rebalance.

## Summary

As Saudi Arabia makes progress toward the goals laid out in Vision 2030, developments involving the Saudi Arabia equity market and its accessibility to international investors will continue to attract global attention – especially if the Kingdom’s plan to offer a portion of Saudi Aramco to the public comes to fruition. While Saudi Arabia is not yet included in the widely-followed FTSE Global Equity Index Series, given the advancements Tadawul and the CMA have made toward bringing Saudi Arabia’s market in line with international standards, FTSE Russell has acknowledged the progress made toward becoming included as a Secondary Emerging market. Until Saudi Arabia officially joins FTSE GEIS, the FTSE Saudi Arabia Inclusion Index Series provides market participants a range of index choices to help them prepare for the transition.

## For more information about our indexes, please visit [ftserussell.com](http://ftserussell.com).

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FTSE Russell index expertise and products are used extensively by institutional and retail investors globally. For over 30 years, leading asset owners, asset managers, ETF providers and investment banks have chosen FTSE Russell indexes to benchmark their investment performance and create investment funds, ETFs, structured products and index-based derivatives. FTSE Russell indexes also provide clients with tools for asset allocation, investment strategy analysis and risk management.

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