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ENVIRONMENTAL, SOCIAL &
CORPORATE GOVERNANCE
PRACTICES IN THE MENA
REGION 2007-2012

REVIEW OF THE S&P/HAWKAMAH PAN ARAB ESG INDEX

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FOREWORD

This is the first review of the S&P/Hawkamah Pan Arab ESG Index which, launched in February 2011, is a groundbreaking initiative. The Index measures the environmental, social and governance (ESG) attributes of publicly traded companies in the Middle East and North Africa (MENA) region.

The first chapter of this review is by Hawkamah. As part of its work in the index construction and annual recalibration, Hawkamah now has a significant database of ESG practices of MENA listed companies, covering the last six financial years. The first chapter of this review looks at some of the key data points which illustrate the developments within MENA companies over the past years.

The second chapter, by Ernst & Young, looks at the general trends evident from the data and contextualizes these within global developments. It notes that many emerging markets have shown great improvement in ESG integration in the last decade and that although ESG integration in the MENA region has increased in the last few years, it is still in its early stages.

The third chapter, by S&P Dow Jones Indices, analyses the share price performance of the Index. The performance of the Index supports the idea that ESG-related considerations can have an impact on companies' business and financial performance in the form of either better controlled risks, or better captured business opportunities. Sustainability may not only be viewed from a perspective of the benefits for society and environment. As generally observed, more sustainable companies happen to be also more efficient, more innovative and stronger branded businesses, they are better places to work and are able to attract more devoted workforce. This appears to pay back to them in the form of increased investor interest and wider investor base, which is reflected by the performance of sustainability indices in their role of investment and benchmarking tools.

THE INDEX

AUTHORED BY ALEC AALTONEN, HAWKAMAH INSTITUTE FOR CORPORATE GOVERNANCE

1. Introduction

The S&P/Hawkamah Pan Arab ESG Index, the first-ever index of its kind in the Arab region, monitors and ranks the transparency and disclosure of regional listed companies on Environmental, Social and Corporate Governance (ESG) issues based on their public disclosures.

This exchange tradeable Index includes the top 50 MENA companies based on their performance on nearly 200 ESG metrics, when compared to their regional peers.

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

1.1 Constituents

Constituents are drawn from a universe of the 150 largest and most liquid companies listed on the national stock exchanges of 11 markets: Bahrain, Egypt, Jordan, Lebanon, Kuwait, Morocco, Oman, Qatar, Kingdom of Saudi Arabia, Tunisia and the United Arab Emirates, subject to a liquidity screen.

1.2 Methodology

Each company is analyzed on nearly 200 ESG issues including carbon emissions, water and energy consumption, employee health and safety, community investment, charitable giving, financial reporting, auditing, board independence and executive remuneration, with the top 50 best performing companies included in the Index. The full criteria can be found in Appendices 1 and 2.

1.3 Why?

Companies which score highly on the ESG metrics are likely to be more sustainable and therefore more attractive to long-term investors. The Index, in other words, is a tool to identify better governed, and environmentally and socially responsible MENA companies and to facilitate investment in those companies.

2. Background

The Middle East and North Africa (MENA) region is an emerging market in which corporate governance is seen as a relatively new concept. Indeed it is only in the last ten years that an Arabic word for 'corporate governance', "Hawkamah", has emerged. Despite its infancy in the region, corporate governance has been making significant headways.

2.1 Hawkamah

The Hawkamah Institute for Corporate Governance (Hawkamah) was set up in 2006 to help bridge the corporate governance gap in the Middle East and North Africa region. The Institute was founded in partnership with international organizations including the OECD, the IFC, and the World Bank GCGF, and regional organizations including the Union of Arab Banks and the Dubai International Financial Centre Authority. Hawkamah resulted from the recognition of a growing need for a regional organization working on the ground, for regional institution-building, in order for corporate governance to achieve buy-in of stakeholders. Since then Hawkamah has been at the forefront of the corporate governance debate in the region.

Hawkamah's primary goal has been to establish corporate governance as a topic on the agendas of MENA policy makers by providing the region's companies and regulators with practical tools on how to improve corporate governance. Hawkamah's work involves engaging governments and industry, conducting surveys and studies, and creating regional benchmarks which often act as catalysts for reform.

In the initial years, Hawkamah's calls for corporate governance reform were very much like voices in the desert. Although the need for better corporate governance was recognized, the prevailing opinion was that the region was not ready for reform. Illustrative of the then state of corporate governance is the finding of the 2007 benchmark Hawkamah-IFC study that only 3% of listed companies and banks in the MENA followed good corporate governance practices, with none complying with international best practices.

Much has changed since then. Subsequent Hawkamah research and surveys have indicated that there have been significant improvements in corporate governance in the MENA region in just a few short years. Although implementation is still patchy, the concept and principles of corporate governance are now well accepted. Regulators and companies have taken substantial steps, albeit from a low base, to improve their practices. The majority of MENA countries have now issued corporate governance codes and guidelines. Similarly, an increasing number of MENA companies have begun investing in better governance and addressing their corporate governance shortcomings.

2.2 Drivers of corporate governance in the MENA

Corporate governance reform in the MENA, to date, has not been investor driven. Much of this stems from a combination of facts such as the ownership structures of MENA companies (mainly family or state-owned), the ready availability of liquidity and financing from regional banks, and the relatively underdeveloped capital markets that are dominated by retail investors. The region is also generally overlooked by global long-term investors largely because of the region's poor track record in transparency,

disclosure and reporting. Regional asset managers such as the sovereign wealth funds have not exhibited governance vigor in their local investment processes and have mainly invested outside the region in order to diversify away from local risk. Consequently, the benefits of good corporate governance have been typically seen by companies in terms of better strategic decision-making and regulatory compliance rather than being associated with better and cheaper access to credit and capital or improved valuation of companies.

2.3 S&P/Hawkamah Pan-Arab ESG Index

To address these gaps, Hawkamah in partnership with Standard & Poor's and the IFC have created the first-ever Environmental, Social and Governance (ESG) Index for the MENA. It ranks and tracks the transparency and disclosure of regional listed companies on ESG issues. The constituents of this Index are derived from 11 Arab equity markets. The purpose of this Index is to identify the MENA companies that go the extra mile in ESG reporting and policy implementation. The Hawkamah-S&P Index is a tool for international and regional investors who may not have the expertise in the MENA companies or in incorporating corporate governance in their investment processes.

The Index is not only a tool for investors, but also for companies. Inclusion in the index provides public recognition for a local company of its ESG practices, but the index is more than just a badge of honor. As the Socially Responsible Investment movement spreads to the region, capital will start flowing towards companies with better ESG reporting, thereby improving their access to external capital.

3. The data

Through this work on the Index, Hawkamah now has a substantial database on the ESG practices of regional listed companies. The data covers the last six financial years.

When Hawkamah started collecting data to create the Index, the first challenge related to the availability of information. Getting hold of annual reports for 2007 and 2008 was a painstaking task. And often times, when the Annual Report was accessible, it amounted to little more than financial statements. In the last two to three years, the situation has changed drastically. It is no longer a challenge to find annual reports of listed companies and there has been significant improvement in the quality of non-financial reporting.

This is reflected in the sizes of annual reports. The average annual report now runs 102 pages, but this is only one half of the story as companies now are publishing more and more material outside their annual reports, particularly on their websites but also increasingly in separate sustainability reports. For example, **Arab Bank's** 2012 annual report is 308 pages and their sustainability report is 128 pages.

SABIC's annual report and sustainability report are both 108 pages each.

It is also becoming common practice for companies to publish their corporate governance manuals on their websites (e.g., **Emaar Properties, Aamal Holding, Arabtec, United Development**) or even as part of the annual report (**Housing Bank**). Stock exchanges are also a channel through which company information is often available.

The great majority of companies in our universe now report in English. In some countries, particularly in the United Arab Emirates, company reporting in English has been the norm for years, but in other countries such as the Kingdom of Saudi Arabia, more and more companies are now choosing to make their annual reports available in English, rather than only in Arabic. In Morocco and Tunisia, annual reports are usually issued in French rather than in English.

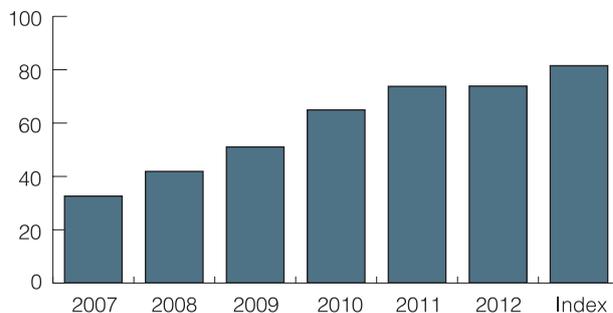
Companies are also increasingly providing discussions of their strategies in annual reports. Although companies generally steer clear from making any forward looking statements (**Savola** is a notable exception here in that their 2012 annual report includes financial projections for the year ending 2013) there is a tendency to provide investors with a more detailed picture of their operations. For example, 22 percent of companies now provide figures for their market shares of some of their businesses, up from 9 percent in 2007.

IFRS is widely used across the region, with certain exceptions such as the Saudi companies which are required to use the Saudi GAAP. Many Islamic financial institutions report in accordance with the Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions.

4. Ownership

Ownership structures in the MENA have often been characterized as opaque. It is therefore positive to note that companies are improving transparency in this respect.

Graph 1 The identity of the largest shareholder disclosed

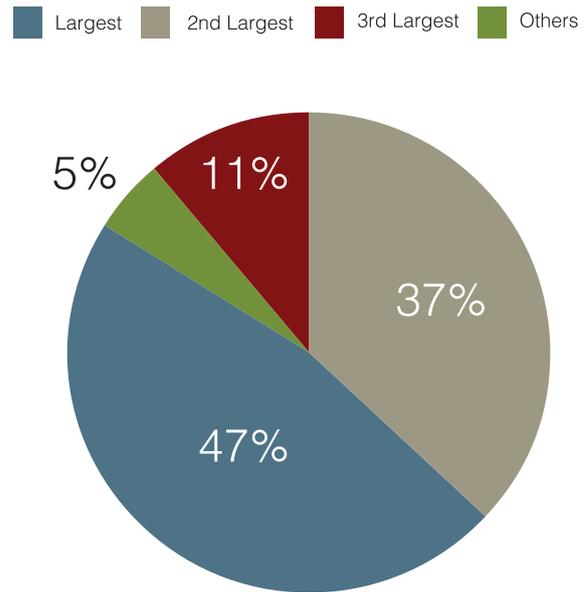


Currently, 74 percent of companies disclose the largest shareholder, and based on this information, on average, the largest shareholder owns 36.7 percent of MENA companies. The second largest shareholder owns, on average, 11.4 percent and the third largest owns 4.9 percent of shares.

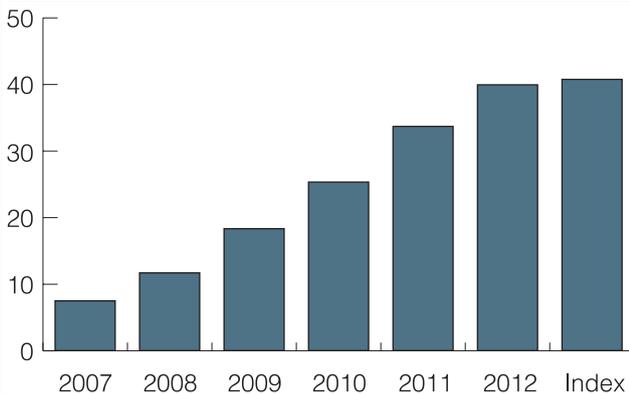
The prevalence of such concentrated ownership structures has significant corporate governance ramifications. Firstly, it explains the lower level of disclosure practices in the region when compared to those with widely dispersed ownership structures. Secondly, it also raises the question whether the US and UK models of corporate governance, where fragmented shareholding is the norm, are appropriate “best practice” models for the region. In many ways, the block holding structure, at least in theory, is the answer to the (weak) principal – (strong) agent problem, which many of the Western governance frameworks attempt to solve. However, the block holding structures raise number of other corporate governance concerns, which chiefly center around the protection of minority shareholders, related party transactions (only 20 percent of companies reported that their related party transactions were conducted on market terms), conflicts of interest, information asymmetry, and on the need for independent non-executive directors.

Companies are also increasingly disclosing the shareholding of their board directors and, to a lesser degree, of their senior managers. **Arab Potash, Alinma Bank, Saudi Airlines Catering** and many others also disclose the number of shares owned by relatives of both board members and senior executives.

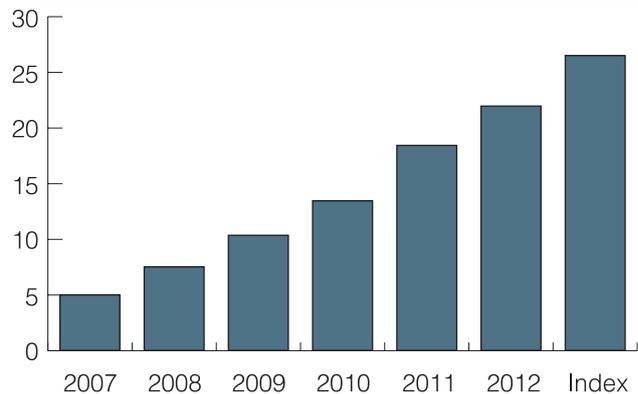
Ownership Pie Chart



Graph 2 Shareholding in the company by individual directors



Graph 3 Shareholding in the company by individual senior managers



5. Boards

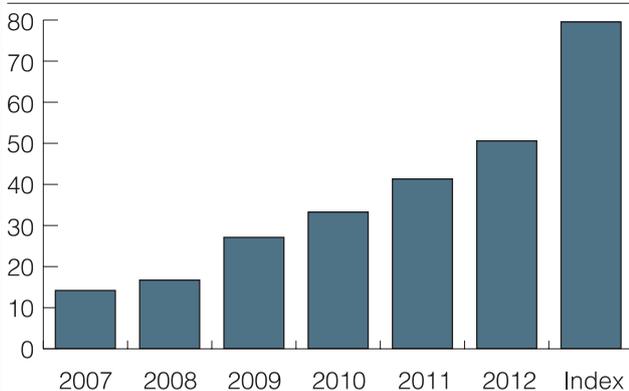
Boards come in different shapes and sizes across the world. In the UK, boards tend to be a combination of two-three executives and a number of non-executives. In the US, the tendency is still strong to have a combined Chairman-CEO. In some Nordic countries, boards are often fully non-executive. German companies famously practice the two-tier board system in which owners and employee representatives sit on the supervisory boards. It is therefore no great surprise that in the MENA boards should also come in various shapes and sizes. In terms of size, they range between five and 18 board members. The average board size across the region is 8.9 directors.

The Boards in Gulf countries tend to be fully non-executive, but some choose to have one executive board member (e.g., **Eastern Province Cement**), and in countries such as Egypt and Lebanon, there may be several executives on the board (e.g., **Global Telecom Holding** and **Blom Bank**).

The roles of the Chairman and CEO are predominately (over 80 percent) separate in most MENA companies, particularly in the Gulf, and the combined roles are usually found in Egyptian and Lebanese companies (e.g., **Solidere**).

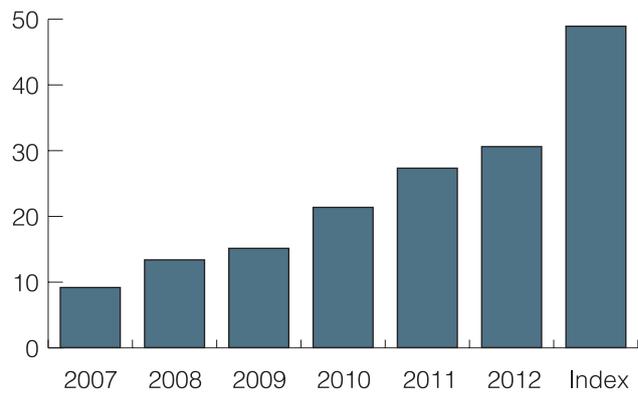
In 2007, the standard practice among MENA listed companies was to disclose only the names of the board members, typically along with their photos. Although there still are companies which hold on to this practice, but this is largely withering away as the great majority of companies are now shedding light on their board members, particularly in relation to their other time commitments. Many companies such as **Arab Bank** and **Housing Bank** also disclose the ages of their board members. Companies are now also more willing to disclose the names and backgrounds of their senior managers who are not on the board of directors.

Graph 4 Disclosure of details about other employment and positions of directors



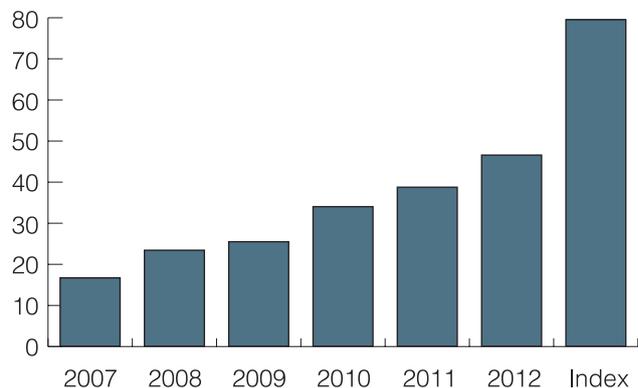
The best practice is that annual reports would set out the company's vision and goals and then provide some information as how the backgrounds and capabilities of the board members and senior executives are linked with achieving those ends. There are instances of MENA companies that are starting to disclose the backgrounds of the executives in this light.

Graph 5 Disclosure of backgrounds of senior managers



Such thinking, however, is not apparent on the board director level. In some cases, this is due to the board directorship still being seen by some as an honorary position, but more often than not, this is because board members are shareholder representatives or at least appointed by shareholders on the basis of trust. And given this, it is easy to see why corporate governance in the MENA is sometimes described as "shareholder centric" rather than "board centric". And consequently, the role of the boards has not always been clear. It is therefore encouraging, that companies are now placing more emphasis on clearly defining the role of the board.

Graph 6 Disclosure of details about role of the Board at the company



Companies typically describe the role of the board in their corporate governance manuals, which are increasingly published on company websites. These provide the basic terms of reference, i.e., what boards should ideally be doing, but very few companies take the time to explain what boards actually did during the year. And this is no easy task given that board deliberations are highly confidential.

Batelco is one of the few exceptions in that its Corporate Governance report provides the dates of each meeting and the key agenda topics for each meeting. The company also does this for each of its board committees. **HSBC Oman** is another refreshing exception in that instead of using the standard, one-size-fits-all, terminology, it states that “the Board as a whole strives to achieve the following core competency, with each candidate contributing at least in one domain: Skills to motivate high performing talent; Strategic insight and ability to direct by encouraging innovation and continuously challenging the organization to sharpen its vision; Expertise in financial and corporate finance; The ability to understand management trends in general; and also to understand the banking industry locally and globally; To acquire and maintain appropriate and relevant industry specific knowledge; and To acquire and maintain business expertise in international markets”.

6. Board composition

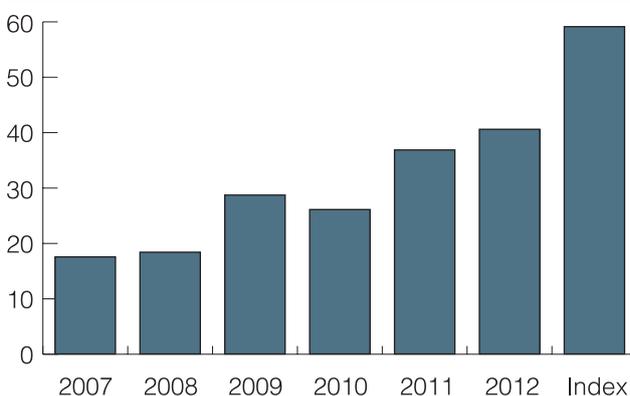
On average, 49 percent of board seats are held by independent non-executive directors. Companies, however, apply the independence criteria differently and, at times, very liberally. There are numerous instances of companies identifying a major shareholder representative as an independent non-executive director. Also, given the size of the markets in some countries, it is not unusual to find individuals on boards whose other businesses have significant business transactions with the company, however, it is a case for concern when such individuals are deemed to be independent. It is worth noting that some regulators have started focusing on this issue. Oman has recently made an amendment to its corporate governance code that has significantly tightened up the definition of ‘independent director’ with the aim of improving corporate governance and better protecting shareholders’ rights and interests. The new definition requires that an independent director must enjoy complete independence from the company and contains an array of exclusions to prohibit persons with potential vested interests from holding the position of independent director.

The issue of gender balance on the board level has become a hot topic in many jurisdictions across the globe. This is because women are under-represented in boards and there has been a push to appoint more women on boards. However, this push is not often translated into practice and this remains the case in the MENA listed companies. Currently 12 percent of boards have a female member. Only two companies in our universe have more than one female director.

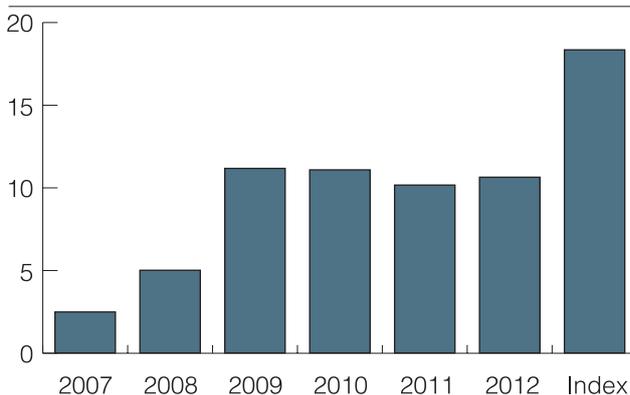
7. Board meetings

There have been significant improvements in the disclosure of board meeting attendance records over the years. Forty-one percent of companies in our universe now provide such disclosure, and based on this, a board of a MENA listed company held, on average, 6.7 meetings in 2012. However, the attendance records leave much room for improvement as only 11 percent of boards had full attendance at more 75 percent of the meetings, and only 2 percent of boards had full attendance at more 90 percent of the meetings. This is a case for concern as investors often view director attendance as an important indicator of the quality of board oversight.

Graph 7 Attendance records for board meetings



Graph 8 All board members have attended more than 75% of board meetings

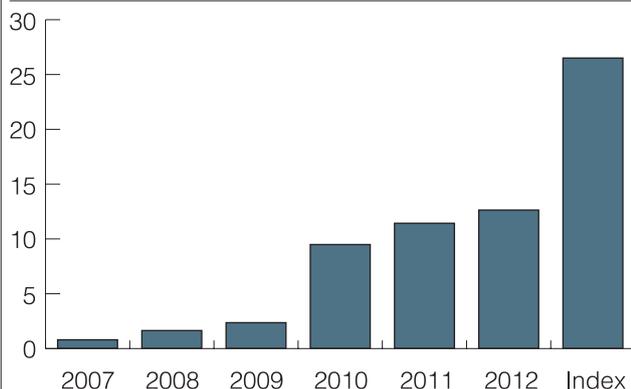


8. Board evaluations

Board evaluations typically cover areas such as is the director's contribution to the board an effective one? Do the board members demonstrate commitment to the role? Are they giving the job the time it requires?

Board evaluations were virtually non-existent in 2007, but they have started gaining ground in recent years. Currently 13 percent of MENA listed companies and 27 percent of the Index companies conduct board evaluations.

Graph 9 Board conducts regular self evaluation



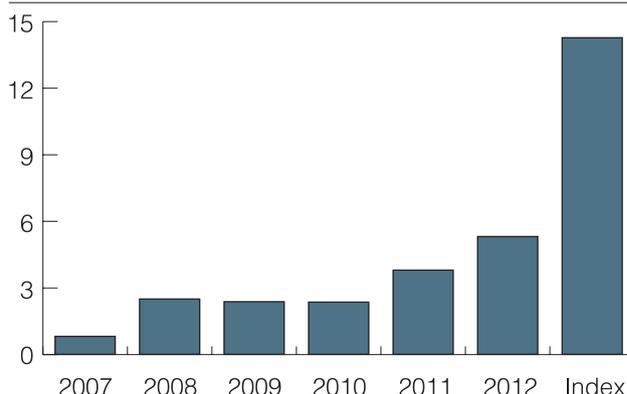
But it is clear that some companies place more emphasis on these than others. Board evaluations may take a number of different forms. They may be self-assessments, they may be carried out by a third party, they may be questionnaire or interview based, they be carried out on the individual level or on the collective level (i.e., the board assessed as a whole), they may also cover board committee performance and etc. MENA companies would benefit from explaining in more detail the form and process of their evaluations.

What companies do with the results of the evaluation also matters to investors. Some companies disclose the general outcome of the evaluation in the annual report (e.g., **Ahli United Bank**) and some share the results with shareholders at the annual general meeting (e.g., **Bank Bahrain Kuwait**). Some companies use the evaluations as a basis for a future action plan (e.g., **DP World**). **DP World** also states that as a result of the evaluation conducted of the Board's performance, "the Company implemented a formally documented professional development framework whereby all Board members are regularly updated on available directors' training courses to further develop and enhance their professional skills. The Board also received an independent presentation on boardroom best practices".

Al Khalij Commercial Bank also states that the board will contract with a specialized development institute to provide a high level development program for the board and board committees members in order to enhance their experience and skills.

But such workshops are still a rarity within MENA companies as can be seen from the graph below.

Graph 10 Board has a formal training program for directors or provides external training



9. Remuneration

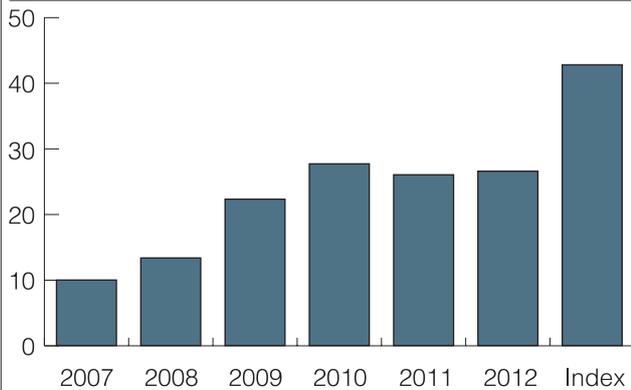
Executive remuneration has become a hot topic in corporate governance, particularly because of the rising remuneration levels in the US and UK markets. This is typically less of an issue in companies where share ownership is more concentrated, and where the power balance between agents and principals is more favorable to the latter.

However, this does not mean that executive remuneration is not a corporate governance concern in the MENA. The structure of how directors and employees are rewarded for their efforts is of considerable interest to investors. It gives insights into the set of incentives being used to reward the operators of a company. It is also important for investors to understand the current and future financial implications and costs to the company associated with reward mechanisms that may be in operation.

And this is an area where MENA companies have the greatest room for improvement in terms of disclosure. Very few companies set out their remuneration policies in their public disclosure. This would be important as remuneration policy is all about recognizing the circumstances, values, strategic goals and performance drivers of the individual company and then designing an approach that will reflect and contribute to these.

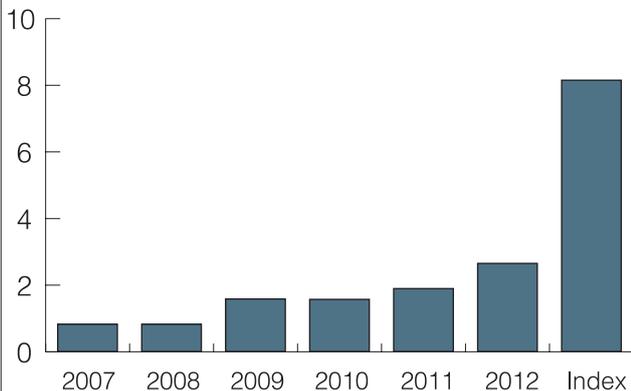
There have been some improvements in disclosure of remuneration in the past years. Companies are now disclosing the pay levels of executives either individually (**Dubai Financial Market**), as a lump sum of the remuneration paid to the five (**Riyadh Bank**), six (**The Saudi British Bank**) or seven (**Bank Al Bilad**) highest paid executives, including the CEO and CFO.

Graph 11 Disclosure of the specifics of senior management (not board) pay, such as salary levels and bonuses



However, very few MENA companies give any details of the structure of their pay packages (**DP World** is of the only exceptions). And the structure of the remuneration packages is the key. Boards must appreciate how damaging wrong remuneration structures can be. As has been made evident by the recent financial crisis, failure to link incentive compensations to the business strategy can cause or encourage managers to book business based upon volume and/or short-term profitability to the company with little regard to short or long-term risk consequences. Also, companies should set publicly disclosed targets for executives. What remuneration committees should do is to establish incentives which are harmonized with the stated objectives of the company, and ensure that there is an appropriate balance between fixed and variable remuneration, and that the targets are appropriately stretching, verifiable and relevant and which take account of risk. Currently less than 3 percent of companies in the universe provide any disclosure of the performance criteria guiding executive remuneration.

Graph 12 Performance related indicators guiding senior management compensation



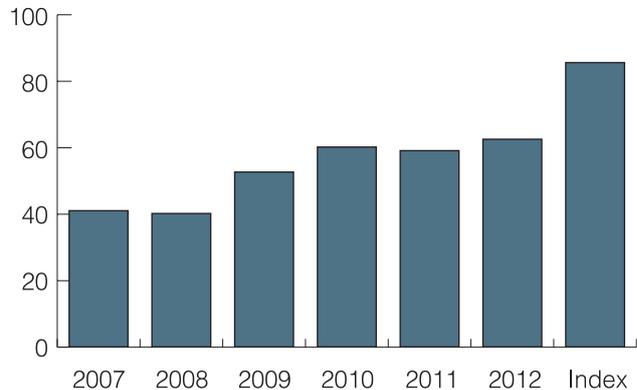
Executive remuneration is not only a concern for investors but also for boards. Robert A.G. Monks, the famous Corporate Governance pioneer and shareholder activist, stated that “possibly the most exact way of determining the quality of governance of a corporation is by examining the

incentive structure for the CEO. Precisely what is the CEO being incentivized to accomplish”. Modern businesses are often complex organizations, and many non-executive boards face the mammoth task of monitoring the activities of these companies. A well designed remuneration structure can go a long way in ensuring that executives operate according to the values set by the board.

10. Environmental & Social data

The concept of corporate social responsibility is deeply rooted within the MENA culture. There are notable examples of regional companies that are very active in promoting the “social good”, making significant charitable contributions, engaging in disaster relief operations and sponsoring events raising awareness on environmental issues. This behavior is closely associated with the Islamic values and the practice of Zakat.

Graph 13 Disclosure of charitable donations



The idea of a corporate citizen is also strong. Quite often companies, even those without significant state ownership, follow the lead and direction of the government of their home country. **Alba (Aluminium Bahrain)**, for example, provides a telling illustration – their CSR vision is built around the Kingdom of Bahrain’s Vision 2030, an economic vision providing direction for the development of the Kingdom with the goal of building a better life for every Bahraini national. Similarly, **Arab Potash** focuses on translating “the vision of His Majesty King Abdullah II Ibn Al Hussein into reality by supporting local communities and working to fulfill their needs so as to raise local standards of living and contribute to the development of services provided in various sectors... in the aim of achieving social balance and sustainable development”. **Omantel** states that “contributing to the growth of the Omani economy is a top priority for us”. This list of examples could go on a few pages.

However, global thinking on CSR and sustainability has evolved from charitable donations to linking sustainability into the individual strategies of companies. And this mindset has yet to take root in the region. The challenge for the region is to have the companies extend their external “corporate social responsibility” activities to cover their own internal operations.

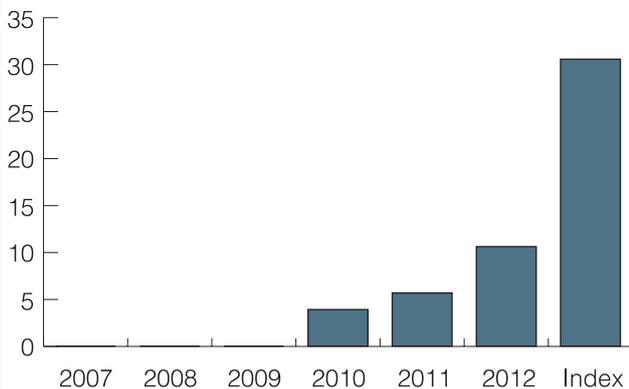
On one hand this means that companies should become more socially accountable for their own actions and operations. This implies that companies recognize the effects of their operations on the wider society, particularly in relation to their carbon dioxide emissions, waste generation, recycling, energy usage, and, perhaps most importantly, water usage.

The MENA region is particularly vulnerable to climate change. It is one of the most fragile ecologies on earth and one of the most vulnerable regions to global warming, reduced precipitation and rise in sea levels. At the same time, the MENA region is becoming a significant contributor in terms of greenhouse emissions. Currently it represents about 6% of global greenhouse gas emissions, but the region has the fastest rising regional per capita emissions in the world. The region's emissions grew five times faster than the global average from 1990-2005.

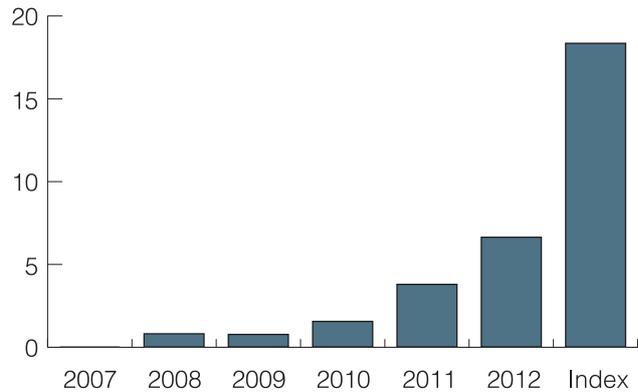
Water supply sources in the Arab world, two-thirds of which originate outside the region, are also being stretched to their limits. The level of water scarcity is the highest in the world and is rapidly growing, threatening to lead to confrontation, to ‘water wars’.

It is therefore encouraging to note that in the last two years, companies in the MENA have started measuring their greenhouse gas emissions and water usage. But what is clear from these graphs below is that more needs to be done on this front.

Graph 14 Disclosure of greenhouse gas emissions



Graph 15 Disclosure of total water used



Addressing environmental issues is not only about protecting the social good, but also about protecting the company itself. Water availability and scarcity, for example, is a major source of risk to businesses. Businesses ranging from manufacturing to utilities to agri-business and food production face direct risk exposure to water scarcity and need to develop tools to manage their business risk.

Paul Polman, the CEO of Unilever, put it well in a speech in 2011: “This is a world that is challenged. When you look at the interdependent challenges that we face on food security, poverty reduction, sustainability of resources, climate change, and social, economic, environmental development, these challenges have never been greater. And I believe that these pressures will only increase as 2 billion more people enter this world and many aspire to increase their living standards.”

Sustainability, in other words, is about “future-proofing” the business. It is about taking all these ESG-related matters into account when making business decisions. Seen from this perspective, ESG is less about philanthropy and all about strategy and risk management.

Historically, the annual reports in the MENA have not made this linkage between strategy and ESG. However, this has started to change in the last two years. For example, the 2012 sustainability report of **National Bank of Abu Dhabi** states that they see a clear link between sustainability indicators and primary business objectives, and that the role of the sustainability team changed to become an internal adviser to the group businesses. **Kuwait Finance House** have included the term “sustainable” into their vision. **SABIC** states that their customers are increasingly requesting products that enhance their sustainability efforts, and **SABIC** is “eager to support [their] customers in this way”. **Mobile Telecommunications Company (Zain)** states that they are seeking to embed the sustainability agenda into our corporate strategy, believing firmly that doing so will provide them with a vital competitive advantage while at the same time greatly benefitting the communities they inhabit. **Union National Bank** also states that they plan to conduct an assessment of all retail products to identify opportunities for integrating sustainability principles.

What is also encouraging is the number of sustainability reports that companies are now publishing. **Aramex** has been one of the pioneers in sustainability reporting in the region, issuing its first sustainability report in 2006. Also **Global Telecom Holding** (formerly known as Orascom Telecom) and **National Bank of Abu Dhabi** have a history of issuing sustainability reports. But in the last two years companies such as **SABIC, Arab Bank, Saudi Investment Bank, Abu Dhabi Commercial Bank, Union National Bank, Bank Muscat, Qatar Gas Transport, Oman Telecommunications Company, Doha Bank, Agility**, and several others have started their sustainability journeys by issuing sustainability reports, working on their baselines for reporting, monitoring progress and often setting targets. Most of these reports follow the GRI framework and many of them have also been independently verified.

11. Conclusion

As the data clearly demonstrates, there have been significant improvements in the ESG practices in the MENA listed companies over the years. But this is no time for complacency as there is still much room for improvement. Boards need to be encouraged to provide more meaningful statements of their activities, not as a compliance activity, but to demonstrate awareness of risks and their skill in managing them.

It is equally important to recognize the efforts of the individual companies that have shown leadership in this important area. The top 10 companies in the rebalanced Index, as of December 2013, are:

RANK	COMPANY NAME
1	DP World Ltd.
2	National Bank of Abu Dhabi
3	Arab Bank
4	Abu Dhabi Commercial Bank
5	SABIC (Saudi Basic Industries Corp)
6	SAVOLA Group
7	Saudi Investment Bank
8	National Bank of Oman
9	Mobile Telecommunications Company (Zain)
10	Aramex Company

SUSTAINABILITY TRENDS

AUTHORED BY ERNST & YOUNG

1. Drivers for sustainability integration

Despite the prevalence of short-termism in the current economy, companies worldwide are increasing their emphasis on sustainability, striving to achieve a better balance between the social, environmental and economic impacts of the company and increasing transparency. Companies as well as investors are currently more concerned about the long-term performance of their companies; this is directly associated with an increased awareness on how improving corporate governance practices can help grow the businesses and increase organizational value.

The need to integrate sustainability and better overall corporate governance into the business is generally driven by the following factors:

1.1 Past governance and management failures

The global financial crisis, which has only formed the peak of a vast set of corporate governance failures and cases of mismanagement in the past, has increased the awareness in the business world and general public for a sound corporate governance system. Both investors and companies themselves have recognized the medium- to long-term effect of environmental and social performance and the ability of good corporate governance to increase their organizational value.

1.2 Growing demand for sustainability reporting

Investors are requesting to incorporate social and environmental aspects into corporate reporting as well as investment indices in order to improve transparency on sustainability performance of the companies. In fact, since 2005, the number of signatories to the UN Principles for Responsible Investment (UN PRI) has increased steadily to reach 1,085 in July of 2012, which represents around %25 of the world's total financial assets and continues to grow in the future. If companies do not meet the rising demand for sustainability reporting, they do not only imperil their reputation, but also risk to lose investors. On the contrary, pleasing investors through increasing transparency on social, economic and environmental performance ultimately result in financial benefits for the company.

In the MENA region, Abu Dhabi seems to be setting the example, as the majority of sustainability reports in the Middle East are being published in Abu Dhabi. This is mainly due to the government drive towards the '2030 Vision', innovation through the Masdar initiative and regulatory reform through Estidama, the Green Building Code.

1.3 Sustainability facilitates performance assessment

Reporting on Environmental, Social and Governance (ESG) performance also means measuring a company's intangible assets. According to the International Integrated Reporting Council (IIRC) the market value for intangible assets of the 500 S&P companies increased from 17% in 1975 to 80% in 2010. By measuring its numerous intangible assets, an organization can implement good risk management and planning strategies, as well as lower its capital constraints and enhance its adaptability to change.

2. Characteristics of corporate governance in the MENA region

Most countries in the MENA region have made progress over the last decade in corporate governance reforms. However, they are still considered to be in the early stages of sustainability integration. According to the OECD, the economies in the region have certain characteristics that "shape the way the corporate sector is currently governed and financed, as well as dictate its ability to respond to rapid technological change and economic globalization". The characteristics identified by the OECD are outlined below.

2.1 Concentration of Ownership/Family Ownership

A large number of corporate organizations in the MENA region are characterized by a highly concentrated ownership, primarily due to family-dominated companies and company groups, including numerous banks. These family companies usually have a strong family leader, who occupies the highest position in an organization and frequently places only family members and close relatives in high ranking positions and on the board of directors. Consequently, individual investors normally have very limited shares in these companies. Due to these circumstances, corporate control has not been made a priority for many of these family-dominated enterprises. In addition, transparency and financial as well as non-financial (sustainability) reporting is not a key priority for the same reasons. However, the number of companies that have been integrating corporate restructuring and rescue plans in their organizations has been slowly increasing.

2.2 Bank-based corporate finance

The financial sector has failed to direct a significant proportion of capital savings into long-term investment in the region, despite the region being a net exporter of capital for decades. Financial systems in the MENA region are highly dominated by banks- sometimes state-owned banks. As mentioned previously, these banks are highly concentrated, and they often hold significant shares in non-financial listed companies, sometimes ranking among the top five shareholders. This trend suggests that good governance of banks in the region should be ensured, specifically in relation to lending and risk management policies.

In addition, the most common form of external finance for corporate companies is bank loans, most likely due to the reliance of family owners on bank financing in order to maintain and develop their businesses. Corporate bonds, on the contrary, play an insignificant role in contributing to corporate financing, and the debt market is still underdeveloped.

Moreover, credit allocation by banks is usually controlled by governments in the MENA region, restricting financing to certain target sectors, generally in the framework of industrial development (import substitution and export promotion).

2.3 Developing capital markets

So far, there are few relatively advanced capital markets in the region, whereas the remaining capital markets still need to be developed. Financial liberalization in the MENA markets has been one driver for the development of the regional capital markets within the last decade. It was not until recently that certain markets started to gradually allow foreign participation in order to promote their economic growth.

2.4 Legal traditions and enforcement patterns

Markets in the MENA region were fundamentally unregulated until the mid 1980-'s. This long gap in corporate governance resulted in the recognition of the need for a regulatory body in order to develop capital markets and introduce new sources of investment. A legal framework for corporate governance is also in place in most of the countries, but numerous improvements can still be made in several aspects. However, in order to reach a stage at which corporate governance is embedded in the MENA countries, capacity building is key, whereby emphasis needs to be placed on defining responsibilities, adequate staffing and correct budgeting.

In addition to complying with either a common law or a civil code, most of the legal systems in the MENA region have to comply with Islamic shariah, which is based on religious rules and principles.

2.5 Privatization

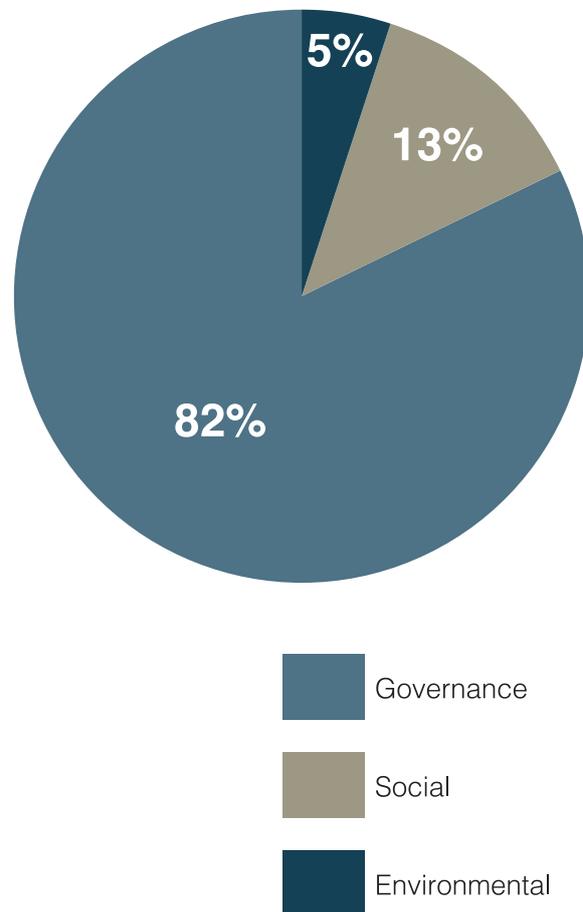
In an attempt to advance economic transformation and growth, there was a shift towards privatization in the 1990s. In fact, the region's privatization receipts reached 8.2\$ billion in 1990, equivalent to proceeds in sub-Saharan Africa at the time and smaller than in other emerging markets. However, privatization was relatively slow in the MENA region due to several impediments including lack of political will, overstaffing, low pace of job creation in the private sector and boycotts by certain interest groups. Seeing that privatization has previously had a positive impact on corporate governance and capital market development in numerous countries including the OECD, execution in the MENA region will potentially

have similar impacts on corporate structural reforms. Some of the benefits of privatization entail reinforcing multiple objectives, increasing investment and enhancing corporate efficiency.

3. Challenges facing ESG integration in the region

Although ESG integration has increased in corporations in the MENA region, this increase has been relatively slow, as mentioned previously. The pie chart below shows the contribution to ESG in the region in 2012. There has not been any significant change from the 2011 Index.

Figure 3 Contribution of MENA Region to ESG in 2012 (Source: Hawkamah)



Several challenges impede the improvement of corporate governance in the MENA region. According to Qatar Financial Centre Regulatory Authority (QFCRA), these challenges, outlined below, are mainly attributed to certain existing practices that organizations implement, as well as conflicting attitudes that certain companies and sectors embrace towards the corporate governance of their respective organizations.

3.1 Tight oversight of corporate management

As mentioned previously, a large number of companies in the region are family-owned, with the head of the family making all major decisions on the governance of the organization. This trend results in tight oversight of management and leaves little room for other shareholders to contribute to major corporate decisions. It also creates a culture that sees a company to be in the possession of one or more directors (often only family members), with the rest of the shareholders simply being 'along on the ride'. Although family control over enterprises in the region has worked well in the past, it is questionable whether this trend can be sustained in the future. Business development cannot always be achieved through retained earnings and credit, as competition is growing and resources are becoming limited. As such, governance practices should align ownership and management patterns with the developmental objectives of a company.

3.2 Deficiencies in corporate law

There is a lack of a proper corporate governance frameworks, which decreases the credibility of the organizations in the MENA region and hinders their ability to expand their access to capital.

If companies already have a corporate governance framework in place, its implementation and enforcement is often relatively weak. In many cases, political pressure at the board level results in long delays in the implementation of corporate governance laws. Moreover, administrative and criminal actions usually take precedence over corporate governance issues resulting in the poor implementation of these corporate laws.

The lack of a sound legal and regulatory corporate framework causes companies not to have sufficient guidelines and support to implement good corporate governance in their particular firms, even if they have the ambition and the resources to adjust their practices.

3.3 Lack of Commitment

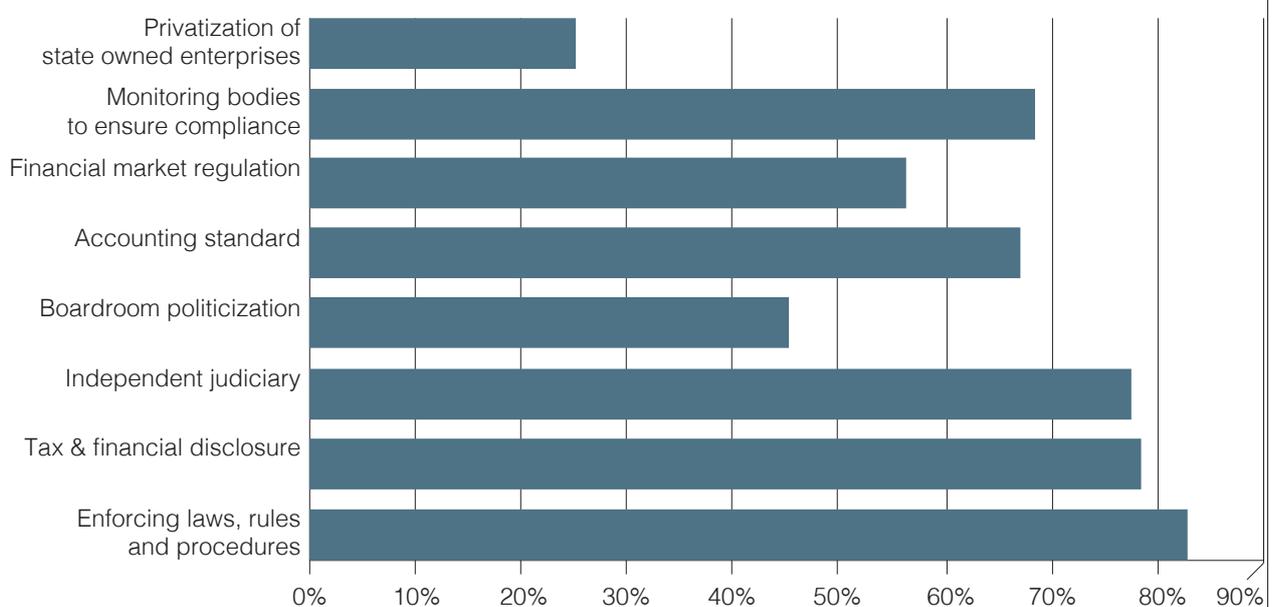
Executives and board members are usually not committed to making the necessary changes within the organization in order to lead and influence the formation of a solid corporate governance framework. In addition, concentrated ownership of mostly family-owned businesses further hinders the commitment towards improving corporate governance.

3.4 Inadequate Transparency and Disclosure Practices

Due to lack of internal controls, organizations show a deficiency in their transparency and disclosure practices. In many cases, these controls appear to be present on paper, but are actually not implemented in practice.

This trend is fostered by the lack of internal as well as external auditing practices, either due to negligence or incompetence, or due to a corporate culture that often supports fraudulent behavior and discourages integrity. As such, certain corporate governance reforms must be implemented on transparency and disclosure, equal treatment of shareholders and regulatory capacity building to ensure compliance.

Figure 4. Corporate Governance Priorities by Topic (Source: The Lebanese Transparency Association)



4. Analyzing the ESG Trends in the MENA Region

In order to begin the process of corporate governance reform, there needs to be a detailed assessment of governance practices in an organization in order to formulate an action plan. However, according to The Lebanese Transparency Association, only six countries in the region, including Algeria, Kuwait, Jordan, Morocco, Tunisia and UAE, have completed and published ROSC (Reports on the Observance of Standards and Codes) reports. Although Egypt and Lebanon have undertaken and completed reports on a number of topics, such as payment systems, data dissemination and banking supervision, they have not published these reports or made them widely available for the public.

Similarly, only four countries, including Algeria, Kuwait, Tunisia, and UAE, have conducted and published a Financial Sector Assessment Program, which the International Monetary Fund (IMF) and the World Bank usually conduct with countries. The purpose of the Financial

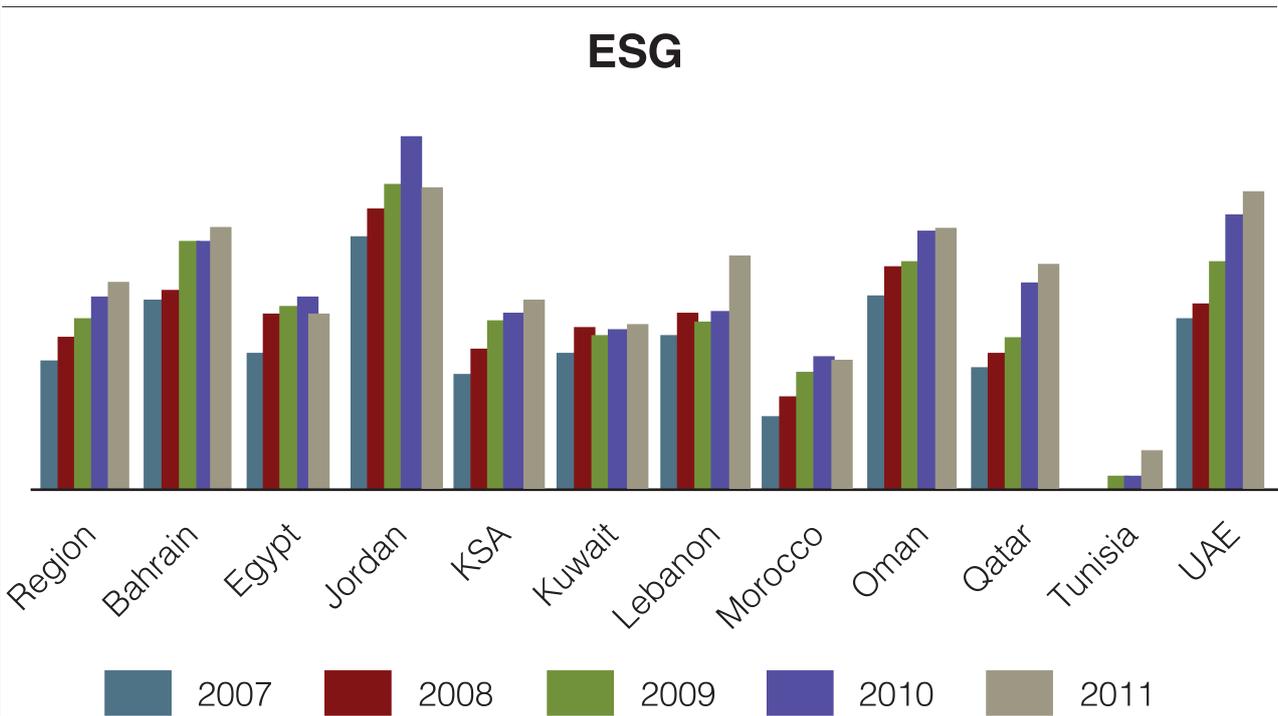
Sector Assessment Program is to evaluate compliance of countries' financial systems with the relevant standards and codes of their respective financial sector.

Moreover, only Egypt and Morocco conducted and published a national corporate governance survey, although Lebanon, Jordan and Tunisia are committed to publishing similar surveys as well. These deficiencies in reporting on the corporate governance practices in the MENA countries delay the process of change in policies, reform and modernization in this sector.

Environmental and social practice in the MENA countries have increased in line with corporate governance, as transparency and stakeholder engagement is becoming more prevalent and society is becoming a more influential factor to corporate decision making, in particular after the Arab Spring uprisings.

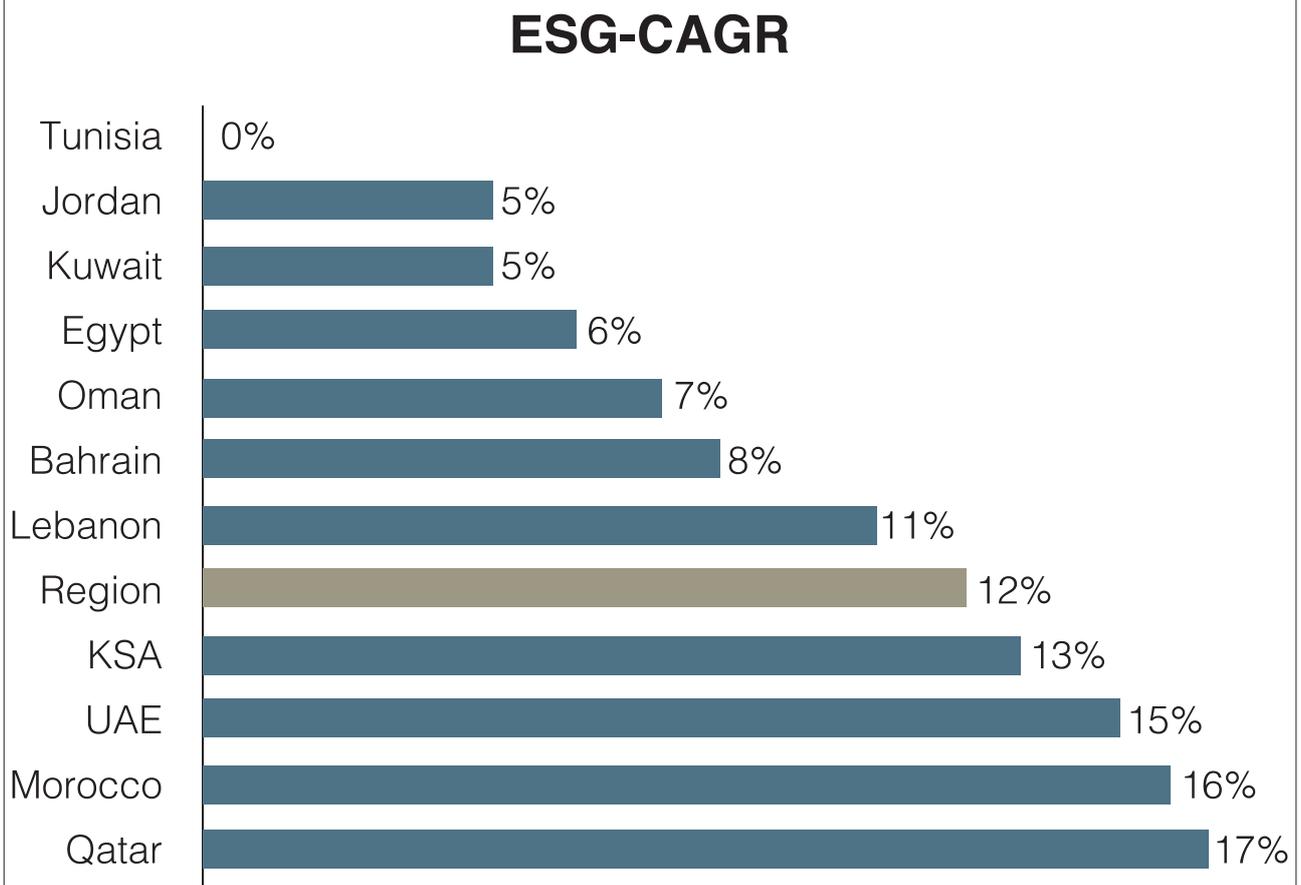
Figure 5, 6 & 7 illustrate the ESG trends in the region in recent years, as determined by Hawkamah.

Figure 5 ESG Trends in the Universe for 2008-2011 (Source: Hawkamah)



The graph above outlines the ESG trends in the Universe (all 150 companies in the Hawkamah universe). The MENA region has seen a steady increase in the number of companies reporting on their ESG performance. It is worth noting that Egypt's ESG score dropped due to political unrest, whereas Jordan's score decreased due to an increase in the number of companies reporting.

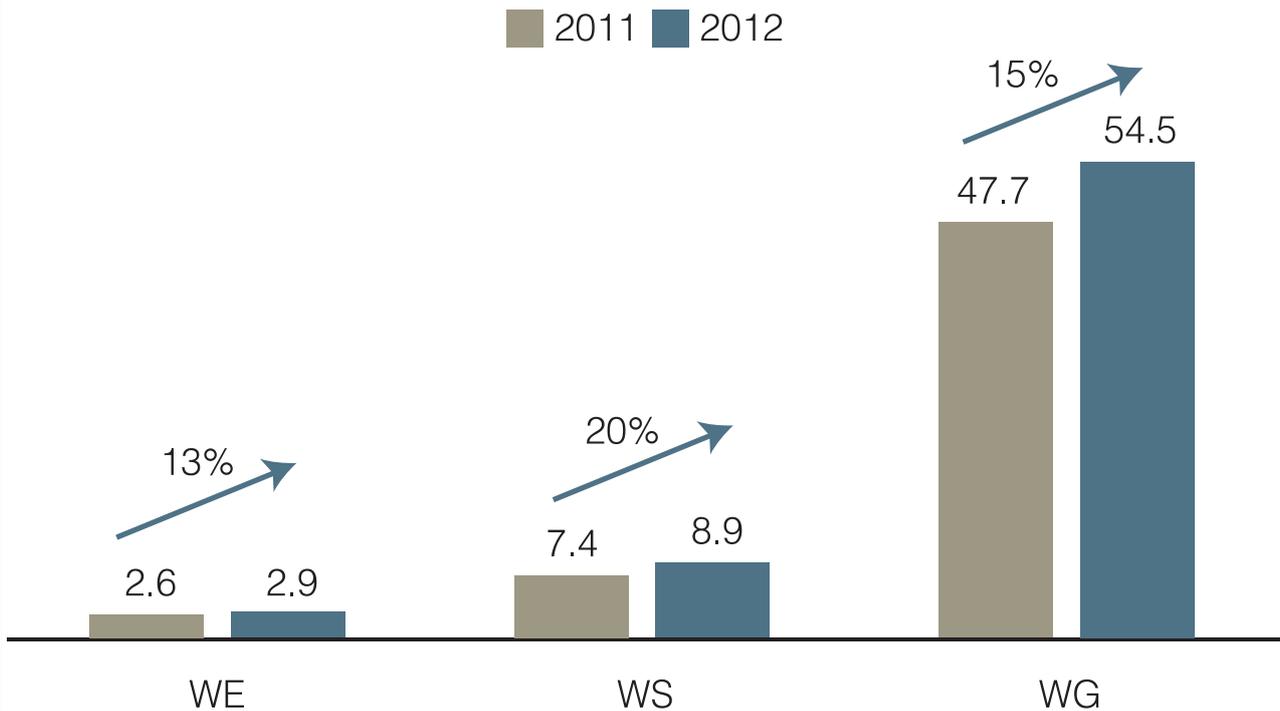
Figure 6 Compound Annual ESG Growth Rate per Country and the Region (Source: Hawkamah)



Compound annual ESG growth rate for 2012 is 12%, with Qatar and Morocco leading at 16% each. The reason for the high growth rate in both countries is that Moroccan companies have just recently started to report on ESG and Qatari companies have shown a relatively low participation in ESG reporting in the last years and have recently started to improve it steadily.

Figure 7 ESG Weighted Growth Rate for 2011-2012 (Source: Hawkamah)

Index 2011 v/s 2012 weighted



The graph above outlines the weighted growth rate for each of the ESG pillars (environment, social and governance) between 2011 and 2012. As seen from the graph, the region has experienced an increase among all three pillars, whereby the highest growth can be seen for the social pillar. However, considering the absolute figures, there is room for improvement for the social and the environmental pillar in particular.

5. ESG trends in emerging markets

As stated in the EIRIS report “Evolving Markets: what’s driving ESG in emerging economies?” emerging markets have experienced an increase in size as well as integration into the global economy in the last decade. This is largely due to the poor performance of many developed markets in recent years and the lingering volatility of the global stock markets.

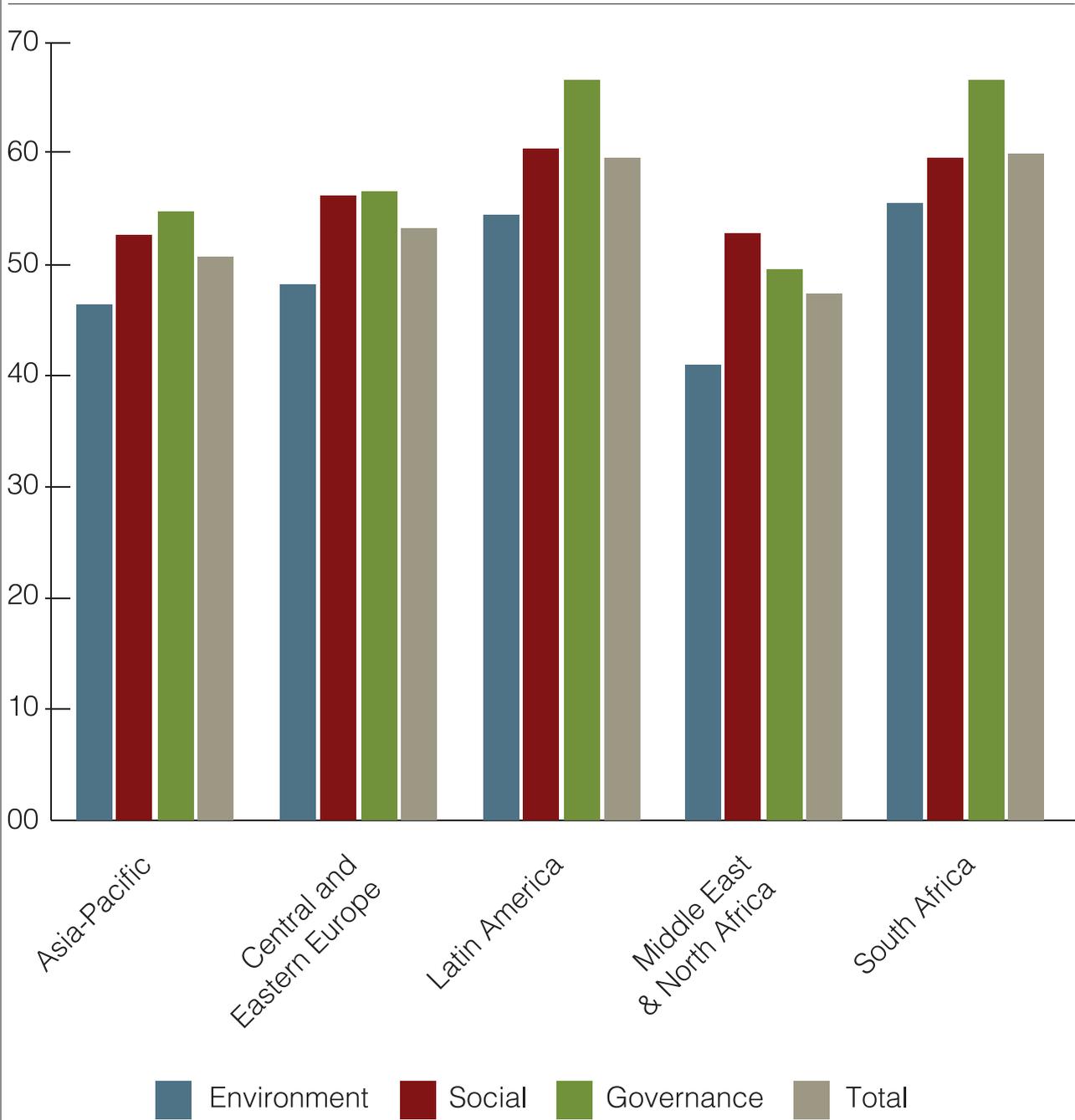
The leading emerging markets identified in the last decade have been Brazil, Russia, India, China, and South Africa, often referred to as the BRICS countries. In fact, investments in companies in these countries have significantly expanded over the last decade resulting in an increased demand from investors for ESG information in these economies.

Although emerging markets still constitute a relatively small fraction of direct global investment, it is expected that more investments will be directed towards these economies. Allocations to emerging markets actually increased by 30% between 2009 and 2012. Although

ESG integration in emerging markets has increased, poor ESG performance remains the number one challenge for investment in emerging markets. Deforestation activities in Brazil, conflict between different groups in India and labor issues in China are only a few examples of ESG issues that dictate the way different companies run their businesses and determine whether foreign investment occurs in these countries.

The figure on the following page provides a general comparison of ESG scores among emerging markets regions, as determined in the Sustainalytics report “Bridging the Gaps: Effectively Addressing ESG Risks in Emerging Markets.”

Figure 8 Average ESG score per geographic region (Source: Sustainalytics)



As seen in figure 8, the overall highest scoring companies are those in South Africa and Latin America in comparison to the overall lowest scoring companies in the Middle East & North Africa. It is important to note that even within these regions there are significant differences among countries.

Despite the aforementioned initiatives in emerging markets, governance and business ethics issues are still of major concern. As stated in the Sustainalytics report, family- and state-owned companies are common in emerging markets, which frequently causes minority shareholder interests not to be adequately represented. Furthermore, emerging market companies have lower reporting rates on corporate corruption than developed countries, because scrutiny from the government, non-governmental organizations and the media is lower than in emerging markets. Moreover, serious labor and human rights violations are widespread in those countries, but they are not adequately addressed.

As the impacts of climate change become more severe and other ESG issues become more alarming in emerging markets, it is expected that there will be increasing pressure from the civil society and the government for companies to improve their corporate practices. Moreover, since many of the companies in emerging markets serve as suppliers for the global economy, they will be required to standardize their systems and improve their transparency and disclosure levels on their relative ESG performance.

In fact, the UNPRI has established country and regional networks in a number of emerging markets including Brazil, South Africa and South Korea. This resulted in domestic investors in these countries becoming active and successful in raising awareness and developing ESG integration into corporate practices. It is expected that improvements will also follow on ESG reporting in these countries.

On the emerging market regional scale, the Dow Jones Sustainability Emerging Markets Index (DJSI Emerging Markets) was established in February 2013, to track the performance of the region's largest companies in leading their corporate sustainability. These companies are assessed by RobecoSAM, specialists in sustainability investing, to capture both general and industry specific criteria in the economic, social and environmental dimensions.

UNPRI's established networks as well as the possibility of being included in the DJSI Emerging Markets Index will act as an incentive for companies in the emerging markets to improve their sustainability initiatives, hence ensuring that key sustainability issues are addressed.

6. ESG trends in international markets

6.1 Reporting

In 2013, Ernst & Young and Green Biz published a joined report on the six growing trends in corporate sustainability, summarizing the results of monthly surveys to provide feedback on corporate initiatives, laws and regulations as well as specific scientific advances that are shaping the sustainability agenda. The report states that amid the dynamic environment, investors and stock exchanges are pressing companies even harder to assess and disclose sustainability issues considered material to stakeholders, and combine their financial and sustainability reporting. However, companies have been slow in implementing these demands.

The Report identifies six growing trends of sustainability, which are highlighted below.

6.1.1 The tone from the top

Corporate sustainability is shifting towards risk reduction and mitigation. The complexity of current corporate sustainability issues has led companies to realize that sustainability has to be firmly integrated within several aspects of the organization. Hence, sustainability is becoming more dispersed within and more fully integrated in the business than just one department or business function.

The method and degree to which companies disclose on their sustainability-related risks depends on top management's engagement in these issues. The more the CEO and board are involved, the greater the alignment between what companies voluntarily disclose and what they are mandated to disclose. Currently, there is a high level of CEO and CFO engagement, which reflects an increased incorporation of sustainability issues within the corporate agenda.

6.1.2 Governments and multilateral institutions aren't playing a key role in corporate sustainability agendas

For several years now, the government's role in promoting corporate sustainability has been lacking. As such, other parties, such as non-governmental organizations (NGOs), have stepped in to fill this void. These NGOs have been playing a major role in campaigning for sustainability causes and pushing for transparency and accountability amongst the organizations.

Moreover, stock exchanges are increasingly viewing sustainability issues as material to their listed companies. Similar to the Johannesburg Stock Exchange in South Africa and the BM&FBOVESPA in Brazil, the NASDAQ OMX (in the U.S. and eight other European countries) is promoting sustainability issues.

6.1.3 Sustainability concerns now include increased risk and proximity of natural resource shortages

Although company concerns about shortage of resources is not new, companies only recently started relating this threat to sustainability-related issues. As environmental, social and economical concerns continue to snowball, companies are realizing that their corporate sustainability is firmly linked to the availability of natural resources.

Among other risks such as climate change and rising greenhouse gas emissions, the water-security crisis is of particular concern for companies worldwide. As stated in the report, "in every sector, the demand for water is expected to increase, and analysis suggests that the world will face a 40% global shortfall between forecast demand and available supply by 2030." As companies anticipate that their core business objectives will be affected by natural resource shortages, they are increasingly considering these issues in their corporate governance practices.

6.1.4 Corporate risk response is not well paired to the scale of sustainability challenges:

Although companies recognize the looming risks associated with sustainability issues, they are failing to assess the materiality of each identified sustainability aspect. Consequently, they also miss to develop adequate counter-measures to control these risks and develop appraisals of the costs and benefits of different adaptive responses.

6.1.5 Integrated reporting is slow to take hold:

Currently, companies publish more than 5,000 sustainability reports a year. However, most of these reports are not written with investors in mind, and they vary in content and comprehensiveness.

Although Integrated Reporting (IR) would encourage transparency, reliability and stability, which would promote investors to make long-term investments, it is still in its early stages worldwide. Challenges include the difficulty to introduce certain concepts such as "natural capital", whereby environmental impacts are assigned to financial costs, as well as the rudimentary tools that companies are using in their reporting strategies.

6.1.6 Inquiries from investors and shareholders are on the rise:

Companies have been experiencing difficulties in coping with the large number of inquiries they receive from various stakeholders in relation to their sustainability performance. As demands for disclosure on environmental and social impacts have been increasing, the numbers of surveys and questionnaires sent to companies has also increased. These inquiries come from many different sources

including investors, customers, media, industry analysts, communities, government bodies and activist groups. As all these groups require different types of data and pose their questions in slightly different ways, it becomes difficult for companies to keep up with all these requirements.

6.2 ESG

As suggested from the trends mentioned above, developed markets are generally experiencing an increase in ESG integration. Governments, shareholders, asset managers as well as other related parties are strictly emphasizing ESG-conscious investing, as environmental and social concerns are mounting and governance issues continue to threaten the corporate ground.

The table on the following page shows the performance of the developed markets across the environmental (En), social (So) and corporate governance (CG) pillars, as determined by "Thomson Reuters Proprietary Research ASSET4 Insight: ESG Landscape Across Major Developed Markets". An integrated rating (IR), which is an equal-weighted score across the three pillars in addition to an economic pillar, is also identified in the table. The percentages within each category represent the degree to which the companies (shown in aggregate for each region) have integrated ESG policies and initiatives as identified under ASSET4. A higher score implies a better performance across all four pillars.

Table 1 ESG Performance Across Developed Markets, 2009 (Source: Thomson Reuters ASSET4)

Region	Country	IR	En	So	CG
Americas	Canada	39%	32%	32%	63%
	United States	48%	40%	43%	54%
Europe	France	74%	77%	77%	51%
	Germany	59%	67%	68%	30%
	Italy	55%	50%	63%	45%
	United Kingdom	70%	63%	66%	77%
Asia Pacific/Oceania	Australia	44%	42%	39%	66%
	Japan	40%	63%	50%	12%
	Hong Kong	35%	39%	37%	31%
	Singapore	36%	36%	39%	33%
Average		50%	51%	51%	46%

As seen in the table above, European countries are leading in ESG integration- showing some of the highest percentages in all the pillars. France is leading with an IR of 74%, whereas countries in Asian markets, such as Hong Kong and Singapore, are lagging behind, showing an IR of 35% and 36%, respectively.

European countries' leading performance in ESG issues is highly attributed to high disclosure as well as the introduction of more stringent regulations to address the growing ESG challenges. On the other hand, poor performance of Asian markets, specifically Japan, in implementing ESG practices is primarily attributed to having few independent/outside directors, no standardized voting rights/structure of institutional investors, and no formal disclosure of cross-holdings among companies.

Similarly, Canadian companies' poor performance, most prominently in the environmental pillar, is also a result of low disclosure and lack of legal requirements for companies to report on their environmental performance. Accordingly, North America continues to lag behind its European counterpart across all the pillars identified above aside from a few core companies.

Although corporate responsibility reporting was merely considered an optional activity, it is now considered a pivotal and mandatory endeavor for a large number of multinational companies in almost all parts of the world. Companies worldwide, especially large corporations, have come to realize the competitive advantage and the monetary return gained from improving their corporate governance strategy, hence it is expected that ESG integration will continue to increase in international markets.

7. ESG comparison matrix

The attached matrix shows the main ESG indicators and illustrates the level of adherence (rarely, sometimes, mostly) of the MENA region, emerging markets and international markets to these indicators in their corporate practices.

As international markets are quite advanced in ESG integration, organizations in these markets generally comply with all of the identified indicators in their corporate practices.

Emerging markets are slightly less developed in ESG integration, particularly in the governance and business ethics parameter, as previously mentioned. Generally, companies in these markets show promise in their adherence to these ESG criteria, improving predominantly in their environmental performance. However, they also need to improve in the social and economic parameters in order to reach the ESG maturity level of international markets.

As for the MENA region, it is still in its early stages of ESG integration. As seen in the matrix, the region has embarked on addressing issues pertaining to environmental, social and governance issues. On the social side, there has been a shift from corporate philanthropy and 'zakat' to a more structured community investment approach. On the environmental side, efforts are being made on smaller scales within premises, and on a bigger scale through implementation of energy management practices such as implementing the ISO 50001 standard. However, these initiatives are not wide-spread yet and require some major improvements.

8. Conclusion

Although ESG integration in the region has increased in the last few years, it is still in its early stages. This is due to several characteristics of the region's economies that shape the way corporations operate, as well as historical and cultural reasons. Environmental and social consciousness, transparency and stakeholder engagement are still developing and will not change overnight. These

challenges are mainly attributed to lacking ambition of companies to embrace towards enhancing their corporate governance and sustainability strategies.

Many emerging markets have shown great improvement in ESG integration in the last decade. In fact, investment in these countries has increased greatly over the last few years resulting in an increased level of sustainability reporting amongst companies in that region. In addition, the Dow Jones Sustainability Emerging Markets Index (DJSI Emerging Markets) was established to track the performance of the region's largest companies in leading their corporate sustainability. This further drove companies in these markets to continually enhance their sustainability initiatives in order to be included in the index.

On an international level, reporting on sustainability has become common practice for all multinational companies. While European countries continue to lead in their corporate responsibility reporting, other regions are quickly catching up, highlighting the importance of ESG integration in influencing the performance of companies worldwide.

Definitions

BM&FBOVESPA	Stock exchange located at Sao Paulo, Brazil
BIRC	An acronym that refers to the economies of Brazil, Russia, India and China, which are seen as major developing economies in the world.
BSR	BSR works with a global network of more than 250 member companies to help them develop sustainable business strategies and solutions through consulting, research and cross-sector collaboration.
EIRIS	A global leader in the provision of environmental, social, governance (ESG) research for responsible investors. It is a not-for-profit organization, which conducts independent assessments of companies' ESG performance, and provides advice on integrating relevant ESG issues with investment decisions.
IFC	International Finance Corporation. Member of the World Bank Group, and the largest global development institution focused exclusively on the private sector in developing countries. It allows companies and financial institutions in these countries to create jobs, improve corporate governance and environmental performance, and contribute to their local communities.
IIRC	The International Integrated Reporting Council. It is a global coalition of regulators, investors, companies, standard setters, the accounting profession and NGOs, which has been leading the development of a global framework for Integrated Reporting in order to induce value creation for companies over time.
IMF	International Monetary Fund. An organization of around 188 countries, working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world.

OECD Organization for Economic Co-operation and Development. It is an international economic organization of 34 countries to stimulate economic progress and world trade. It serves as a platform for countries to compare policy experiences, seek answers to common problems, identify good practices and co-ordinate domestic and international policies of its members.

QFCRA Qatar Financial Center Regulatory Authority. It is an independent regulator of the Qatar Financial Center (QFC), which was established to authorize and regulate firms and individuals conducting financial services in or from the QFC.

The Lebanese Transparency Association The National Chapter of Transparency International in Lebanon. It is pursuing initiatives in the following 4 main programs:

- Democratization and Public Accountability
- Promoting Access to Information
- Transparency in the Private Sector
- Youth against Corruption

Thomson Reuters ASSET4 Provides objective, relevant and systematic environmental, social and governance (ESG) information based on 250+ key performance indicators (KPIs) and 750+ individual data points along with their original data sources. Professional investors use this ESG data to define a wide range of responsible investment strategies and integrate it into their traditional investment analysis.

UNPRI An initiative and a set of voluntary guidelines for investment entities wishing to address environmental, social and corporate governance issues.

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2013 six growing trends in corporate responsibility – Ernst & Young Report

SUSTAINABLE INVESTING IN S&P/HAWKAMAH ESG PAN ARAB INDEX

AUTHORED BY JULIA KOCHETYGOVA, S&P DOW JONES INDICES

Sustainability investing is becoming more and more important to the marketplace. Over the last several decades, we have observed continuous growth of investors' interest towards sustainable and responsible investments (SRI). This interest has been prompted by the United Nations Principles of Responsible Investments (UN PRI) initiative and supported by various academic studies showing advantageous risk and return parameters of SRI comparing them with more conventional forms of investing. The potential downside risk protection provided by the SRI approach has been a focus in the latest studies on the portfolio performance during the credit crisis period of 2008-2013². As shown by the US SIF studies, during the sharpest phase of the financial crisis, from 2007 to 2010, the overall universe of professionally managed assets has remained roughly flat while SRI assets grew by 13%³.

In Europe, the growth of sustainable investments has been particularly impressive having increased by 39% over two years (2009-2011) to the level of 7.4 trillion euros⁴. Growth of SRI is becoming an important trend in the Middle East and Asia too. More than 130 investment managers in Asia use sustainable investment approaches, and there is 74\$bn of identified sustainable investment assets under management in the region, according to a report by the Association for Sustainable & Responsible Investment in Asia (ASrIA)⁵. In the Middle East and Northern Africa region (MENA), according to the report issued by IFC in 2011, the total sustainability-related assets under management (AUM) were estimated to be at 54.25\$ billion, or 17.1\$ billion without Shariah-compliant investments⁶. The demonstrated interest from asset owners, however, is much higher, with the leading positions taken by the government pension schemes and sovereign wealth funds.

The array of sustainable investing strategies has become quite wide in recent years, varying from ethical values based exclusions to a more value-based approach, seeing it as simply "good business," over the long term, to be concerned about sustainability. Coupled with another recent market trend, which is the worldwide growth of passive investments⁷, the growth of the sustainably investments supports the growing interest to, and the development of, sustainability indices. S&P Dow Jones Indices has designed several types of sustainability indices focusing on the needs of different types of investors in different regions, and the company keeps working on new indices of this kind.

Jointly developed by S&P Dow Jones Indices and Hawkamah (The Institute for Corporate Governance for

the MENA region), the S&P/Hawkamah ESG Pan Arab Index measures the performance of 50 of the stocks with the highest score in the MENA region as measured by environmental, social and governance factors⁸.

The S&P/Hawkamah ESG Pan Arab Index is the first Pan Arab Index of its kind in the Pan Arab region. S&P DJI's innovative ESG methodology is based primarily on quantitative factors, bringing in qualitative analysis as an overlay. For the first time, environmental, social, and corporate governance 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 companies with the highest score in the environmental, social and corporate governance areas, but also is designed to be efficiently representative of the Pan Arab equity markets by excluding small and illiquid securities. Screened annually, the index uses an innovative ESG score-weighting scheme to ensure that stocks with higher ESG scores have a greater influence on the index than those with lower ESG scores.

The index constituents are selected from a universe of the top 150 Pan Arab companies (based on total market capitalization), listed on the national exchanges of Bahrain, Egypt, Jordan, Lebanon, Kuwait, Morocco, Oman, Qatar, Saudi Arabia, Tunisia, and the United Arab Emirates, subject to a liquidity screen. The index comprises the 50 highest-scoring stocks, according to their composite ESG scores from the selection universe, subject to a maximum individual country representation of 15 stocks. The scoring process includes, as the first step, assessing companies' levels of transparency and disclosure in the areas of environment, social and governance, and then looking at their actual sustainability performance characteristics, based on independent sources of information, news stories, web sites, and CSR reports. Existing indices have 197 indicators/questions covering environment, social or corporate governance dimensions. Weighting of items differs by sector based on their impact. As a result of the scoring process, composite ESG score is assigned, and each company's weight in the index is determined as a function of its ESG score.

The S&P/Hawkamah ESG Pan Arab Index serves as an investment and benchmarking tool for both purely sustainable investors and those who want to apply passive strategy with an ESG overlay. Historically it has demonstrated strong performance implying positive correlation between companies' sustainability practices

¹ See for instance: Eccles, Ioannou, Serafeim, Harvard Business School. "The Impact of a Corporate Culture of Sustainability on Corporate Behavior and Performance", 2011

² See for instance: Hoepner, Yu, Ferguson "ESG integration in 10 GICS industries", 2010

³ Report on Socially Responsible Investing Trends in the United States, 2010

⁴ EuroSIF. European SRI Study 2012.

⁵ Investment & Pensions Asia. 9 January 2013. Sustainable investing becoming a significant force in Asia

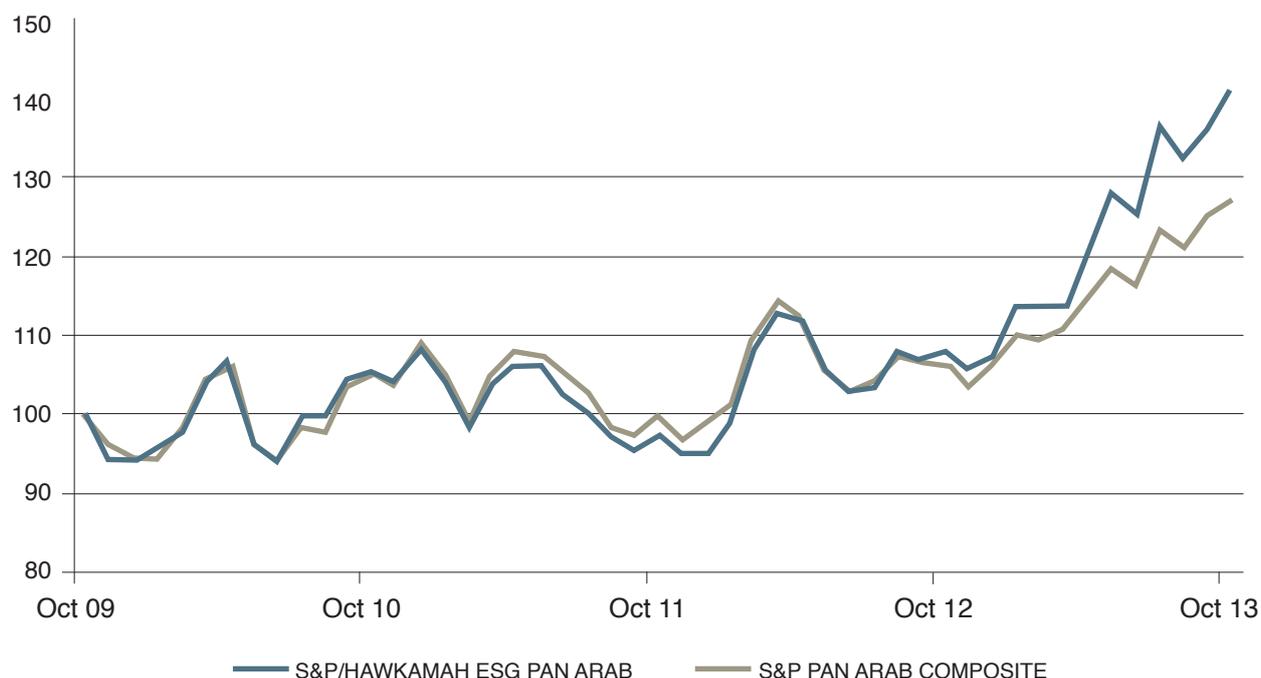
⁶ IFC. Sustainable Investment in the Middle East and North Africa Region Report. 2011

⁷ For information on this trend, see <http://eu.spindices.com/resource-center/thought-leadership/spiva/>

⁸ See S&P/Hawkamah ESG Pan Arab Index Factsheet. <http://us.spindices.com/indices/equity/sp-hawkamah-esg-pan-arab-index>

and their stock valuations. Figure 1 below shows comparative performance of the S&P/Hawkamah ESG Pan Arab Index and the S&P Pan Arab Index over the period of four years. And Table 1 shows key quantitative characteristics of both indices.

Figure 1. Comparative performance of the S&P/Hawkamah ESG Pan Arab Index and the S&P Pan Arab Index



Source: S&P Dow Jones Indices LLC. Data as of October 2013 ,31. Index performance is based on USD total return index levels. Charts and graphs are provided for illustrative purposes. Past performance is no guarantee of future results. The inception date of DJSI Diversified Family of Indices was February 2011 ,1, at the market close. All information presented prior to the index inception date is back-tested. Back-tested performance is not actual performance, but is hypothetical. The back-test calculations are based on the same methodology that was in effect when the index was officially launched. Complete index methodology details are available at www.spdji.com.

Table 1. Key performance characteristics of the S&P/Hawkamah ESG Pan Arab Index and S&P Pan Arab Index

Annualized Returns			
Index	1YR Return	3YR Return	5YR Return
S&P/Hawkamah ESG Pan Arab Index TR	30.52%	10.21%	11.11%
S&P Pan Arab Composite (TR)	19.75%	6.67%	5.68%
Annualized Volatility			
Index	1YR Risk	3YR Risk	5YR Risk
S&P/Hawkamah ESG Pan Arab Index TR	13.01%	13.44%	17.67%
S&P Pan Arab Composite (TR)	8.88%	11.55%	16.74%
Sharpe Ratio			
Index	1YR	3YR	5YR
S&P/Hawkamah ESG Pan Arab Index TR	0.471	0.085	-0.031
S&P Pan Arab Composite (TR)	0.357	0.016	-0.108

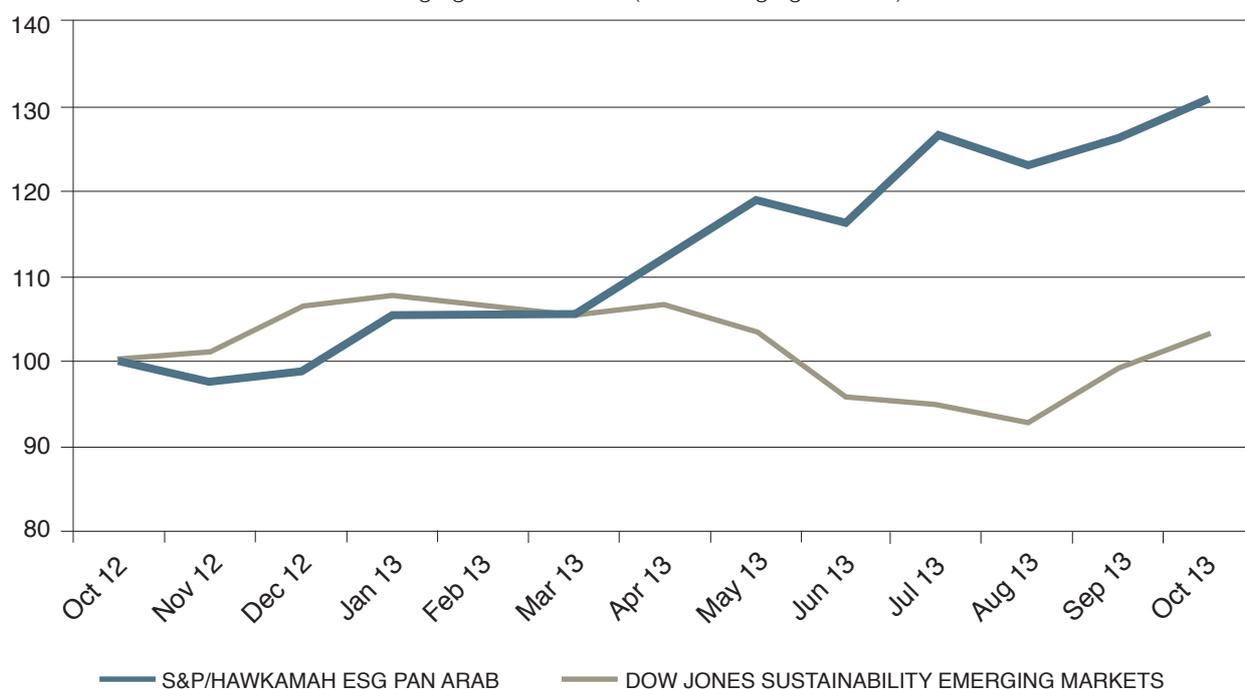
Source: S&P Dow Jones Indices LLC. Data as of October 2013 ,31. Index performance is based on USD total return index levels. Charts and graphs are provided for illustrative purposes. Past performance is no guarantee of future results. The inception date of DJSI Diversified Family of Indices was February 2011 ,1, at the market close. All information presented prior to the index inception date is back-tested. Back-tested performance is not actual performance, but is hypothetical. The back-test calculations are based on the same methodology that was in effect when the index was officially launched. Complete index methodology details are available at www.spdji.com.

It is important to note that even though the S&P/Hawkamah ESG Pan Arab, as a more concentrated index, has demonstrated higher volatility in each of the periods, its risk-adjusted returns are still better than those of a more diversified and ESG-neutral S&P Pan Arab Composite Index. This supports the idea of materiality of the sustainability characteristics of companies in the financial context. As evidenced by this index, the ESG-related considerations can have an impact on companies' business and financial performance in the form of either better controlled risks, or better captured business opportunities. Sustainability may not only be viewed from a perspective of the benefits for society and environment. As generally observed, more sustainable companies happen to be also more efficient, more innovative and stronger branded businesses, they are better places to work and are able to attract more devoted workforce. This appears to pay back to them in the form of

increased investor interest and wider investor base, which is reflected by the performance of sustainability indices in their role of investment and benchmarking tools.

Most sustainable companies in the Middle East have recently demonstrated stronger performance than their peers from global emerging markets, as evidenced from comparison between the S&P/Hawkamah ESG Pan Arab Index and the Dow Jones Sustainability Emerging Markets Index. The latter index is produced jointly by S&P Dow Jones Indices and Swiss-based sustainability investment and research company RobecoSAM. This is a best-in-class index that selects the top 10 percent of companies in each industry by their total sustainability scores assigned by RobecoSAM. The total return of the S&P/Hawkamah ESG Pan Arab Index was approximately 10 times higher than that of the DJSI Emerging Markets.

Figure 2. Comparative performance of the S&P/Hawkamah ESG Pan Arab Index and the Dow Jones Sustainability Emerging Markets Index (DJSI Emerging Markets)



Source: S&P Dow Jones Indices LLC. Data as of October 2013 ,31. Index performance is based on USD total return index levels. Charts and graphs are provided for illustrative purposes. Past performance is no guarantee of future results. The inception date of DJSI Diversified Family of Indices was February 2011 ,1, at the market close. All information presented prior to the index inception date is back-tested. Back-tested performance is not actual performance, but is hypothetical. The back-test calculations are based on the same methodology that was in effect when the index was officially launched. Complete index methodology details are available at www.spdji.com.

APPENDIX 1: Governance Criteria

Shareholder Capital

Disclosure of:

1. The number of issued and outstanding ordinary shares disclosed.
2. The number of issued and outstanding other shares disclosed (preferred nonvoting)
3. The par value of each ordinary share disclosed.
4. The identity of the largest shareholder
5. The identity of holders of all large stakes (blocking > 25 percent, controlling > 50 percent).
6. The identity of shareholder holding at least 25 percent of voting shares in total.
7. The identity of shareholders holding at least 50 percent of voting shares in total
8. The identity of shareholders holding at least 75 percent of voting shares in total
9. The number and identity of shareholders each holding more than 10 percent.
10. Shareholding in the company by individual senior managers.
11. Shareholding in the company by individual directors.
12. The description of share classes provided.
13. A review of shareholder by type.
14. Cross-ownership.

Extra Point Question

Disclosure that:

1. Company's articles of association or by-laws are accessible over the web

Shareholder rights

Disclosure of:

15. The contents of any corporate governance charter or code of best practices.
16. Existence of a Code of business conduct and ethics.
17. The contents of the Code of business conduct and ethics.
18. The changes in company's articles of association
19. The existence of voting rights for each voting or nonvoting share.
20. The transparency of the way that shareholders nominate directors to the board.
21. The transparency of the way by which shareholders convene an extraordinary general meeting.
22. The transparency of the procedure for initiating inquiries with the board.
23. The transparency of the procedure for putting forward proposals at shareholders meetings.
24. A formalized dividend policy
25. The existence of a review of the last shareholders meeting.
26. Full general shareholders meeting (GSM) minutes.
27. The existence of a calendar of important shareholders dates.

Financial Information

Disclosure of:

28. The company's accounting policy.
29. The accounting standards it uses for its accounts.
30. Whether the accounts meet local accounting standards.
31. Annual financial statements according to an internationally recognized accounting standard (IFRS/U.S. GAAP).
32. Notes to annual financial statements according to IFRS/U.S. GAAP.
33. Independent auditors report with regard to annual financial statements according to IFRS/U.S. GAAP.
34. Unqualified (clean) audit opinion with regard to annual financial statements according to IFRS/U.S. GAAP.
35. Disclosure of related party transactions (RPTs): sales to/purchases from, payables to/receivables from related parties.
36. Indication that RPTs are made on market or non-market terms.
37. Interim (quarterly or semiannual) financial statements according to an internationally recognized accounting standard (IFRS/U.S. GAAP).
38. Notes to such financial statements.
39. Whether these financial statements are audited or at least reviewed.
40. A basic earning forecast of any kind.
41. A detailed earnings forecast.
42. Financial information on a quarterly basis.
43. Segment analysis (results broken down by business line).
44. Revenue structure (detailed breakdown).
45. Cost structure (high degree of detail).
46. The name of company's auditing firm.
47. A copy of the auditors report.
48. How much the company pays in audit fees to the auditor
49. Non-audit fees paid to the auditor.
50. Whether there are consolidated financial statements or whether only the parent or holding company is audited.
51. Methods of asset valuation.
52. Information about the method of calculating fixed-asset depreciation.
53. A list of affiliates in which the company holds a minority stake.
54. The ownership structures of affiliates.

Extra Point Questions

Disclosure that:

2. Company's independent auditor reports directly to an independent audit committee (at least 66 percent independent)
3. Auditor does not also provide non audit services greater in value than 25 percent of total audit fees
4. Auditor does not provide any non audit services

Operational Information

Disclosure of:

55. Details of the kind of business the company engages in.
56. Output in physical terms (values of sales for services sector companies)
57. Characteristics of fixed assets employed.
58. Efficiency indicators.
59. Any industry-specific ratios.
60. A discussion of corporate strategy.
61. Any plans for investment in the coming years.
62. Detailed information about investment plans in the coming years.
63. An output forecast of any kind.
64. An overview of trends in its industry.
65. The market share for any or all of the company's businesses.

Board and management information

Disclosure of:

66. The list of board members (names).
67. Details about directors other than name and title.
68. Details about other employment and position of independent directors
69. Details about the directors' previous employment and positions.
70. When each director joined the board.
71. A named chairman listed.
72. Details about the chairman, other than name and title.
73. Details about role of the Board of Directors at the company.
74. A list of matters reserved for the board.
75. A list or board committees.
76. Names of all members of each existing committee.
77. Whether there are internal audit functions besides the Audit Committee.
78. Attendance record for board meetings.
79. The list of senior managers not on the Board of Directors.
80. The backgrounds of senior managers.
81. The non-financial details of the CEO's contract.
82. The number of shares held in other affiliated companies by managers.

Extra Point Questions

Disclosure that:

5. Independent directors constitute more than 33 percent of the board.
6. Independent directors constitute more than 50 percent of the board.
7. Independent directors constitute more than 67 percent of the board.
(Note here the incremental build up of points if all three are answered positively, which is another way to provide weightings of independence. This should be regardless of whether or not the CEO is also Chairman)
8. Board size is no less than 7 and no more than 18.
9. CEO and Chair is not the same person.
10. Voting in AGM-s takes place by poll rather than by a show of hands
11. Audit committee is over 50 percent independent
12. Audit committee is at least 66 percent independent
13. Audit committee is 100 percent independent
14. Nomination or governance committee is over 50 percent independent
15. Nomination or governance committee is at least 66 percent independent
16. Nomination or governance committee is 100 percent independent
17. Compensation committee is over 50 percent independent
18. Compensation committee is at least 66 percent independent
19. Compensation committee is 100 percent independent
20. A risk management committee exists at the board level
21. No directors sit on more than 3 other public company boards
22. All board members have attended more than 75 percent of board meetings
23. All board members have attended more than 90 percent of board meetings
24. Board conducts regular self evaluation.
25. Independent board members regularly meet together independently of the company's executive management
26. Board meets more than 4 times per year.

Board and management remuneration

Disclosure of:

- 83. The decision-making process for directors' pay.
- 84. The specifics of directors' pay, including the salary levels.
- 85. The form of directors' salaries, such as whether they are in cash or shares.
- 86. The decision-making process for determining managerial (not board) pay.
- 87. The specifics of senior management (not board) pay, such as salary levels and bonuses.
- 88. Performance related indicators guiding senior management compensation.

Extra Point Question

Disclosure that:

- 27. Board has a formal training program for directors or provides external training

BUSINESS ETHICS AND CORPORATE RESPONSIBILITY

Corporate Governance

Disclosure of:

- 89. Policy and procedures on whistle blowing
- 90. Policy and procedures on insider trading
- 91. Contribution to political parties

Corruption

Disclosure of:

- 92. Disclosure on policy and procedures on bribery and corruption

Leadership

Disclosure of:

- 93. Stated commitment to recognize corporate responsibility standards
- 94. CEO statement regarding corporate governance
- 95. CEO statement regarding corporate responsibility/CSR
- 96. Signatory to recognized global CSR conventions (e.g. Global Compact, Global Sullivan)

Business Ethics

Disclosure of:

- 97. Publication of CSR report
- 98. CSR report audited or independently assured
- 99. Report under GRI framework
- 100. Social and environmental performance in operational MD&A or operational analysis

APPENDIX 2: Environmental & Social Criteria

ENVIRONMENT

Environmental Pollution

Disclosure of:

1. Emissions of greenhouse gases
2. Emissions of ozone-depleting substances
3. NO_x, SO_x and other emissions
4. Physical or regulatory risks associated with climate change
5. Policy on management of emissions or regulatory risks associated with climate change

Extra Point Question

Disclosure of:

1. Defined targets relating to emission
2. A committed carbon credit programme

Natural Resources Use

Disclosure of:

6. Energy consumption broken down by primary energy source
7. Use of renewable resources of energy
8. Total energy saved due to conservation and efficiency improvements
9. Initiatives to reduce energy consumption or energy audit
10. Defined targets relating to energy conservation
11. Type of raw materials used
12. Percentage of materials used that are recycled
13. Initiatives to improve efficiency of material usage
14. Policies/Initiatives for management of water use
15. Total water used
16. Total water used by source
17. Policy/initiatives taken for management of hazardous waste
18. Policy for management of (waste) water discharged

Extra Point Question

Disclosure of:

3. Production of energy efficient products (e.g. solar panels)

Management Policy and Performance Indicators

Disclosure of:

19. Information relating to product life cycle
20. Incidents of, and fines or non-monetary sanctions for, non-compliance with applicable environmental regulations
21. Environmental impact of type of transportation used for logistical purposes
22. Explicit environmental policy
23. Efforts to preserve biodiversity (e.g. plantation of tree)
24. Management system/certification regarding environmental practices (that is status on ISO 14001 certification)
25. Policy on disaster management

Extra Point Question

Disclosure of:

4. EMS in all location/ facilities and 100 percent ISO 14001 certification

ENVIRONMENT

Employee Relations/Job Creation

Disclosure of:

26. Programs for career development
27. Initiatives to involve employees in decision making (including intra-management level communication etc.)
28. Information on policy/rules relating to non-financial benefits to employees (including housing etc.)
29. Information on policy/rules relating to healthcare
30. Policy/Rules relating to employee separation and lay off
31. Policy/Rules for profit sharing (stock options etc.) with lower management/employee

Labor Rights

Disclosure of:

32. Management system/certification regarding employment and labour practices (that is the status on SA 8000 certification)
33. Policy on code of conduct for protecting human rights
34. Initiatives to enforce the above policy
35. Number of strikes/ lockouts and the number of employees involved

Extra Point Question

Disclosure of:

5. SA 8000 certification at all locations/facilities
6. Reference to ILO core convention in code of conduct
7. Code of conduct applies to supply chain as well

Employee Health & Safety (H&S)

Disclosure of:

36. Explicit health and safety policy
37. Incidents of work related injury/ accidents
38. Initiatives on employee health and safety
39. Dissemination of health based knowledge and training including awareness about HIV/AIDS
40. Management system/certification regarding health and safety practices (that is status on OHSAS 18000 certification)

Extra Point Question

Disclosure of:

8. OHSAS 18000 certification at all locations/facilities

Equal Opportunity

Disclosure of:

41. Explicit statement about equal opportunity employer (gender, caste, religion etc.)
42. The gender breakdown of total workforce
43. Number of employees by ethnicity or caste (whatever applicable)
44. Initiatives for promoting employment of women and/or disabled people.
45. Policy on discrimination in employment/treatment of employees affected with HIV aids
46. Policy/Rules to address incidence of sexual harassment and recourse

Extra Point Question

Disclosure of:

9. The Board of Directors has an independent women director

Union Relations

Disclosure of:

47. Number or percentage of employees that are unionized

COMMUNITY

Human Rights

Disclosure of:

48. Policy or code of conduct on addressing human rights (e.g. child labour, forced labour, bonded labour etc.)

Community Investment

Disclosure of:

49. Explicit policy/statement regarding community investment
50. Initiatives on community awareness or education
51. Company participation in public-private initiatives for community development
52. Description/Amount of total contributions/donations to charitable initiatives (health, education etc)
-

CUSTOMERS/PRODUCT

Product Safety

Disclosure of:

53. Policy/procedures on recall of product

Anti-trust

Disclosure of:

54. Policies covering fair practices and monopolistic practices

Customer Outreach and Product Quality

Disclosure of:

55. Annual expenditure incurred on customer awareness initiatives
56. Number of customer satisfaction surveys conducted in a year
57. Mechanism for redressing grievances and feedback from customer
58. Policy/procedures for protection of customer confidentiality/privacy
59. Procedures and programs for adherence to laws, standards, and voluntary codes related to marketing communications including advertising, promotion and sponsorship
60. Policy/procedures on customer education regarding product/service provided
61. Management system/certification regarding product quality (status on ISO 9000/Six sigma)



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