

Saudi Stock Market Opens for Foreign Investment

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Recent volatility in listed share values has again highlighted weaknesses in the KSA capital market when the Tadawul All Shares Index nose dived following plummeting oil prices. Many market commentators remarked that the extent of the dive was, to a large extent, unjustified.

Unlike most other stock exchanges, the vast majority of significant investors in Tadawul are local retail investors having short term goals underpinning their investment strategy.

In 2008 the Capital Market Authority ("**CMA**") introduced equity swap arrangements where foreign investors could purchase only the economic benefit of listed shares for a defined period of time. Swaps never attracted the level of investment the CMA hoped for mainly because they were cumbersome to implement and gave no underlying shareholder rights.

On 25/10/1435H (corresponding to 21/08/2014G), the CMA issued draft rules enabling certain qualified foreign institutions to directly access share trading on Tadawul for themselves and on behalf of their clients. The CMA invited comments in regard to these draft rules.

The rationale behind opening up the Tadawul for direct foreign investment is largely the following:

- improvement in market stability and a reduction in pricing volatility;
- an increase in local expertise of financial markets;
- encourage listed entities to raise their overall performance;
- improved corporate governance and transparency for listed entities; and
- lift the international rating of Tadawul.

The last point above is very important because it is envisaged that by mid-2017 Tadawul will be classified as an emerging market under global indices. Should Tadawul achieve this status then many believe the resultant direct foreign investment will be in the region of USD50 Billion

Finally on 15/07/1436H (corresponding to 04/05/2015G), the CMA formally released the "Rules for Qualified Foreign Financial Institutions Investment in Listed Shares", pursuant to Resolution Number 1-42-2015 ("**Rules**").

The Rules became effective from 01/06/2015G with a planned live opening two weeks later and mark a significant move towards the long-awaited opening of the KSA capital markets to foreign investment.

Under the Rules, investors will be able to exercise shareholder rights that include voting, participation in appointing board members and trading in rights issues. These rights were not present in equity swap arrangements.

Overview of Rules for Qualified Foreign Financial Institutions for Investment in Listed Shares

The objectives of the Rules are the following:

- to set out the procedures, requirements and conditions for the registration of a qualified foreign investor (“**QFI**”) – (defined as a foreign investor registered with the CMA in accordance with these Rules to invest in listed shares);
- to set out the procedures, requirements and conditions for the approval of QFI clients to invest in listed shares; and
- to specify the obligations of KSA registered securities businesses in their dealings with a QFI.

Eligibility for Registration as a QFI

Broadly speaking, in order to qualify as a QFI, an applicant must satisfy each of the following criteria:

- be a bank (including a central bank), brokerage/securities firm, fund manager or insurance company and must be duly licensed or otherwise subject to regulatory oversight and incorporated in a jurisdiction that applies regulatory and monitoring standards equivalent to those of the CMA;
- have assets under management of at least USD5 Billion, subject to discretionary reduction by the CMA to USD3 Billion; and
- have been engaged in securities and investment related activities for at least five years.

The Rules do not apply to nationals and companies of States that are members of the Cooperation Council of the Arab States of the Gulf as these persons may invest directly in KSA listed shares.

Authorised Assessing Person

An application for registration as a QFI must be made by submitting an application in the prescribed form to an assessing authorised person (“**AAP**”). An AAP must be a KSA registered securities business licensed to conduct securities dealing activity and authorised by the CMA to review, process and submit to the CMA the application by a foreign applicant to become a QFI.

The AAP will not approve the assessment unless the applicant agrees to enter into a QFI Assessment Agreement that meets the minimum requirements specified in the Rules.

As an additional condition, where an applicant intends to invest in listed shares on behalf of one or more of its clients, an application for approval of the client(s) in question as approved QFI clients must be made by submitting an application in to an AAP.

Approval of QFI’s Clients

A QFI can invest in listed shares on behalf of clients where the client has itself been approved in accordance with the Rules.

Broadly speaking, in order for a QFI client to be approved, the following must be considered:

- The QFI or the applicant must be responsible for the management of the client funds when invested in listed shares;
- The client is neither a QFI nor approved QFI client of another QFI; and
- The client is either:

(a) an investment fund incorporated in a jurisdiction that applies regulatory and monitoring standards equivalent

to those of the CMA; or

(b) a financial institution that meets each of the eligibility criteria that are applicable to the QFI itself.

In order to become a QFI client, various pieces of documentation are required to be submitted to the AAP. The overall process to become registered as a QFI or QFI client is expected to take around 11 days from the time the AAP receives the necessary documentation.

Interestingly there are no CMA registration fees planned for 2015 although the CMA will review this for 2016. The agreement between an AAP and the QFI will details what the agreed fee structure is between these two entities.

Commencement of Trading

A QFI cannot commence trading or invest in any listed shares unless it:

- holds a client account;
- holds an account with the Depository Centre; and
- has satisfied any conditions as may be imposed by the CMA.

While not clear in the Rules, it is expected that QFIs will be able to have direct access to Tadawul via an electronic platform provided by the AAP and able to buy/sell KSA listed shares. The trading times for listed shares on Tadawul are 11am to 3.30pm Sunday to Thursday (excluding official holidays).

To facilitate trading on the Tadawul, the Saudi Arabian Monetary Agency (KSA Central Bank) has issued a circular to all KSA licensed banks introducing a new rule that will permit KSA banks to open accounts for QFI's after certain documentary and other requirements are met.

Investment Limits

Investments of QFIs and approved QFI clients will be subject to various limitations including:

- Each QFI (together with its affiliates), or approved QFI client (together with its affiliates) may own a maximum of 5% of the shares of any issuer whose shares are listed;
- The maximum proportion of the shares of any issuer whose shares are listed that may be owned by QFIs and approved QFI clients is 20%;
- The maximum proportion of the shares of any issuer whose shares are listed that may be owned by all foreign investors (in all categories, whether residents or non-residents) in aggregate is 49%, including interests under swaps; and
- The maximum proportion of the shares of all issuers whose shares are listed that may be owned by QFIs and approved QFI clients in aggregate is 10% by market value, including any interests under swaps.

Continuing Obligations

As a general rule, a QFI and QFI clients must comply with the relevant provisions stated in the Capital Market Law and its Implementing Regulations, as well as the rules and regulations of Tadawul as well as other relevant laws.

In addition to the above, the following requirements must be met:

- A QFI must continue to engage an AAP for as long as it remains registered as a QFI - (i.e. the QFI must have an executed and valid QFI Assessment Agreement with the AAP);
- If the QFI Assessment Agreement lapses or is terminated, then the QFI must engage a replacement AAP within ten days, with notification to be provided to the CMA; and
- A QFI must meet specific disclosure and reporting requirements specified in the Rules and must upon request by the CMA, provide it with any information, documents or written explanations without delay.

KSA taxation will apply including a 5% withholding by the listed company on dividend payments.

Disputes

A KSA quasi-judicial committee known as the Committee for the Resolution of Securities Disputes will have jurisdiction over any public or private dispute that falls under the Capital Market Law (including implementing regulations) and any regulations, rules and instructions issued by the CMA and/or Tadawul.

Conclusion

The world's financial commentators and participants will no doubt watch with keen interest on how things play out on the KSA Stock Market over the coming months - with a key indicator being the fluctuations in Tadawul.

Many global institutions are positioning themselves to capitalise on the envisaged opportunities presented by the opening up of the largest Middle Eastern capital market.