CLIFFORD CHANCE

Briefing note May 2015

Saudi Arabia opens stock market to Qualified Foreign Investors from 15 June 2015

Further to the publication by the Capital Market Authority of Saudi Arabia (the CMA) of the Draft Rules for Qualified Foreign Financial Institutions Investment in Listed Shares for public consultation on 21 August 2014 (the Consultation Draft), the CMA has recently approved the final version of the rules (the Rules) with a number of changes having been made to the Consultation Draft. In this briefing, we analyse these changes.

To view our original briefing on the Consultation Draft please click here.

Introduction

On 4 May 2015, the CMA approved the Rules that will govern the investment by Qualified Foreign Investors (QFIs) into shares listed on the Saudi Arabian Stock Exchange (Listed Shares), together with supplementary material that includes a helpful set of frequently asked questions (FAQs), which can be viewed on the CMA's website.

The Rules set out the requirements and conditions that will govern (i) the registration of QFIs and their approved clients (QFI Clients) to invest in Listed Shares; (ii) the continuing obligations of QFIs; (iii) the investment restrictions to which QFIs will be subject; and (iv) the obligations of authorised persons when dealing with QFIs. The Rules also prescribe the obligations of authorised persons when dealing with QFIs. For a detailed analysis of the content of the Rules please read our previous briefing.

The Rules include a number of substantive changes to the Consultation Draft. In our view, the changes constitute significant improvements as they resolve many of the concerns that we and other market participants indicated to the CMA during the consultation period.

Definition of GCC investors

A definition of GCC investors has now been included in the Rules. This definition is of significance as it identifies those GCC investors who are unable to register as QFIs. The definition uses the same criteria that are used to determine the eligibility of GCC investors to trade directly in Listed Shares. In other words, the definition clarifies that GCC investors who are already permitted to trade directly in Listed Shares will not be able to benefit from the QFI framework. This effectively means that GCC fund managers (and local authorised persons) will not be able to invest in Listed Shares on behalf of mutual funds that are established in foreign jurisdictions.

Qualifying jurisdictions

The Rules indicate that the CMA will provide authorised persons with a list of qualifying jurisdictions so that they can assess QFI applications with the knowledge of which jurisdictions are acceptable to the CMA.

Application process to become a QFI

The application process remains substantially the same: an application for registration must be submitted, and assessed by, an authorised person licensed by the CMA to carry out the activity of dealing in securities (the Assessing AP). The CMA however introduced some helpful changes to the process as follows:

- there is no longer a requirement for the Assessing AP to be independent of the applicant. In other words, foreign investors can now apply through their licensed Saudi subsidiaries (if applicable)
- there is no longer a requirement for the Assessing AP to accept the application if the applicant meets all registration conditions. This means that the Assessing AP will have the discretion to reject an application for commercial reasons even where the applicant is eligible for QFI status
- the Assessing AP can now agree with the applicant to extend its review period of the application

beyond the five days prescribed by the Rules

- the CMA no longer has the discretion to force the Assessing AP to accept the application if the Assessing AP's initial decision was to reject it. The CMA however retains the discretion to change the Assessing AP's determination if it initially approved the application.

Investment limitations

The CMA has addressed the concerns raised during the consultation period over the ambiguity of some of the investment limits (for more details on this please refer to our previous briefing) by providing further clarity on how QFIs can comply. The Rules also now require the Exchange (Tadawul) to publish on its website the specific limitations that QFIs need to comply with by virtue of other legislation, or as imposed by regulators of specific sectors or by the by-laws of relevant companies.

Management of QFI assets

The CMA has clarified that QFIs can appoint local authorised persons (who have an asset management licence) to act as discretionary managers to manage their investments in Listed Shares. However, assets belonging to QFI Clients must be managed by the relevant QFI without the ability to delegate this to any third party, including local authorised persons.

Swap framework

The CMA confirmed in the FAQs that the swap framework will continue. That said, it will only be available for investors who are not registered as QFIs or QFI Clients. It is also possible for investors investing currently through swaps to apply for QFI status provided that they transfer all of their holdings via swaps to their direct accounts once they have been registered as a QFI or QFI Client. It remains unclear whether QFIs could continue to be counterparties to swap agreements, providing exposure to third parties who are not QFIs or QFI Clients. We anticipate that the CMA will modify the swap framework in the near future to take the QFI framework into account.

Participation in IPOs

The CMA confirmed that QFIs and QFI Clients can participate in initial public offerings of shares (IPOs) if the subscription criteria for the relevant IPO permit them to do so. In other words, the CMA is likely to look at IPOs on a case by case basis and determine whether or not QFIs should participate.

QFIs and QFI Clients are permitted to participate in rights issues conducted by listed companies.

Independent custody

Perhaps the most significant development communicated by the CMA on 4 May 2015 is the introduction of independent custody. At present, custody of listed securities can only be conducted by the broker through which trades are executed for the relevant portfolio. The CMA in the FAQs disclosed for the first time that it is now permitted for an investor to appoint a custodian (to take custody of its Listed Shares) which is a different entity to that providing trade execution services. The CMA indicated that Tadawul would be providing workshops on how this new arrangement would be implemented. This is indeed a significant (and helpful) development as it will allow QFIs to segregate the custody of their assets from the provision of brokerage services.

Creation of derivatives on Listed Shares

The CMA remained silent on whether QFIs can create synthetic exposure on Listed Shares for third parties. We would caution against interpreting such silence as the CMA blessing such arrangements, as we understand that the CMA is currently considering additional regulation in this regard.

Conclusion

The publication of the Rules signals a positive and long-anticipated development to investment in the Saudi stock market. We welcome the improved Rules and the CMA's invitation to market participants to participate in the consultation process.

For further information, please reach out to any of the Clifford Chance contacts below.

Contacts

Tim Plews
Partner

T: +966 11 4819 770
E: tim.plews
@cliffordchance.com

Khalid Al-Abdulkareem
Partner

T: +966 11 4819 740
E: khalid.alabdulkareem
@cliffordchance.com

Omar Rashid
Partner

T: +966 11 4819 720
E: omar.rashid
@cliffordchance.com

Mike Taylor
Partner

T: +971 4 362 0638
E: mike.taylor
@cliffordchance.com

Mansoor Al-Hagbani
Senior Associate

T: +966 11 4819 760
E: mansoor.alhagbani
@cliffordchance.com

Sahel Mughal
Senior Associate

T: +966 11 4819 758
E: sahel.mughal
@cliffordchance.com

Clifford Chance Law Firm, Building 15, The Business Gate, King Khaled International Airport Road, Cordoba District, Riyadh, P.O. Box: 90239, Riyadh 11613, Kingdom of Saudi Arabia

Clifford Chance Law Firm is a registered Professional Company No. 323/12/511, Commercial Registration No. 1010380646, Chamber of Commerce and Industry Membership No. 36650.

www.cliffordchance.com

Abu Dhabi ■ Amsterdam ■ Bangkok ■ Barcelona ■ Beijing ■ Brussels ■ Bucharest ■ Casablanca ■ Doha ■ Dubai ■ Düsseldorf ■ Frankfurt ■ Hong Kong ■ Istanbul ■ Jakarta* ■ Kyiv ■ London ■ Luxembourg ■ Madrid ■ Milan ■ Moscow ■ Munich ■ New York ■ Paris ■ Perth ■ Prague ■ Riyadh ■ Rome ■ São Paulo ■ Seoul ■ Shanghai ■ Singapore ■ Sydney ■ Tokyo ■ Warsaw ■ Washington, D.C.

*Linda Widyati & Partners in association with Clifford Chance.