Client Briefing May 2016

Saudi CMA announces further liberalisation of the Saudi equity market in 2017

The Saudi Capital Market Authority (CMA) announced on 3 May 2016 three initiatives designed to improve international participation in the Saudi equity market and the settlement infrastructure of the Saudi Stock Exchange (Tadawul):

1. changes to the rules governing the investment by qualified foreign financial institutions ("QFIs") in Saudi listed shares ("QFI Rules") that should facilitate greater levels of foreign interest in Saudi listed shares
2. moving from a T+Zero settlement cycle to the internationally recognised T+2 standard for securities settlement
3. the introduction of securities lending regulations and covered short selling of Saudi listed shares.

These changes will be the subject of new regulations and rules that will be published by the CMA and Tadawul in the first half of 2017. It has not been stated as to when any public consultation on the detailed proposals will take place.

SME market

Tadawul has also indicated an intention to launch a new subsidiary market for small and medium sized enterprises (SMEs). Whether the current listing rules will be adjusted to facilitate SMEs joining Tadawul remains to be seen.

Expanding the scope of the QFI Rules

The QFI asset qualification criteria will be reduced from US$5 billion to US$1 billion (i.e. SAR3.75 billion). The CMA's expectation is that this should increase the number of foreign investment funds obtaining QFI or Approved QFI Client status ("QFI Client"). The benefit of either status is the ability to hold legal title to Saudi listed shares. Before the QFI Rules were introduced in 2015, foreign investors could only obtain economic exposure, and not legal title, to Saudi listed shares.

The CMA will also expand the range of institutions eligible to be QFIs or QFI Clients by altering the eligibility criteria in the QFI Rules. Sovereign wealth funds and university endowments have struggled to comply with the mutual fund focus of the current eligibility criteria. The criteria will now be changed to allow these specialist categories of investment fund to hold legal title to Saudi listed shares.

Increasing foreign investment limits

A number of the investment limits in Article 21 of the QFI Rules will be removed and others will be relaxed. For example, the restriction that no more than 10% of all Saudi listed shares (by market value) may be owned by QFIs or QFI Clients will be abolished. The 5% limit on a shareholding by a QFI or QFI Client, aggregated with the shareholdings of its affiliates, will be increased to just short of 10%.

The overall 49% limit for foreign shareholders will not change. Saudi/GCC shareholders will continue to maintain majority control of Saudi listed companies (a Saudi issuer's by-laws or other Saudi regulations governing foreign ownership may require foreign ownership to be capped at a lower level than 49%).

In order to track all foreign participation in Saudi listed shares, economic interests (not legal title) in Saudi listed shares held by foreigners pursuant to the CMA's Swaps Circular (the latest version of which was issued in July 2015) will continue to be aggregated with foreign ownership of Saudi listed shares under the QFI Rules.

The formal amendments to the current QFI Rules are expected to be published and in force before the end of Q2 2017.

Tadawul settlement system: moving from T+Zero to T+2

T+2 is the recognised global standard for securities settlement. By announcing the adoption of this standard with an anticipated go-live date in 2017, the CMA and Tadawul are sending a positive signal to the international investment community. The current T+Zero settlement system allows for ownership of securities to transfer at the point of trade execution with payment taking place hours later after trading has finished for the day. This presents selling investors with a payment risk that is out of date when compared with other securities markets. T+Zero represents an impediment to the inclusion of Tadawul's listed companies in major international indices which are popular with foreign fund managers. Moving to T+2 will increase the attractiveness of Saudi listed shares to these professional investors.

Securities lending and covered short selling

The introduction of securities lending and covered short selling of Saudi listed shares will assist with the proper implementation of T+2. T+2 settlement arrangements afford time to buyers and sellers to borrow securities to ensure that delivery versus payment takes place as scheduled on T+2. Securities lending freedoms are seen by institutional investors as essential prerequisites for safeguarding their investments and managing the risks inherent in securities settlement. We expect relevant regulations to be issued by the CMA, and possibly new Tadawul rules too, before the end of Q2 2017.

Contacts

Tim Plews
Partner

T: +966 11481 9770
E: tim.plews
@cliffordchance.com

Mansoor Al-Hagbani
Senior Associate

T: +966 11481 9760
E: mansoor.alhagbani
@cliffordchance.com

Sahel Mughal
Senior Associate

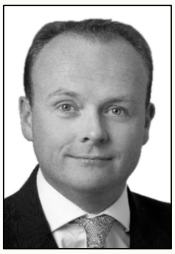
T: +966 11481 9758
E: sahel.mughal
@cliffordchance.com

Khalid Al-Abdulkareem
Partner

T: +966 11481 9740
E: khalid.alabdulkareem
@cliffordchance.com

Omar Rashid
Partner

T: +966 11481 9720
E: omar.rashid
@cliffordchance.com



Mike Taylor
Partner

T: +971 4503 2638
E: mike.taylor
@cliffordchance.com

Simon Gleeson
Partner

T: +44 20 7006 4979
E: simon.gleeson
@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

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