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Saudi Arabia's New Qualified Foreign Investor Rules

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On May 4, 2015, the Saudi Arabian Capital Market Authority ("CMA") published its long-awaited Rules for Qualified Foreign Financial Institutions Investment in Listed Shares ("QFI Rules"). The new QFI Rules permit foreign financial institutions to make direct portfolio investments in shares listed on the Saudi Stock Exchange ("*Tadawul*"), thereby opening the Saudi equity market to foreign investors on a scale and in a manner that has not previously been possible. The CMA also published a set of FAQs and several forms relating to the QFI Rules to clarify their intent and operation.

The QFI Rules, which were published in draft form by the CMA last year (see report by Natalie Boyd, of K&L Gates, Dubai, at WSLR, December 2014, page 31), are effective from June 1, 2015.

This Special Report analyzes the aspects of the QFI Rules that most concern offshore financial institutions that may wish to invest in shares listed on the *Tadawul*.

Background

The *Tadawul* is by far the largest equity market in the Persian Gulf region. According to the *Tadawul's* statistics, the aggregate market capitalization of listed companies at March 31, 2015, was SAR 1,898.75 billion (about U.S.\$506.33 billion). Saudi Arabia also has the largest economy in the Gulf region. Moreover, the

Saudi economy has shown solid growth in recent years, and the Kingdom is perceived as having a business-friendly environment generally. As a result, foreign investors have evinced interest in Saudi Arabia's equity market, but have had little opportunity to actually participate in that market.

Prior to issuance of the QFI Rules, investment in listed Saudi shares by foreigners has been limited to 1) foreigners resident in the Kingdom, 2) non-voting economic interests obtained via swaps with a CMA-licensed "authorized person" under the CMA's Swaps Circular, 3) a small number of exchange-traded funds, and 4) investors from member countries of the Cooperation Council for the Arab States of the Gulf ("GCC").

These channels have resulted in a limited level of investment by offshore financial institutions in Saudi equities. The *Tadawul's* "Trading by Nationality" report for April 2015 shows total foreign participation in buy-side transactions as constituting 5.5 percent of total transactions by value, with GCC investors and resident foreigners accounting for the majority of those transactions (1.89 percent and 1.48 percent, respectively) and swaps accounting for 2.13 percent of transactions. The sell-side data are similar, with 4.19 percent of total transactions by value being attributed to foreigners (2.64 percent GCC, 1.68 percent resident foreigners and 0.87 percent via swaps). The *Tadawul's* statistics also demonstrate that individual investors dominate

trading on the Saudi market — Saudi individuals accounted for almost 86 percent of buy-side trades and almost 89 percent of sell-side trades.

The new QFI Rules permit foreign financial institutions to make direct portfolio investments in shares listed on the Saudi Stock Exchange, thereby opening the Saudi equity market to foreign investors on a scale and in a manner that has not previously been possible.

Effect on Swaps on Listed Shares

For several years, the CMA has permitted foreign investors to gain exposure to Saudi Arabian listed equities via swaps with CMA-licensed authorized persons in accordance with the CMA's Swaps Circular. The swaps structure enables investors to acquire non-voting beneficial economic interests in shares listed on the *Tadawul* that do not amount to full share ownership.

Following implementation of the QFI Rules, an investor that has accumulated a beneficial position in a listed Saudi equity under the Swaps Circular and that becomes a qualified foreign investor ("QFI") or approved QFI client as provided in the QFI Rules may, in effect, convert the position into true, voting ownership of the underlying shares through procedures established by the CMA.

The CMA has confirmed, however, that swaps will continue to be available as an alternate investment mechanism, so investors that do not meet the requirements to, or do not wish to, qualify as a QFI or an approved QFI client may nonetheless gain exposure to Saudi listed equities via swaps and retain any exposure they already have.

The CMA's Objectives

The CMA stated five objectives in opening the Saudi stock market in a short brochure that it published on May 4, 2015:

1. to promote institutional investment in order to contribute to market stability and reduce price volatility by attracting the expertise of specialized foreign investors with long-term investment goals;
2. to facilitate transfer of knowledge and expertise to Saudi investors and financial institutions and to raise the level of professionalism of local market participants by attracting highly professional foreign experts;
3. to enhance market efficiency and motivate Saudi listed companies and investment companies to raise their performance by improving the level of transparency, financial information disclosure and governance practices;

4. to strengthen the Saudi capital market's efforts to become a leading market and to facilitate attaining its goal of being classified as an emerging market under global indexes, such as the Morgan Stanley Capital International ("MSCI") index; and
5. to raise the level of research, studies and investment evaluation in general and, as to listed companies in particular, in order to provide more accurate information and more fair assessments relating to investments in Saudi companies.

The Saudi Stock Exchange is by far the largest equity market in the Persian Gulf region.

Notably, the CMA expressly disclaimed that one of its objectives in promulgating the QFI Rules was to attract capital or liquidity to the Saudi market. While one effect of the market opening will surely be that new sources of institutional capital will become available to listed companies, the investment limitations established in the QFI Rules, and in particular the rule that limits aggregate foreign investment in listed shares to 10 percent of total market capitalization, will constrain such investment and should prevent domination of the *Tadawul* by off-shore institutions.

Overview of the QFI Rules

The QFI Rules provide for registration of a qualified foreign investor via a procedure that involves submitting an application and additional information and documentation to an "assessing authorized person," which will make an initial assessment of whether the applicant has met the conditions specified in the QFI Rules. The assessing authorized person must determine to accept or reject the application and submit its determination to the CMA, along with a statement of the reason for its decision. If the determination is to accept the application, the assessing authorized person will also submit the applicant's supporting documents, certain declarations and a draft of an agreement between the assessing authorized person and the applicant containing at least certain specified provisions.

The CMA will review the submission. An assessing authorized person's determination to accept an application will become final five business days after the CMA's notice of receipt of the applicable documents and information, unless the CMA notifies the assessing authorized person that it is extending the review period. A rejection is final when the CMA notifies the assessing authorized person of receipt of its determination to reject an application.

The QFI must be a bank, brokerage or securities firm, fund manager or insurance company that is licensed or otherwise subject to regulation equivalent to CMA regulation or acceptable to the CMA and having at least SAR 18.75 billion (U.S.\$5 billion) of assets under manage-

ment and five years of investment experience (the CMA may reduce the asset requirement to SAR 11.25 billion (U.S.\$3 billion)).

If the QFI will invest on behalf of clients, the QFI's clients must be approved, which requires the submission to the assessing authorized person of an application and related information and documentation. The QFI client must be either an investment fund or a financial institution of the kind mentioned above.

The QFI Rules include several investment limitations that 1) confine any particular QFI or approved client to ownership of not more than 5 percent of the shares of any listed issuer, 2) limit aggregate foreign ownership of listed shares of an issuer to 49 percent, including both resident and non-resident owners and beneficial interests held under swaps, 3) confine aggregate ownership by QFIs and their approved clients to 20 percent of the shares of any listed issuer, 4) limit aggregate ownership by QFIs and their approved clients, including interests owned under swaps, to 10 percent (by market value) of the total market capitalization of all listed shares, 5) recognize restrictions that may be established in other regulations and 6) recognize restrictions that particular listed companies may impose in their corporate organizational documents.

Other provisions impose ongoing disclosure and additional compliance requirements on the QFI and the assessing authorized person and grant broad authority to the CMA to monitor and take remedial actions in respect of the QFI and the assessing authorized person.

The QFI Rules do not apply to individuals who are citizens of member states of the GCC or certain GCC legal entities because they are able to invest in listed shares by virtue of other rules.

Registration of a QFI

Registration Conditions

To become a QFI that may invest in shares listed on the *Tadawul*, an offshore institution must register as such with the CMA. The QFI Rules specify type, size and experience conditions that establish certain minimum qualifications that a QFI must possess in order to register.

Type of Institution

Article 6(a) of the QFI Rules provides that an applicant for registration as a QFI must be a bank, brokerage or securities firm, fund manager or insurance company that is "licensed or otherwise subject to regulatory oversight by a regulatory authority and incorporated in a jurisdiction that applies regulatory and monitoring standards equivalent to those of the [CMA] or acceptable to it." The CMA has reserved the right, "at its absolute discretion," to determine whether the regulatory and monitoring standards that an applicant is subject to in its home country are "equivalent to those of the [CMA] or acceptable to it."

The CMA will provide authorized persons that are li-

censed to conduct dealing activities (*i.e.*, those that are qualified to act as assessing authorized persons) with "a list of jurisdictions that [apply] regulatory and monitoring standards equivalent to those of the [CMA] or acceptable to it," as well as periodic updates to that list.

Foreign investors have evinced interest in Saudi Arabia's equity market, but have had little opportunity to actually participate in that market.

Size of Institution

An applicant for registration as a QFI must meet the size requirement set forth in Article 6(b) of the QFI Rules. Specifically, the applicant must have assets under management of at least SAR 18.75 billion (U.S.\$5 billion) or the equivalent amount, although the CMA is authorized to reduce the asset requirement to SAR 11.25 billion (U.S.\$3 billion) or the equivalent amount.

The expression "assets under management" is defined to include: "a) assets owned by the applicant or its group for the purpose of investment; and b) assets managed by the applicant or its group for the account of another person or persons."

The definitions found in the CMA's Glossary of Defined Terms Used in the Regulations and Rules of the Capital Market Authority (the "Glossary") apply to terms used in the QFI Rules, which means that the term "group" will be interpreted as set forth in the Glossary.

The Glossary defines "group" as follows: "in relation to a person . . . that person and each affiliate of it."

The Glossary in turn defines "affiliate" as:

a person who controls another person or is controlled by that other person, or who is under common control with that person by a third person. In any of the preceding, control could be direct or indirect.

"Control" is defined as follows:

the ability to influence the actions or decisions of another person through, whether directly or indirectly, alone or with a relative or affiliate (a) holding 30 percent or more of the voting rights in a company, or (b) having the right to appoint 30 percent or more of the members of the governing body; "controller" shall be construed accordingly.

In view of these definitions, the applicant for registration will meet the size of institution requirement if assets owned or managed by the applicant and its affiliates reach the specified level.

Experience of Institution

An applicant for registration as a QFI or any of its affiliates must have been engaged in securities activities and investment for a minimum of five years.

Again, the definition of "affiliate" found in the Glossary extends the experience condition beyond the applicant

itself so that the applicant for registration may satisfy the experience requirement on the basis of the relevant securities experience of an affiliate.

Registration Procedures

The Assessing Authorized Person

As an initial matter, an investor that wishes to become a QFI will need to establish a relationship with an “assessing authorized person.” An assessing authorized person is an “authorized person” licensed by the CMA to engage in the security activity of dealing that has agreed with an applicant to assess its application for registration as a QFI; the term also encompasses an authorized person that has signed a QFI assessment agreement with a QFI (discussed below).

The CMA website displays a list of 88 licensed authorized persons and the securities activities they are licensed to engage in. These organizations are Saudi Arabian entities, a number of which have affiliations with regional, Western or Asian institutions. The majority of authorized persons possess a license to engage in at least one of the three “dealing” activities that the CMA licenses (the QFI Rules do not specify whether any particular category of dealing license is required).

An investor wishing to become a QFI should review the CMA list and consider carefully which authorized person would be a suitable assessing authorized person in light of any of its existing relationships with authorized persons or their affiliates, the general reputation of the authorized person, and any relevant expertise of a particular authorized person.

Application and Supporting Documents

An applicant for registration as a QFI must submit an application form, together with the information and documents set forth in Part 1 of Annex 2.1 of the QFI Rules, to the assessing authorized person that will review them and make a determination as to whether the application should be approved or rejected.

The CMA published the QFI application form and Annex 2.1 when the QFI Rules themselves were published.

Annex 2.1 is reproduced at the end of this Special Report.

An applicant for QFI registration that wishes to invest in listed shares on behalf of one or more clients must also include in its submission the information and documents specified in Part 2 of Annex 2.1 to the QFI Rules as to the relevant clients (discussed below).

The form of QFI application which the CMA published contains bilingual text in Arabic and English. Information and documents submitted to the CMA with the application may be submitted in English (or, of course, Arabic).

All documents submitted to an assessing authorized person in connection with an application must be complete, accurate, current and not misleading, and an applicant must notify the assessing authorized person im-

mediately if there is any material change to documents and information that have been submitted.

Assessment of Application

Upon receipt of an application and supporting documentation, the assessing authorized person will assess them in accordance with criteria set forth in the QFI Rules. The assessing authorized person will ensure that 1) the information and documents submitted by the applicant are complete and accurate, 2) the application complies with the requirements of the QFI Rules, and 3) the applicant (and its clients, if client approvals are also being sought) meet the applicable registration conditions.

The assessing authorizing person must provide a determination as to whether it accepts or rejects the application within five business days of receipt of the application and related information and documents, unless the assessing authorized person and the applicant agree on a different period.

Acceptance by Assessing Authorized Person

If the assessing authorizing person accepts an application, it must agree with the applicant on the form of a draft “QFI assessment agreement” containing terms that meet the five requirements set forth in Article 12 of the QFI Rules. Specifically, the QFI assessment agreement must include at least the following provisions:

1. a representation by the applicant that it meets the registration conditions stated in the QFI Rules;
2. an undertaking by the applicant to provide the assessing authorized person with all information and documents required under the QFI Rules;
3. an undertaking by the applicant to notify the assessing authorized person immediately of any event or circumstance requiring such notification under the QFI Rules;
4. a confirmation by the applicant of its consent that the assessing authorized person may disclose to the CMA or the *Tadawul* information or documents which the assessing authorized person receives under the QFI Rules or the Capital Market Law and its Implementing Regulations, and that such information may also be disclosed to other Saudi Arabian government agencies in accordance with the relevant laws; and
5. an undertaking by the applicant to abide by the Capital Market Law and its Implementing Regulations and the rules of the *Tadawul* and other relevant laws.

These five requirements are also set forth in a separate document that the CMA published along with the QFI Rules. The CMA may specify the form that these provisions must take.

CMA Review

Within one business day of its determination to accept or reject an application, the assessing authorized person must notify the CMA in writing of the reasons for its de-

termination. If the application is accepted, the assessing authorized person will deliver to the CMA certain of the documents submitted with the application, as well as the draft QFI assessment agreement and the assessing authorized person's written declaration that the applicant (and any client, if applicable) meets the requirements of the QFI Rules and that the applicant and the assessing authorized person have agreed to the draft QFI assessment agreement containing the required terms described above.

The CMA will notify the assessing authorized person upon receipt of the determination and documentary submissions, at which time any rejection of an application by the assessing authorized person becomes final. The assessing authorized person's determination of acceptance of an applicant will become final five business days after the CMA's notice to the assessing authorized person, unless the CMA notifies the assessing authorized person during such five business days that it will require an additional period, specified in the notice, to review the determination. The CMA will notify the assessing authorized person within the specified period whether or not the CMA approves the assessing authorized person's determination.

Registration

The CMA will register an applicant as a QFI when the five business day period mentioned above passes unless the CMA has notified the assessing authorized person that it requires additional time, in which case the CMA will register the applicant if it approves the assessing authorized person's acceptance determination within the additional time. The CMA will notify the assessing authorized person in writing of the registration.

An applicant attains QFI status when registration occurs.

Unless the CMA requires additional time for its review, the overall length of the process from submission of the QFI application and related information and documents to the assessing authorized person to completion of registration should take no more than 11 business days.

Notice of Registration or Rejection

The assessing authorized person must notify a QFI of its registration as such within one business day of receipt of the CMA notice of registration. It must then accept the QFI as a client, sign the QFI assessment agreement and deliver a copy of the agreement, signed by both parties, to the CMA.

If an application for QFI registration is rejected, the assessing authorized person must notify the applicant when the rejection is final or the assessing authorized person receives the CMA's notice that it rejects the assessing authorized person's acceptance of the application. An applicant whose application is rejected is free to re-apply by submitting a new application and supporting information and documents.

Registration Fees

The QFI Rules contemplate that the CMA may charge fees for registration of a QFI and approval of a QFI cli-

ent. However, the CMA has announced that it does not in fact plan to impose fees for such services during 2015, and that it is considering what the fee rates will be when they are subsequently imposed.

The investment limitations established in the QFI Rules, and in particular the rule that limits aggregate foreign investment in listed shares to 10 percent of total market capitalization, will constrain such investment and should prevent domination of the Saudi Stock Exchange by offshore institutions.

Approval of QFI Clients

A QFI may not invest in listed shares on behalf of a client unless the client has been approved as provided in the QFI Rules.

Under Article 7, a QFI client may not be approved unless:

1. the QFI or the applicant is responsible for the management of the client funds when invested in listed shares;
2. the client is neither a QFI nor an approved QFI client of another QFI; and
3. 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 acceptable to it or b) a financial institution that meets the type, size and experience conditions applicable to QFI applicants, described above.

Again, the CMA has reserved the right to determine whether the regulatory and monitoring standards that a QFI client is subject to in its home country are "equivalent to those of the [CMA] or acceptable to it," and the CMA will provide authorized persons that are licensed to conduct dealing activities with "a list of jurisdictions that [apply] regulatory and monitoring standards equivalent to those of the [CMA] or acceptable to it," as well as periodic updates to that list.

An applicant for QFI registration that wishes to invest in listed shares on behalf of one or more clients must submit an application for approval of those clients, together with the information and documents specified in Part 2 to Annex 2.1 to the QFI Rules. Note that, under Part 2 of Annex 2.1, the documents required in Part 1 are also required "insofar as they apply to each relevant client," but alternate documentary requirements apply to QFI clients that are investment funds.

A QFI may seek approval of a client either simultaneously with the QFI's own application for registration or subsequently, after the QFI has been registered. This permits an offshore institution that has been registered as a QFI to expand its approved QFI client base.

The procedure for approval of a QFI client follows the procedure for registration of a QFI outlined above, except that there is no separate QFI assessment agreement for a QFI client.

Opening of Accounts for Trading

A QFI may not commence trading in shares listed on the *Tadawul* unless it 1) holds a client account, 2) holds an account at the Depository Center and 3) has satisfied any other condition imposed by the CMA. These requirements also apply to each approved QFI client.

Under the CMA's practices, a "client account" is an account maintained at a bank licensed in Saudi Arabia by the Saudi Arabian Monetary Agency ("SAMA"). The Depository Center is a department of the *Tadawul* established pursuant to the Capital Market Law to administer the deposit, transfer, settlement, clearing and registration of ownership of securities listed on the *Tadawul* via accounts maintained at the Depository Center.

When it promulgated the QFI Rules, the CMA announced that it had worked with SAMA and the Depository Center to establish procedures under which an assessing authorized person would process the opening of both accounts on behalf a QFI or QFI client using documents provided by the QFI or QFI client. The SAMA documentary requirements to open the bank account that will be the client account and the Depository Center account-opening document requirements are detailed in a document entitled "Information and Documents Required From Foreign Investors to Invest in Listed Shares." (That document also includes the documentary requirements of Annex 2.1 that apply to QFI and QFI client applications.) A number of the documents submitted in connection with application for registration as a QFI or approval as a QFI client should also satisfy some of the account-opening requirements. An investor would be well-advised to coordinate these processes carefully with its assessing authorized person.

Rights of a QFI

Under Article 1(d) of the QFI Rules, "QFIs and approved QFI clients are entitled to exercise all rights related to listed shares owned by them, including trading in rights issues." Generally, companies whose shares are listed on the *Tadawul* are organized as Saudi Arabian joint stock companies (since 2012, the CMA's Listing Rules have permitted foreign companies to list, but no foreign company has in fact listed). Under the Listing Rules, the Corporate Governance Regulations and the Regulations for Companies, listed joint stock companies and their boards and directors have certain obligations and duties to shareholders. Similarly, shareholders have various legal rights, including certain rights with respect to dividends, information about the company, and participation in shareholder votes. A QFI will be entitled to these rights to the same extent as a Saudi shareholder is.

Investment Limits

An array of investment limits is found in Article 21 of the QFI Rules. These limits apply at the level of each par-

ticular QFI and QFI client, and also at a level that encompasses other, unrelated foreign investors. Moreover, some limitations may be established in other Saudi Arabian laws or by particular companies.

Article 21(a) reads as follows:

Article 21: Investment limits

a. Investments of QFIs and approved QFI clients shall be subject to the following limitations:

1) Each QFI, together with its affiliates, or each approved QFI client together with its affiliates may own a maximum of 5 percent of the shares of any issuer whose shares are listed.

2) Where a QFI invests on behalf of an approved QFI client, it must not execute a transaction which would result in the relevant client, together with its affiliates, owning more than 5 percent of the shares of any issuer whose shares are listed.

3) 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 percent, including interests under swaps.

4) 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 percent.

5) 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 percent by market value, including any interests under swaps.

6) Other legislative limitations on foreign ownership in joint stock companies.

7) The limitations set forth in the articles of association or by-laws of the listed companies or any instructions issued by the supervisory or regulatory authorities to which these companies are subject.

In order to enable a QFI to determine whether these investment limits have been or will be reached or exceeded at any particular time or as a result of any particular transaction, Article 21(b) provides that the *Tadawul* will publish on its website statistics reflecting the ownership percentages specified in Article 21(a) (3), (4) and (5) and the limitations specified in Article 21(a) (6) and a (7).

Presumably, assessing authorized persons will adopt compliance procedures to ensure that trades they execute for a QFI or approved QFI client do not contravene the investment limitations. QFIs and their approved clients would be well-advised to establish and follow their own compliance procedures as well.

As is apparent from these investment limitations, the QFI Rules permit portfolio investment, but in effect prohibit share acquisitions that would be expected to enable individual foreign investors to obtain control of, or even substantial minority positions in, particular listed companies. They further foreclose the ability of all foreign investors collectively (whether or not they are acting in a coordinated way) to obtain majority positions in a listed company. As noted above, the limit set forth in Clause 5) will act as a general constraint on foreign domination of the Saudi Stock Exchange. The restric-

tions in Clauses 6) and 7) will allow Saudi regulators and individual companies to impose additional limitations on foreign investment.

The QFI Rules permit portfolio investment, but in effect prohibit share acquisitions that would be expected to enable individual foreign investors to obtain control of, or even substantial minority positions in, particular listed companies.

Continuing Obligations of QFIs and QFI Clients

QFIs and approved QFI clients will be subject generally to the applicable provisions of the Capital Market Law and the CMA's Implementing Regulations, the *Tadawul's* rules, and Saudi Arabian law with respect to their shareholder rights, trading in Saudi listed shares, and interactions with the CMA. Some specific ongoing obligations of QFIs set forth in the QFI Rules are discussed below.

Disclosure and Recordkeeping Requirements

Annual Disclosure

A QFI must disclose to its assessing authorized person on an annual basis the information specified in Part 1 of Annex 3.1 to the QFI Rules. The required information is the QFI's annual report and consolidated financial statements and those of its QFI clients, as well as any material changes to the information provided by the QFI under Annex 2.1 of the QFI Rules or furnished subsequently in connection with 1) the granting or maintenance of the QFI's registration and/or 2) the approval of its approved QFI clients.

Immediate Disclosure

A QFI must "immediately disclose" to its assessing authorized person the occurrence of any of the events specified in Part 2 of Annex 3.1 to the QFI Rules. These events include, with respect to a QFI or an approved QFI client:

1. the commencement of insolvency, criminal, legal or regulatory proceedings;
2. any breach or anticipated breach of the investment limits in Article 21(a)(2), (6) or (7) or of any obligation under the QFI Rules;
3. the QFI or QFI client becoming the client of another authorized person for the purpose of investing in listed shares;
4. any material change that affects the status or activities of a QFI or approved QFI client relating to:
 - a) the business of the QFI or any of its approved QFI clients;

- b) the regulatory status or authorizations of the QFI or any of its approved QFI clients in its home jurisdictions; and
 - c) the identity of any controller of the QFI or any of its approved QFI clients;
5. the QFI becoming aware that it or any of its approved QFI clients no longer meets or will no longer meet the registration conditions stated in the QFI Rules; and
 6. any restructuring of the QFI or any of its approved QFI clients.

If a QFI reasonably believes that disclosure of any of the immediately reportable events to its assessing authorized person would materially prejudice the business and operations of the QFI or a third party, the QFI may instead make the notification directly to the CMA.

Other Disclosure

The QFI must also provide to the CMA any information, documents or written explanation the CMA may request.

All information and documents disclosed to the CMA or the assessing authorized person must be complete, accurate, current and not misleading.

Recordkeeping

For as long as it remains a QFI, a QFI must retain and make available to the CMA on request the information and documentation required under the QFI Rules.

Compliance Program

In view of these ongoing disclosure and recordkeeping requirements, QFIs will need to implement compliance programs including procedures that will ensure that they will be positioned to make adequate and timely disclosures and to maintain and access appropriate records.

Maintaining and Changing Assessing Authorized Persons

The QFI Rules require that a QFI always have an assessing authorized person with which it has in effect a valid QFI assessment agreement, but a QFI may not have more than one assessing authorized person at any time. The QFI Rules do permit a QFI to change its assessing authorized person, and they provide that QFI registration will be maintained if, upon termination or lapse of a QFI assessment agreement, the QFI engages a replacement assessing authorizing person within 10 days. Various notification rules apply.

Withholding Tax

Saudi Arabia imposes a withholding tax at the rate of 5 percent on dividends paid to foreigners on shares of listed companies. The company paying the dividends is responsible for withholding the tax from the dividend payments it makes and remitting the withheld funds to

the Saudi Arabian tax authority, the Department of Zakat and Income Taxation.

Investors are encouraged to consult with their tax advisers as to any other tax issues that may arise from purchases and disposition of shares in Saudi listed companies.

Authorized Person Obligations

Only an authorized person that has been licensed by the CMA to engage in the security activity of dealing may act as an assessing authorized person.

Authorized persons are subject to various obligations in their dealing with QFIs, including the duty to comply with the Capital Market Law and the CMA's Implementing Regulations, as well as *Tadawul* rules. Among other things, rules that apply to an authorized person in its dealings with customers generally (including those set forth in the Authorized Persons Regulations) will apply to its dealing with QFIs. Further, the QFI Rules provide that the CMA may impose any limitation and conditions that it sees fit on such dealings.

Monitoring of QFIs

An assessing authorized person must review on an annual basis whether a QFI that it engages with and its approved clients continue to meet the applicable registration conditions and to comply with the QFI Rules. If it finds at any time that a QFI or approved QFI client fails to meet such conditions or to comply with the QFI Rules, the assessing authorized person must report the failure to the CMA in writing "without delay."

The QFI Rules set forth in Article 25(c) a number of events that an assessing authorized person must report to the CMA "immediately after being aware of" any such event. These events include: the commencement of criminal, legal, regulatory or insolvency proceedings against a QFI or an approved client; the QFI or approved client becoming the client of another authorized person for the purpose of investing in listed shares; any restructuring of a QFI or an approved client; and material changes to certain information submitted with an application for QFI registration.

Recordkeeping

An assessing authorized person must retain and make available to the CMA on request the information and documentation required under the QFI Rules as to a QFI as long as the QFI retains its QFI status. In addition, if an application for registration is rejected or a QFI's registration is cancelled or withdrawn, the assessing authorized person must retain and make available to the CMA on request the information and documentation required under the QFI Rules for 10 years.

Other Obligations and Requirements

The CMA may prohibit an authorized person from dealing with QFIs, require an authorized person to provide any information, documents or written explanation the

CMA may request, and require an authorized person to appear before the CMA to answer questions and provide explanations.

In an emergency situation, the CMA "may assume any assessing authorized person's rights against a QFI" by notice to the assessing authorized person and the QFI.

Voluntary Cancellation of QFI Registration

A QFI may, through its assessing authorized person, request that its registration be cancelled or withdrawn or that the approval of one of its approved QFI clients be cancelled or withdrawn. The request must include a confirmation that the QFI and its QFI clients do not own any listed shares or, in the case of a request relating solely to a QFI client, that the QFI client does not own any listed shares. The CMA may reject any such request, but if it does not do so within two days of receiving the request, the cancellation or withdrawal will be effective. The assessing authorized person will notify the QFI of such rejection or effectiveness.

CMA Powers in Relation to QFIs and Approved QFI Clients

Article 28(a) of the QFI Rules affords the CMA broad powers to investigate and sanction QFIs if it considers that any of the events enumerated in Article 28(d) "has occurred in relation to a QFI or any of its approved QFI clients, or is likely to occur." The triggering events found in Article 28(d) include:

1. the QFI or any of its approved QFI clients no longer meets the conditions, obligations or requirements stated in the QFI Rules;
2. the QFI has not established a client account or an account with the Depository Center or met any other condition imposed by the CMA within 60 days of its registration;
3. an approved client of the QFI has not established a client account or an account with the Depository Center or met any other condition imposed by the CMA within 60 days of its approval;
4. an insolvency event has occurred in relation to the QFI or any of its approved QFI clients;
5. the QFI or any of its approved QFI clients has breached any of its obligations under the Capital Market Law or the Implementing Regulations and/or any other laws of Saudi Arabia;
6. the QFI has obtained its registration or the approval of any of its approved QFI clients on the basis of incomplete, false, outdated or misleading information;
7. the QFI or any of its approved clients has been the subject of any material legal or regulatory sanction in any jurisdiction;
8. any restructuring of the QFI or any of its approved QFI clients; and

9. any other event that the CMA believes necessitates its intervention in order to protect investors or safeguard the functioning of the capital market within the Kingdom.

Upon the occurrence of one of these events, the CMA is empowered to undertake a range of remedial actions. It may:

1. require the QFI to provide such information, documents and/or written explanation as the CMA requires in respect of the matters giving rise to its consideration;
2. require the QFI or its representative to attend before the CMA to answer questions and explain any matter the CMA considers relevant;
3. carry out any enquiries that it considers appropriate;
4. take any steps to verify any information furnished by the QFI, including by communicating with overseas regulatory authorities;
5. suspend the QFI's registration or prohibit the QFI from dealing on behalf of one or more of its approved QFI's clients for such period as the CMA requires;
6. cancel the QFI's registration, or withdraw the approval of any of its approved QFI clients;
7. prohibit the QFI from dealing on behalf of one or more of the approved QFI's clients in listed shares; and
8. exercise any of its other powers under the Capital Market Law.

The CMA may publish the identity of any institution whose registration has been suspended or revoked or whose approval has been withdrawn.

Upon revocation or suspension of the registration of a QFI or the approval of a QFI client, the QFI Rules prohibit purchases of listed shares by the affected party and require the consent of the CMA to dispositions of listed shares by the affected party.

CMA General Enforcement Powers

In addition to the powers granted to the CMA in the QFI Rules, the Capital Market Law empowers the CMA to investigate and prosecute violations of the Capital Market Law and the CMA's Implementing Regulations.

QFIs and approved QFI clients should bear in mind that the Capital Market Law and the Market Conduct Regulations contain provisions that prohibit market manipulation and insider trading. The CMA actively monitors the Saudi securities markets and enforces these provisions, which can be the basis for criminal proceedings and fines, as well as punishment by imprisonment. In recent months, the CMA has been referring certain cases, including some market manipulation cases, to the Bureau of Investigation and Public Prosecution for prosecution as criminal offenses.

As a member of the International Organization of Securities Commissions ("IOSCO") and a signatory to IOSCO's Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information, the CMA has the ability to consult and exchange information with securities regulators in other jurisdictions regarding enforcement and other matters. This arrangement can facilitate investigations or remedial actions that the CMA may wish to undertake with respect to a QFI or QFI client by enabling the CMA to deal directly with the QFI's or the QFI client's home-country regulator.

The Committee for the Resolution of Securities Disputes

Foreign investors should be aware that Saudi Arabia has established a specialized tribunal to adjudicate cases arising under the Capital Market Law and the CMA's Implementing Regulations, including the QFI Rules. The tribunal is called the Committee for the Resolution of Securities Disputes, and it decides cases brought by the CMA and by private litigants. Its decisions are subject to appeal to the Appeals Committee for the Resolution of Securities Disputes. Both bodies function as courts do, with formal rules of procedure and processes that lead to formal judgments. Judgments of both the Committee and the Appeals Committee are in effect the equivalent of court judgments, which may be enforced in accordance with applicable law.

Conclusion

The QFI Rules represent an important advance in Saudi Arabian law with respect to foreign investors. They reflect the Kingdom's ongoing efforts to develop, deepen and generally strengthen its capital markets.

Given the investment limits contained in the QFI Rules, it is doubtful that the impact of the QFI Rules will be dramatic in the short term, nor is it intended to be.

However, noticeably increased foreign participation in the Saudi Arabian market is likely to occur and, over time, to exert a favorable influence on Saudi securities market practices.

Moreover, the QFI Rules will enable foreign institutions to further diversify their portfolios by establishing direct equity positions in companies based in Saudi Arabia's strong and growing economy.

Annex 2.1 Information and documents to be provided by applicants

1. Information and documents to be provided by applicants:

The applicant must provide the below information to the assessing authorized person, in such form as the Authority may prescribe:

- a. Details of the applicant's legal form and jurisdiction

of establishment, supported by copies of relevant constitutional documents;

b. A description of the applicant's business activities (which may be extracted from the applicant's annual report or equivalent corporate documents, but should include confirmation of the period for which the applicant has been engaged in securities activities and investment therein);

c. Evidence of the applicant's regulatory status;

d. A list of all controllers of the applicant, and provide details of the identity and ownership of each controller (if applicable);

e. A copy of the most recent annual report and consolidated accounts of the applicant and (where applicable) its group;

f. The identity of any affiliate;

g. Details of other account names or affiliations under which the applicant or its affiliates invest in the Kingdom, if any;

h. Details of all authorized persons of which the applicant or any of its affiliates or its clients on whose behalf it intends to invest in listed shares is a client;

i. Details of all of the following legal or regulatory sanctions imposed on the applicant or its affiliates during the 5 years prior to the submission of the application:

- 1) the suspension or revocation by a regulatory authority of any license or permission in any jurisdiction or the imposition by a regulatory authority of any material restriction or condition upon any such license or permission; and
- 2) any criminal, civil or regulatory sanction or penalty imposed as a result of insider trading, market manipulation or other market abuse or misconduct.

together with a declaration from the applicant that no other such sanctions have been imposed on the applicant or its affiliates during this period. If no legal or regulatory sanctions falling within the categories specified in this paragraph have been imposed on the applicant or its affiliates during the past 5 years, a declaration by the applicant to this effect.

j. Details of any pending or ongoing criminal or regulatory investigations or civil proceedings;

k. Details of any settlement regarding criminal or regulatory investigations or civil proceedings during the 5 years prior to the submission of the application;

l. Financial statements prepared and accredited by the applicant's auditors in accordance with accounting standards prescribed by the relevant authorities in the applicant's jurisdiction of establishment, and showing the applicant's current financial position, including its capital, financial resources, revenues and expenses at the date of the financial statements;

m. Confirmation of its consent that the assessing authorized person may disclose to the Authority or the Exchange information which the assessing authorized person

receives under these Rules or the Capital Market Law and its Implementing Regulations, and that such information may also be disclosed to other government agencies of the Kingdom in accordance with the relevant laws;

n. Confirmation by the applicant of its consent to disclose any information or documents required by the Authority or other government agencies of the Kingdom in accordance with the relevant laws; and

o. Such other documents or other evidence as may be sufficient to satisfy each of the registration conditions under these Rules.

2. Additional information and documents to be provided by applicants intending to invest in listed shares on behalf of their clients:

Where an applicant intends to invest in listed shares on behalf of one or more of its clients, it must provide, in relation to each client for which approval is sought:

a. All the information and documents specified in paragraph (1) of this Annex insofar as they apply to each relevant client.

b. Where the client is an investment fund, only the following information needs to be provided to satisfy paragraph (1) of this Annex:

- 1) details of the fund's jurisdiction of establishment;
- 2) the fund's investment policy;
- 3) a list of all of the fund's controllers, details of the identity and ownership of each controller (if applicable);
- 4) the identity of any affiliate;
- 5) details of other account names or affiliations under which the fund or its affiliates invest in the Kingdom, if any;
- 6) confirmation of the fund's consent that the assessing authorized person may disclose to the Authority or the Exchange information which the assessing authorized person receives under these Rules or the Capital Market Law and its Implementing Regulations, and that such information may also be disclosed to other government agencies of the Kingdom in accordance with the relevant laws; and
- 7) confirmation by the fund of its consent to disclose any information or documents required by the Authority or other government agencies of the Kingdom in accordance with the relevant laws.

c. A signed written confirmation from persons duly authorized to sign on behalf of the applicant, confirming that:

- 1) the client for which approval is sought meets the applicable registration conditions under these Rules;

- 2) the applicant has the authority to manage the client's funds, and the authority to take investment decisions based on its absolute discretion when investing in listed shares; and
- 3) the applicant will notify the assessing authorized person immediately of any changes to the terms of its investment management that would alter or impede the extent of this discretion.

The CMA has created a webpage dedicated to its QFI Rules that includes links to its English translations of its QFI Rules, its FAQs on the QFI Rules, various required forms and various related documents. That webpage can be viewed at <http://www.cma.org.sa/en/Pages/QFI.aspx>.

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