SAUDI ARABIA: NEW RULES FOR FOREIGN STRATEGIC INVESTORS

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As part of the drive to make the Saudi market more accessible to foreign investors, the Saudi Arabian Capital Market Authority (**CMA**) recently issued the "Instructions for the Foreign Strategic Investors' Ownership in Listed Companies" (the **FSI Rules**), which are effective immediately.

Overview

In summary, the FSI Rules allow foreign strategic investors (**FSIs**) to own Saudi listed shares directly with the intention of "promoting the financial or operational performance of the listed company" (a **Strategic Shareholding**).

The requirements to become an FSI are very light, such that practically all well-established foreign legal entities can own Saudi listed shares as FSIs without being subject to any restrictions or limitations, other than a two-year lock-up on the shares purchased by the FSI.

While the FSI Rules contemplate that the listed shares should be owned with the intention of "promoting the financial or operational performance of the listed company", the FSI Rules do not include any objective tests or requirements to measure whether the stake is in fact a Strategic Shareholding. It could therefore be the CMA's position that the FSI's willingness to abide by the two-year lock-up period is sufficient evidence of its intention, by demonstrating a long term commitment to the relevant listed company.

Who can become an FSI?

FSIs must be legal entities that (i) are non-GCC[1] and (ii) satisfy the following eligibility criteria (the **Eligibility Criteria**):

1. The entity must be established or licensed in a country that applies regulatory and supervisory measures similar to those applied by the CMA or acceptable to it.

   Based on guidance published by the CMA, the CMA will consider a country to be acceptable if it is one of the "state members of the International Organization of Securities Commissions (IOSCO) that are applying and cooperating in anti-money laundering and financing of terrorism [measures] in accordance with the Financial Action Task Force (FATF), in a manner that does not conflict with the relevant laws in force in Saudi Arabia and any directives issued by the Anti-Money Laundering Permanent Committee."

Key issues

- In practice, most foreign (i.e. non-GCC) legal entities are now permitted to invest directly in Saudi listed shares as foreign strategic investors (FSIs)
- FSIs have direct legal and beneficial ownership of Saudi listed shares
- No CMA licensing or registration required
- No specific investment restrictions
- Two-year lock-up on shares acquired
- Other means of investing in Saudi listed shares continue to be available
- A foreign legal entity is not permitted to own shares in the same listed company at the same time as both an FSI and a Qualified Foreign Investor (QFI)

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[1] **GCC** means:
- natural persons holding GCC nationality; and
- legal persons but only to the extent they are majority owned by natural persons holding a GCC nationality or GCC governments,

in accordance with the definition set out in the resolution of the Supreme Council of the Cooperation Council for the Arab States of the Gulf in its 15th session approved by Council of Ministers Resolution No. 16 dated 20/01/1418H.

2. The entity must have a client account in Saudi Arabia and an account with the Saudi Arabian Securities Depository Centre (**Edaa**).
3. The CMA has the discretion and authority to impose any additional requirements it deems appropriate.

Are there any licensing or registration requirements?

No, however an FSI will have to engage a person authorised by the CMA to conduct securities business in Saudi Arabia (an **Authorised Person**) who will in turn ensure that the Eligibility Criteria above are satisfied.

While the FSI Rules are silent here, in our view the Authorised Person will have to undertake this verification exercise once for each FSI, rather than each time the same FSI acquires shares in a different listed company.

Authorised Persons may seek to satisfy themselves that a foreign investor satisfies the Eligibility Criteria in a number of ways, including conducting KYC checks, seeking account confirmations from Edaa and/or obtaining representations/warranties from the investor itself.

What exactly are FSIs permitted to do?

FSIs can:

1. **Directly own** Strategic Shareholdings in Saudi listed companies including shares acquired by way of:
   - on-market transactions;
   - off-market/private transactions; and
   - tender offers.
2. **Subscribe** for shares as part of public offerings, including initial public offerings (IPOs) and capital increases (rights issues, conversions of debt, etc), provided that the terms and conditions of relevant offering permit their participation.
3. **Trade** such shares (subject to the two-year lock-up period), including trading in rights issues.

Are there any restrictions?

1. **No ownership limits**: There is no upper or lower limit on the Strategic Shareholding of an FSI in a Saudi listed company.

   However, an FSI will be subject to any ownership limitations otherwise imposed by statute or contract.
2. **Trading limits**: An FSI is subject to a two-year lock-up period which is triggered from the date of acquisition of the relevant shares.

Do the FSI Rules apply to foreign legal entities (non-QFIs) who were shareholders in Saudi listed companies prior to the issuance of the FSI Rules?

Yes. Based on guidance published by the CMA, non-QFI foreign legal entities who are shareholders in Saudi listed companies will now be treated as FSIs under the FSI Rules, however the two-year lock-up period will not apply to the shares currently owned by them.

In our view, this should mean that such shareholders (including **founding foreign shareholders**):

1. will not be subject to foreign-investor specific ownership limits, i.e. they can now acquire additional shares in Saudi listed companies in excess of the 49% limit on foreign ownership that applies to Saudi listed companies (see the Foreign Investment Limitations described below); and
2. will not be subject to any trading limits, i.e. they should be free to trade their shares. Historically, these have been held in restricted portfolio accounts where regulatory approval has been required to lift the restriction to enable trading.

Can an FSI also be a Qualified Foreign Investor (QFI) for the purposes of investing in Saudi listed shares?

Yes, an FSI can register separately to become a QFI pursuant to the "Rules for Qualified Foreign Financial Institutions Investment in Listed Securities" issued by the CMA (the **QFI Rules**). However, the same investor may not invest in a single listed company as both an FSI and QFI. A shareholder in a listed company can change its status from a QFI to an FSI (or vice versa) with respect to its shareholding in such company, subject to satisfying the applicable criteria.

Why would an investor prefer the QFI route rather than the FSI route?

Different drivers may be considered for each option:

1. Investors who are looking to freely trade a non-material stake (e.g. less than 10%) in a Saudi listed company within a short period of time should consider registering as QFIs as they will not be subject to any trading restrictions (i.e. no lock-up). However, they would be subject to the Foreign Investment Limitations (set out below).
2. Investors who are looking for a long-term investment and who would like to acquire a material stake, or even a controlling or majority stake, in a Saudi listed company, should consider investing as FSIs. Investors who do not meet the QFI eligibility criteria may also consider investing as FSIs. However, they would be subject to a two-year lock-up period.

Is an FSI subject to any continuing obligations?

While there are no specific continuing obligations imposed by the FSI Rules, an FSI will be subject to and must comply with the applicable provisions of the Saudi Arabian Capital Market Law and its implementing regulations, as well as the rules and regulations of the Saudi Stock Exchange (Tadawul) and any other relevant laws.

Will the listed joint stock company in which an FSI invests require a foreign investment licence?

The FSI Rules do not address this point, nor has the Saudi Arabian General Investment Authority (**SAGIA**) made any announcements to address this specifically. However, on 22 October 2017 the CMA and SAGIA signed a memorandum of cooperation to establish a collaborative framework to be followed by the CMA and SAGIA in relation to FSIs prior to the issuance of the FSI Rules. Although the memorandum is not publicly available, and in the absence of official pronouncements to the contrary, we would expect SAGIA to mirror the approach it has adopted to date with respect to QFIs, i.e. not to require Saudi listed companies who have FSIs as shareholders to obtain a foreign investment licence.

Are there any other ways in which non-GCC investors can invest in Saudi listed shares?

Yes

1. **Directly as a QFI**
   - A QFI applicant must meet certain eligibility criteria as set out in the QFI Rules.
   - The QFI applicant must submit an application to, and sign an "assessment agreement" with, an Authorised Person.
   - A QFI is subject to the following **Foreign Investment Limitations** in addition to any other applicable statutory or contractual restrictions:
     - no QFI may own more than **10%** of the shares or convertible debt instruments of any listed company; and
     - the aggregate of all shares or convertible debt instruments owned by all categories of foreign investors (resident or otherwise **but excluding FSIs**) cannot exceed **49%** of the shares or convertible debt instruments of any single listed company.
2. **Directly in the Parallel Market (known as 'Nomu')**
   - Non-GCC investors may invest in the Saudi Parallel Market (Nomu) directly provided they (i) are incorporated in a CMA-approved jurisdiction and (ii) have an investment account in Saudi Arabia as well as an account with Edaa.
   - The Foreign Investment Limitations apply to investments in the Parallel Market (Nomu).
3. **Indirectly through swaps**
   - Under the Saudi rules, a swap is a contractual agreement entered into with an Authorised Person to gain access to the economic benefits (without having legal ownership) of Saudi listed shares.
   - The term of a swap agreement may not exceed four years.
   - The Foreign Investment Limitations are applicable to swap agreements.

How do I find out more?

Please contact any of our experts on the following page. We would be happy to help.

AUTHORS

Mansoor Alhagbani
Partner,
Head of Capital Markets &
Financial Regulatory

E mansoor.alhagbani
@ashlawksa.com

Sahel Mughal*
Counsel,
Corporate and Capital
Markets

E sahel.mughal
@ashlawksa.com

Mashael Alshebaiky
Senior Associate,
Corporate and Capital
Markets

E mashael.alshebaiky
@ashlawksa.com

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OTHER CONTACTS

Khalid Al-Abdulkareem
Senior Partner,
Corporate and Capital
Markets

E khalid.alabdulkareem
@ashlawksa.com

Majid Al-Sheikh
Partner,
Head of Corporate

E majid.alsheikh
@ashlawksa.com

Omar Rashid*
Clifford Chance Partner,
Co-Head of Corporate

E omar.rashid
@ashlawksa.com

Daniel Royle*
Clifford Chance Partner,
Corporate and Capital
Markets

E daniel.royle
@ashlawksa.com

**Seconded from Clifford Chance*

www.ashlawksa.com

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Registered office: Building 15 The Business Gate, King Khaled International Airport Road, PO Box 90239, Riyadh 11613, Kingdom of Saudi Arabia