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## New Saudi Qualified Foreign Investor Rules and IPO Book Building Instructions Approved

This year has witnessed remarkable legal developments in the capital markets landscape of the Kingdom of Saudi Arabia. In particular, the Capital Market Authority of the Kingdom (“**CMA**”) approved the amended Rules for Qualified Foreign Financial Institutions Investment in Listed Securities (the “**QFI Rules**”), which came into effect on 4 September 2016. Another significant legal development is the CMA’s approval of the Instructions of Book Building Process and Allocation Method in Initial Public Offerings (the “**Book Building Instructions**”), which will become effective on 1 January 2017. These legal developments are part of the Kingdom’s ongoing efforts to grow its capital market, which has the largest market capitalisation in the MENA region, by facilitating foreign investment.

### QFI Regime

A qualified foreign investor (“**QFI**”) is a foreign investor that is registered with the CMA and permitted to invest directly in securities listed on the Saudi Stock Exchange (Tadawul). The QFI Rules set out the procedures, requirements and conditions for the registration of QFIs with the CMA, as well as the obligations of QFIs and of CMA-authorized persons in this regard.

Until the introduction of the QFI regime in June 2015, foreign investors could not invest directly in Tadawul-listed securities and instead were only able to invest indirectly through Swap Agreements with CMA-authorized persons. A Swap Agreement, which creates a type of nominee relationship between the swap purchaser (foreign investor) as principal and the CMA-licensed swap provider as nominee, provides foreign investors with an ability to obtain economic exposure to an underlying listed security, without legal ownership.

### Key Highlights of the QFI Regime

- QFIs may invest in all securities listed on Tadawul, including equities (including in IPOs), debt instruments and exchange traded funds (ETFs).
- As the legal owner of the security, a QFI is entitled to exercise all rights attached thereto, including, for example, voting on shareholder matters and exercising pre-emptive subscription rights.
- Banks, brokerage and securities firms, insurance companies, governments and government-related entities and investment funds are eligible to apply for registration as a QFI. Government-related entities are defined in the QFI Rules as central banks and investment funds (such as sovereign funds, pension and endowment funds) that are fully owned, directly or indirectly, by a government entity. In addition, the CMA has discretion to register other financial institutions that it considers eligible for QFI registration.

- Applicants for QFI registration must satisfy the following conditions:
  - Except for governments, government-related entities and investment funds, applicants must have five years of experience in securities business and investment.
  - Banks, brokerage and securities firms and insurance companies must be licensed or otherwise subject to regulatory oversight by a regulatory authority in a jurisdiction that applies regulatory and monitoring standards equivalent to those of the CMA or acceptable to it.
  - Except for governments and government-related entities, applicants must have assets under management of at least SAR 3.75 billion (US\$ 1 billion).
- Each application for QFI registration is reviewed by an assessing authorised person (“**AAP**”), who is a CMA-authorized person holding a custody or dealing licence. Following the AAP’s assessment of a QFI application, the AAP must notify the CMA whether the application is accepted. Applications that are approved by an AAP are then subject to a CMA review and approval process. The overall CMA review process takes up to 5 days from the CMA’s receipt of all required information.

The QFI Rules impose the following investment restrictions and limits:

- A QFI may not own more than 10% of the shares or convertible debt instruments of any Tadawul-listed issuer.
- All foreign investors (in all categories, whether resident or non-resident, including strategic foreign investors and those investing through the Swap Agreements Framework) cannot own in aggregate more than 49% of the shares or convertible debt instruments of any Tadawul-listed issuer.

QFI investments are also subject to:

- other legislative limitations on foreign ownership in joint stock companies;
  - any instructions or limitations imposed by the supervisory or regulatory authority with jurisdiction over the issuer; and
  - any limitations set forth in the constitutional documents of the issuer.
- QFIs are subject to the ongoing disclosure obligations, including the notification to its AAP of certain events listed in Annex 3.1 of the QFI Rules, e.g., insolvency or restructuring of the QFI or breach of the investment limits.

### **Book Building Instructions**

The new Book Building Instructions will come into force on 1 January 2017. These new rules are intended to regulate the book building process and allocation methods used in initial public offerings. In particular, the Book Building Instructions deal with how the IPO price is set and prescribe a priority waterfall for allocations.

The book building process is run by the financial adviser of the issuer, who must be a CMA-authorized person. The financial adviser’s role is akin to the role played by a sponsor on listings on the Premium segment of the Main Market of the London Stock Exchange.

The following investors are eligible to participate as bidders in the book building process via a bid process organised by the financial adviser:

- Saudi public funds that invest in securities listed on Tadawul;
- CMA-authorized persons that are licensed to deal as principal;
- Companies listed on Tadawul;
- Banks and insurance companies listed on Tadawul;
- Saudi Government entities and Government-owned companies;
- Unlisted Saudi companies provided they have an equity capital of not less than SAR 50 million and an active portfolio; and
- QFIs.

### ***Pre-Marketing and Other Information Disclosure***

The new Book Building Instructions allow financial advisors to test investor appetite prior to obtaining the CMA's approval of the prospectus, but may only disclose information about the issuer and its financial statements on a no-name basis.

After the CMA's approval of the prospectus, but prior to the start of the book building process, the issuer and its financial adviser may disclose information about the issuer and its financial statements to CMA authorized persons, which provides helpful investor feedback in advance of the formal book building and price range setting processes.

### ***Duration of Book Building Process and Price Range***

- IPO shares can be offered to institutional investors only during the book building process.
- The bookbuilding process begins once the CMA approves a prospectus.
- The duration of the book building process cannot exceed 14 calendar days, during which time the issuer and financial advisor, with the assistance of the underwriters, are expected to set a price range, conduct investor roadshows, complete the bookbuilding and set the IPO price.
- Consistent with current practice, the CMA does not participate in the determination of the price range or the final price to investors.
- The difference between the top and bottom of the price range cannot exceed 20% of the minimum price.
- Bidding on prices outside the price range is allowed but must not exceed 20% of the minimum or maximum price in the price range.
- The book building period and the price range are announced by the financial adviser, and this information must be available on the websites of the issuer and the financial adviser.

## ***Institutional and Retail Offering Allocations***

The CMA-approved prospectus will set out the proportions of the overall transaction that are reserved for retail and institutional investors, respectively. Customary market practice has been that the majority of shares available for sale are allocated to institutional investors and we understand that the CMA intends to increase the allocations to institutional investors going forward. Out of the total institutional investor allocation for each transaction, a certain percentage is reserved for Saudi mutual funds in accordance with the formula set out in the Book Building Instructions. The IPO prospectus will set out the percentage of the offering reserved for Saudi mutual funds. Under the current practice, at least 90% of the institutional investor allocation goes to Saudi mutual funds.

Before any shares are offered to retail investors, the offer price is set by reference to the institutional book building process. Retail investors may participate in the IPO at the offer price.

To offer the IPO shares to retail subscribers, the entire IPO offering must first be covered by bids accepted from institutional investors.

It should be noted that price stabilisation and market making, which are widely used in Europe and the US to help stabilise the after-market share price and maintain liquidity in the issuer's shares, are not currently permitted in Saudi Arabia.

## **Changing the Price Range**

The financial adviser may, after obtaining consent from the issuer and the underwriters, change the price range, if the offered shares were fully covered at the highest price in the price range or any price above that price or if the offered shares were not fully covered. Bidding outside the revised price range is not permitted.

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If you have any questions regarding this publication, please do not hesitate to contact one of our key people below.

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