

Accessing Saudi Securities – the New Circular Gives Greater Clarity

A common feature of the legal regimes across the Gulf Co-Operation Countries is their restrictions on foreigners' ownership rights whether of real or other property. Shares in companies are not immune to this, with GCC laws limiting and, in some cases, prohibiting the ownership of domestic shares by foreigners. This has not, however, prevented financial institutions wanting to give their clients exposure or "access" to the value and performance of those shares. One preferred method for providing access is via swaps creating, in essence, a contractual mechanism through which to make (or lose) the money that would have been made had the client bought and sold the shares from which the swaps derive their value. One feature of this structure is the fact that, without an ownership right in the shares but merely a claim against the swap provider for the value or change in the value of the shares, the access purchaser or swap purchaser may lose his money where the swap provider becomes insolvent.

It is with this in mind that the Saudi Arabia Capital Market Authority ("CMA") has recently amended Circular (2-28-2008 dated 17/8/1429H corresponding to 18/8/2008G by Resolution No. 3/10/2010 dated 30/3/1431H corresponding to 16/3/2010G) (the "[Circular](#)").

A Clarification of the Concept

The CMA has sought to address this structural issue. The amendments clarify that the arrangements contemplated under the Circular were not really intended to replicate those under a traditional swap or other access product. Instead, the intention was to create a type of nominee relationship between the swap purchaser as principal and the CMA licensed swap provider - the "Authorised Person" ("AP") - as nominee.

The first amendment replaces the requirement that the AP be the legal owner with the requirement that the shares are held in the name of the AP. This reinforces the requirement under the Circular that an AP ensure that the swap purchaser provides the AP with all the funds necessary for purchasing the shares before the AP makes the purchase. It also makes clearer the existing requirement that the AP hold the shares for the duration of the swap agreement. Many had mischaracterised this requirement as a "hedging requirement", which it was not, because hedging implies a degree of flexibility on the part of an AP as to how to manage its exposure to the swap purchaser under the swap. The holding requirement under the Circular was just that, a non-voluntary requirement imposed by the regulator to hold the underlying shares. If the arrangement envisaged under the Circular is understood as a type of nominee holding arrangement, the requirement becomes clearer and the "hedging requirement" fallacy is laid to rest.

Added Protections

The second amendment gives teeth to the first: under the revised Circular, the swap purchaser is to be given the benefit of the client asset and client money provisions in Part 7 of the Kingdom of Saudi Arabia Authorised Persons Regulations ("[APR](#)").

In common with other client asset and client money regimes, the primary obligation under the APR is for an AP to hold securities that qualify as client assets in accounts separate from its own and to open bank accounts separate

Client briefing
April 2010

Key Issues

A Clarification of the Concept

Added Protections

What has not Changed?

The Nature of the Protections

If you would like to know more about the subjects covered in this publication or our services, please contact:

[Mohammed Al Jadaan](#)
+ 966 1 478 0220

[Habib Motani](#)
+44 207006 1718

[Tim Plews](#)
+44 20 7006 1411

[Simon Clinton](#)
+971 43620 672

[Mohamed Hamra Krouha](#)
(Seconded to Al Jadaan & Partners Law Firm*)
+966 14780 220

[Muna Motaleb](#)
+971 43620 630

[Andrew Henderson](#)
+971 43620 687

[Peter Stansfield](#)
(Seconded to Al Jadaan & Partners Law Firm*)
+966 1 478 0220

Al-Jadaan & Partners Law Firm*
P.O. Box 3515
Riyadh 11481
Kingdom of Saudi Arabia
www.aljadaan.com

Clifford Chance,
3rd Floor, The Exchange Building
Dubai International Financial Centre
PO Box 9380
Dubai, United Arab Emirates
www.cliffordchance.com

from its own into which it places monies received for the purpose of purchasing securities or as a result of liquidating such securities. In addition, the APR give a client a special claim to the assets in the event of the AP's insolvency.

An implication of this second amendment and of this requirement regarding the holding of client money and client assets is that the AP should treat the swap purchaser as its client and enter into terms of business with the swap purchaser for custody services, thereby ensuring that the swap purchaser is given all of the other relevant protections under the APR, in addition to those in Part 7.

What has not Changed ?

Licensing requirements remain stringent with the result that the AP must still be licensed by the CMA to deal as principal. The detailed reporting obligations imposed on the AP remain unchanged. However, the Circular continues to give the CMA extensive powers to order the AP to close out or vary the terms of the swap.

The Nature of the Protections

The amendments clarify that, notwithstanding the synthetic nature of the rights under a normal swap agreement, the intention here is for the swap purchaser to have some protections. Seen in the context of the fact that a non-resident Saudi investor cannot have direct ownership rights in Saudi Arabian listed shares (hence the perceived need for the Circular in the first place), we believe the intention of the CMA is to give the swap purchaser a claim against the assets and the funds, because these are regarded as, in effect, the swap purchaser's assets and funds, although held by the AP as nominee. This is achieved through the provisions of the APR which require the accounts in which the assets and these funds are held to be segregated and to refer to the client name specifically. We understand that the Exchange, Tadawul, now provides segregated accounts for each swap purchaser so that the swap purchaser may claim the assets in case of insolvency of the AP.

The amendments should be welcomed for the clarification they provide of the overall approach of the arrangements envisaged by the Circular. Interestingly, the requirements of the amended Circular are one of the first occasions in the Middle East where a remedy has been created specifically for a foreign beneficiary.¹

The question arises whether it is still appropriate to document arrangements permitted under the Circular as swaps using adapted ISDA or similar documentation. Prior to the amendments, some market participants had sought to give swap purchasers the types of protection provided under Part 7 by providing, for example, segregation of securities accounts. They had done this within an ISDA or ISDA type framework and in these cases there does not appear to be a need to abandon the documentation altogether.

That said, some may feel that, following this clarification by the CMA of the true nature of the arrangements contemplated under the Circular, a revision of their documentation and the use of nominee holding documentation would be appropriate.

Clearly, financial institutions who provide such access products to their clients should review their existing arrangements to ensure that they comply with the requirements of the Circular, that they are internally recorded, managed and accounted for consistently with the nature of the relationship envisaged by the Circular and that their regulatory capital treatment is also consistent with the nature of the relationship envisaged by the Circular.

¹ We now also have the CMA's informal position on what is meant by a non-resident foreign investor: an ultimate beneficiary who is domiciled outside Saudi Arabia. Note that a special purpose vehicle or corporate entity incorporated in the Cayman Island or in Guernsey would qualify as a foreign non-resident investor for the purposes of the Circular even if the shareholders in such entity are Saudi nationals. We understand that the AP would be expected to report such company as the ultimate beneficiary and would only be required to disclose the shareholders of such company if asked by the CMA to disclose. We understand that it is the CMA's current practice to treat GCC nationals and entities incorporated in the GCC countries (other than Saudi Arabia) as foreign non-resident investors for the purposes of the Circular.

This Client briefing does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

www.cliffordchance.com

Clifford Chance LLP is a limited liability partnership registered in England and Wales under number OC323571.

Registered office: 10 Upper Bank Street, London, E14 5JJ

We use the word 'partner' to refer to a member of Clifford Chance LLP, or an employee or consultant with equivalent standing and qualifications.

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

* Clifford Chance has a co-operation agreement with Al-Jadaan & Partners Law Firm