

# Client Alert

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## Relaxed Requirements for Saudi Arabian Funds and Fund Managers

On 1 October 2017, the Saudi Arabian Capital Market Authority (“CMA”) announced amendments to the licensing and asset management regulations to relax requirements for Saudi Arabian funds and fund managers. The paid-up capital of managers for private non-real estate investment funds as well as managed accounts for sophisticated investors has been dramatically reduced to SAR 5 million. A management license could be attractive to asset managers, private equity groups or venture capitalists to potentially access deals and/or tap capital in Saudi Arabia. Further, the revised definition of “professional investor” allows high net worth individuals with net assets of not less than SAR 5 million to invest in private funds. The amendments are intended to assist in the development of private equity and venture capital industry in Saudi Arabia, in support of Saudi Arabia’s National Transformation Program and Vision 2030.

### Background

The CMA is the regulator governing the asset management and securities business in Saudi Arabia. All Saudi Arabian investment funds must be submitted to and authorized by the CMA. Every investment fund domiciled in Saudi Arabia is a contractual entity formed between the fund manager and its investors. The fund must be managed by an “Authorized Person” in Saudi Arabia which is licensed by the CMA to undertake asset management activities.

The Saudi CMA-regulated fund is arguably the most efficient vehicle for structuring investments into Saudi Arabia. If properly structured, they create the ability to minimize regulatory restrictions (particularly in relation to foreign inbound investment) and can also provide certain tax efficiencies not available with other structures. Due to the relative ease of establishing a CMA fund (compared to other Saudi Arabian corporate vehicles), we have seen an increase in the use of single asset funds for private equity deals as they offer a means to pool investors in a vehicle to acquire an asset while largely avoiding many of the challenges normally associated with foreign investment into Saudi Arabia.

As of January 2018, there are 65 Authorized Persons in Saudi Arabia holding a management license and approximately 600 active investment funds split nearly evenly between retail funds and privately placed funds.

## Lower Capital Requirements

Prior to the recent changes to the Authorized Persons Regulations,<sup>1</sup> the minimum paid-up capital for an applicant for an asset management license was SAR 50 million. The paid-up capital requirement was lowered to:

- SAR 5 million (approximately US\$ 1.3 million) in respect of “private funds” that do not invest in real estate and in respect of managed accounts for “sophisticated investors”, provided that the total assets under management by such authorized person do not exceed SAR 1 billion; and
- SAR 20 million (approximately US\$ 5.3 million) for other CMA Funds and managed accounts for non-sophisticated investors.

A “private fund” is an investment fund that is offered pursuant to Articles 74 and 75 of the Investment Funds Regulations<sup>2</sup>. A private fund may only be offered to “sophisticated investors” or to offerees whose investment is not less than SAR 1 million or an equivalent amount in another currency.

The recent amendments did not affect the paid-up capital for companies holding the other licenses issued by the CMA. An applicant that wishes to pursue dealing and custody activities will be subject to the higher minimum paid-up capital of SAR 50 million. An applicant that wishes to pursue arranging or advising activities is subject to the lower minimum paid-up capital of SAR 2 million in respect of arranging activities and SAR 400,000 in respect of advising activities.

## High Net Worth Individuals as “Professional Investors”

A private fund may only be offered to a “sophisticated investor”, which includes government organizations, institutions acting for their own account, CMA-regulated authorized persons acting on their own account or for their clients, as well as “professional investors”.

The definition of a “professional investor” was recently amended to include a net worth test. The term “professional investor” now means any natural person who fulfils at least one of the following criteria:

- has net assets of not less than SAR 5 million;
- has carried out at least 10 transactions per quarter over the last 12 months of a minimum total amount of SAR 40 million on securities markets;
- works or has worked for at least three years in the financial sector in a professional position which requires knowledge of securities investment;
- holds a professional certificate that is related to securities business and is accredited by an internationally recognized entity; or

<sup>1</sup> Authorized Persons Regulations issued by the CMA pursuant to its resolution No. 1-83-2005 dated 21/05/1426H (corresponding to 28/06/2005G).

<sup>2</sup> Investment Funds Regulations issued by the CMA pursuant to Resolution No. 1-219-2006 dated 3/12/1427H (corresponding to 24/12/2006G) as amended by Resolution No. 1-61-2016 dated 16/8/1437H (corresponding to 23/5/2016G).

- holds the General Securities Qualification Certificate that is recognized by the CMA and has an annual income that is not less than SAR 600,000 in the two most recent years.

## **General Requirements to be Licensed as a Fund Manager**

The CMA also updated the process to obtain a management license and for the first time is allowing certain activities to be outsourced to third parties (e.g. finance and compliance). These changes were made to lower costs and encourage smaller groups to consider obtaining licenses.

A potential applicant wishing to be licensed as an “Authorized Person” to act as fund manager must demonstrate:

- it is fit and proper to carry on securities business of the kind and scale for which it seeks authorization;
- it has adequate expertise and resources for the kind of securities business that it proposes to carry on;
- it has managerial expertise, financial systems, risk management policies and systems, technological resources, and operational procedures and systems that are sufficient to fulfil its business and regulatory obligations and to conduct the kind of securities business that it proposes to carry on; and
- its directors, officers, employees and agents who will be involved in the applicant’s securities business have the necessary qualifications, skills, experience and integrity to carry on the kind of securities business that it proposes to carry on.

The applicant must have a presence in Saudi Arabia and be one of the following entities (which for the avoidance of doubt can be owned by foreign shareholders up to 100%):

- a joint stock company;
- a subsidiary of a local bank or foreign financial institution licensed in Saudi Arabia; or
- a subsidiary of a Saudi joint stock company that is engaged in financial services business.

The information and documents that must be submitted to the CMA by an applicant wishing to be licensed as an “Authorized Person” include the following:

- a list of persons who “control” the applicant;
- a list of persons that have, or are proposed to have, close links with the applicant;
- board resolution approving the application to the CMA;
- business profile including full details of all securities and all services for which the applicant proposes to provide for each securities activity that it is applying to carry on;
- a business plan setting out a detailed description of the securities business activities that the applicant proposes to undertake during, at least, the first 12 months after authorization;

- financial statements. An applicant must submit its financial statements (or that of its founders or controlling shareholders of an applicant, in the case of a new entity or an entity under formation) prepared and accredited by the applicant's auditors. The regulations require audited financial statements prepared in accordance with the standards issued by the Saudi Organization for Certified Public Accountants (“SOCPA”), although we expect financial statements prepared in International Financial Reporting Standards will also be accepted by the CMA;
- a list of the “registered persons” (as defined below) and the details of their qualification and experience;
- systems and controls documentation;
- operations manual;
- terms of business;
- a list of proposed fees, commissions, charges and other expenses;
- agreements with third parties to provide any material services or operations;
- details of professional indemnity insurance policies;
- copy of articles of association;
- ownership structure chart; and
- business continuity plan.

An applicant must have the following “registered persons”:

- managing director;
- finance manager;
- compliance officer; and
- money laundering and terrorism financing reporting officer (“MLRO”).

A person may perform more than one registrable function for an Authorized Person except that the CEO, finance manager and compliance officer must be separate persons, and the compliance officer cannot perform client functions. A registered person must be resident in Saudi Arabia, unless the CMA grants an exemption from this requirement (which is typically granted to non-executive board members). A registered person must have passed the qualification examinations required by the CMA or secured an exemption from the CMA from such a requirement (which is typically granted to the managing director and board members).

An “Authorized Person” that does not engage in dealing and custody activities or that does not conduct management activities other than private non-real estate investment funds or managed accounts for sophisticated investors is permitted to outsource:

- the function of finance officer to an accounting firm certified by the SOCPA; and
- the function of compliance officer to another Authorized Person, an accounting firm certified by the SOCPA or a law firm authorized in Saudi Arabia.

Under the regulations, the CMA must approve or refuse (with reasons) applications to be licensed as an Authorized Person within thirty (30) days. Any new Authorized Person with shareholders not from a Gulf Cooperation Council (“GCC”) country (i.e. Saudi Arabia, United Arab Emirates, Bahrain, Qatar, Kuwait and Oman) must be licensed by the Saudi Arabia General Investment Authority (“SAGIA”), which regulates foreign investment into Saudi Arabia, but SAGIA has pledged to fast-track CMA license applications.

## Conclusion

The recent changes to the paid up capital requirements for fund managers and the opening up of private funds to high net worth individuals increases the attractiveness of the Saudi Arabian asset management market. International and local players now have added reasons to consider becoming licensed as a fund manager for investment funds established in the Saudi Arabia which can potentially allow for access to deals which are not open to foreigners and unregulated entities and also allow for expanded fundraising activities.

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