

Enforcement of capital commitment structures in Saudi Arabia



SAUDI ARABIA

By Nabil A Issa

As the asset management landscape in Saudi Arabia develops and aligns with global best practices, a growing number of investment funds in the Kingdom are being structured on a capital commitment basis. Pursuant to such structures, investors commit to investing a certain amount of money over a certain period of time pursuant to capital drawdowns from the fund manager, as and when needed by the respective fund.

In the event investors default on their commitments to provide the requested funding, fund managers are typically given the right to exercise certain remedies in accordance with relevant offering documents. Such remedies include charging late payment fees, withholding future distributions, preventing the defaulting investors from voting or even forfeiting the defaulting investors' interests in the fund and distributing them to other existing investors.

In the Kingdom, where a considerable number of funds are structured on a Shariah compliant basis, such remedies may prove to be questionable notwithstanding the fact that they have been incorporated in various offering documents approved by prominent

Shariah scholars and the Saudi Arabian Capital Market Authority (the CMA). In particular, the extent to which the CMA upholds the provisions of the offering documents and recognizes the relevant default remedies was historically uncertain until a recent judgment was issued in July 2020 by the CMA's appeal committee in which the CMA recognized and upheld certain default remedies exercised by a Saudi Arabian fund manager against a defaulting investor in a private real estate fund.

As background, in January 2019, a Saudi Arabian defaulting investor filed a claim against a Saudi Arabian fund manager who forfeited the investor's units in the fund (in accordance with the fund's offering documents) claiming that its units were unjustly forfeited by the fund manager in violation of the general principles of Shariah (notwithstanding the fact that the fund's offering documents were approved by a reputable Shariah scholar).

In May 2019, the CMA's committee for the resolution of securities disputes issued its judgment in favor of the defaulting investor on the basis that the fund manager violated its obligations under the general principles of Shariah and the Authorized Persons Regulations (now referred to as the Capital Markets Institutions Regulations).

On appeal, however, the CMA's appeal committee overturned the judgment and dismissed the investor's claim on the basis that (i) the investor subscribed into the fund as a sophisticated investor and was well aware of the consequences of default as clearly set forth in the relevant fund documents, (ii) enforcement of contracts in accordance with their terms and enhancing the predictability of enforcement are crucial for supporting the capital market industry in the Kingdom, (iii) the investor clearly defaulted on its contractual obligations under the fund's offering documents, and (iv) the committee does not regard any step taken by the fund manager to be in violation of the applicable regulations.

The judgment issued by the CMA's appeal committee is widely welcomed by fund managers, institutional investors and other participants within the asset management industry in Saudi Arabia, as it clearly removes any ambiguities regarding the enforceability of default remedies and provides comfort to fund managers and institutional investors that enforceability of contractual terms (including default remedies) is clearly prioritized by the CMA. ☺

Nabil Issa is a partner at King & Spalding. He can be contacted at nissa@kslaw.com.

☺