THE Asset Management Review

Eleventh Edition

Editor
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THE ASSET MANAGEMENT REVIEW

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PREFACE

Last year we reflected on how 2020 might primarily be remembered as the year of the novel covid-19 pandemic. A few events of global significance punctured covid-19's monopoly of economic news: the Democrats winning the White House; an 11th-hour 'deal' being reached between the European Union and the United Kingdom a mere week before the end of the transition period; and a wrong turn in the Suez canal. However, a year on and the pandemic continues to dominate the global geopolitical landscape and remains a source of significant uncertainty. While it is clear that 2021 was also overshadowed by the pandemic, successful vaccination campaigns appear to be providing fragile grounds for economic optimism in the near future. Yet unprecedented levels of government spending combined with labour shortages and supply chain disruption mean any recovery will have to grapple with rising inflationary pressures. In the asset management world, it is clear that the sector has faced one of its greatest and most sustained tests in recent history. The need for the industry to remain adaptable and resilient has perhaps never been greater.

Leaving all of this aside, though, the importance of the asset management industry continues to grow. Nowhere is this truer than in the context of pensions, as the global population becomes larger, older and richer, and government initiatives to encourage independent pension provision continue. Both industry bodies and legislators are also increasingly interested in pursuing environmental, social and governance (ESG) goals through private sector finance. This should not be a surprise: lack of shareholder engagement has been identified as one of the key issues that contributed to the governance shortcomings during the financial crisis. Given the importance of the asset management industry in investing vast amounts on behalf of clients, the sector is the natural focus of regulatory and governmental initiatives to promote effective stewardship and take the lead in instilling a corporate cultural focus on sustainability and ESG initiatives.

The activities of the financial services industry remain squarely in the public and regulatory eye, and the consequences of this focus are manifest in ongoing regulatory attention around the globe. Regulators are continuing to seek to address perceived systemic risks and preserve market stability through regulation. Operational resilience – a concept focused on ensuring asset managers' holistic preparedness against any risk event, particularly significant operational risks – continues to be a significant focus point for global regulators.

It is not only regulators who continue to place additional demands on the financial services industry: the need to rebuild trust has led investors to call for greater transparency around investments and risk management from those managing their funds. Senior managers at investment firms are, through changes to regulatory requirements and expectations as to firm culture, increasingly being seen as individually accountable within their spheres of responsibility. Industry bodies have also noted further moves away from active management into passive strategies, illustrating the ongoing pressure on management costs. This may, in itself, be storing up issues for years to come.

The rise of fintech and other technological developments, including cryptocurrencies, data analytics and automated (or 'robo') advice services, is also starting to have an impact on the sector, with asset managers looking to invest in new technologies, seeking strategies to minimise disruption by new entrants, or both. While regulators are open to the development of fintech in the asset management sector, they also want to ensure that consumers do not suffer harm as a consequence of innovations. Regulators across various jurisdictions launched the Global Financial Innovation Network, which aims to facilitate collaboration and communication between regulators regarding financial innovation and to create a cross-border sandbox in which firms can test their new technologies. This continues to be a period of change and uncertainty for the asset management industry, as funds and managers act to comply with regulatory developments and investor requirements, and adapt to the changing geopolitical landscape and respond to the ongoing uncertainties brought about by the global pandemic. Although the challenges of regulatory scrutiny and difficult market conditions remain, a return of risk appetite has also evidenced itself, and the global value of assets under management continues to increase year-on-year. The industry is not in the clear, but, prone as it is to innovation and ingenuity, it seems well placed to navigate this challenging and rapidly shifting environment.

The publication of the 11th edition of *The Asset Management Review* is a significant achievement, which would not have been possible without the involvement of the many lawyers and law firms who have contributed their time, knowledge and experience to the book. I would also like to thank the team at Law Business Research for all their efforts in bringing this edition into being.

The world of asset management is increasingly complex, but it is hoped that this edition of *The Asset Management Review* will be a useful and practical companion as we face the challenges and opportunities of the coming year.

Paul Dickson
Slaughter and May
London
August 2022

Chapter 15

SAUDI ARABIA

Nabil A Issa, James R Stull, Macky O'Sullivan and Sayf Shuqair[1]

I OVERVIEW OF RECENT ACTIVITY

The Saudi Arabian economy is the largest in the Arab world (nearly twice the size of that of the United Arab Emirates) and is currently on an upswing following a severe drop in oil prices several years ago and the spread of the covid-19 pandemic. While the economy is still driven by abundant oil reserves and related hydrocarbon industries, the country's leadership has adopted a national transformation plan named 'Vision 2030' to modernise and diversify the economy, and has entrusted a vast amount of assets under the authority of the Public Investment Fund (PIF), which is now one of the world's largest sovereign wealth funds. Vision 2030 focuses on increasing the country's non-oil revenue and employment, particularly in the private sector, in retail, education and healthcare. The effects of Vision 2030 have been felt, as non-oil sector private sector growth has substantially increased since the start of 2017.

Saudi Arabia has raised tens of billions of dollars in sovereign issuances in the past six years (after nearly a decade without any public debt issuances). As of the end of March 2022, Saudi Arabia's total outstanding direct indebtedness amounted to 958.6 billion riyals, comprising 579.4 billion riyals of domestic indebtedness and 379.3 billion riyals of external indebtedness.

The government is also focusing on increasing foreign investment into the country. In a long-awaited and very welcome move, the government opened the Saudi Arabian Stock Exchange (Tadawul) to foreign investment in June 2015 and liberalised the foreign ownership rules in subsequent years. In February 2021, the government announced that it will no longer work with or enter into contracts with foreign companies whose regional headquarters are not in Saudi Arabia, in an attempt to lure multinational companies to increase their presence in the Kingdom. The Capital Market Authority (CMA) has also been encouraging many of the country's blue chip and large family-operated companies and financial services companies to list, and created a small cap market, the Parallel Market, in February 2017, which has seen 31 listings to date. Further, Saudi Arabia has introduced a real estate investment trust (REIT) regime and, in November 2016, Riyad REIT was the first REIT to be listed in Saudi Arabia (and only the second REIT to be listed in the Middle East), which was followed by another 17 REITs up to July 2022, with a number of them also increasing their capital to acquire additional assets. More recently, the CMA has published regulations for listed funds pursuant to which the Alkhabeer diversified income traded fund was the first non-real estate fund to be

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listed on the Tadawul, followed by the Alkhabeer growth and income fund, which was listed in April 2022. It is hoped that the successful listing of this fund will spur the development of exchange-traded private equity funds.

Over the past four years, the CMA has released numerous regulations covering the establishment of new corporate vehicles, the initial public offering (IPO) process and foreign investment in Saudi Arabia, and has promised a complete revamp of existing financial services regulations. In addition, the Ministry of Commerce published new Companies Regulations in June 2022 in a step that was widely welcomed by companies and investors operating in the Kingdom. Three regulations in particular are pivotal for asset managers looking to raise Saudi Arabia-targeted funds: the rules on the offer of securities and continuing obligations, the investment funds regulations and the real estate investment funds regulations. These regulations provide opportunities to investment banks, private equity firms and asset managers to expand their product offerings and access additional investor bases, particularly with the rules on the offer of securities and continuing obligations, which would potentially allow foreign companies to list their shares on the Tadawul main market.

Saudi Arabia is home to the largest number of investment funds domiciled in the Gulf Cooperation Council (GCC). Funds and asset managers have been gradually diversifying from primarily real estate investments into other parts of the economy, with a particular focus on venture capital and private equity, as these sectors are being supported by governmental programmes and investors including the CMA, PIF, Jada Fund of Funds, Sanabil Investments, the Saudi Venture Capital Company, Elm Company, Takamol, the Ministry of Commerce, the Ministry of Investment (MISA), the Ministry of Labour, Social Development Bank, the Small and Medium Enterprise Authority (SMEA), the Saudi Technology Development and Investment Company (TAQNIA) and other government institutions. Similar to other countries within the GCC, there have also been recent developments within the sphere of private debt with the CMA's issuance of the Instructions on the Direct Financing Investment Funds, which aim to introduce a regulatory framework for credit funds in Saudi Arabia.

II GENERAL INTRODUCTION TO THE REGULATORY FRAMEWORK

The CMA and the Saudi Central Bank (SBC) are the government bodies that regulate asset management and financing transactions in Saudi Arabia.

The CMA regulates Saudi Arabia's capital markets, including securities, sales of assets, equity securities and debt securities (such as *sukuk*). Its power is granted under the Capital Market Law, which was originally implemented in 2003.

The CMA has recently issued resolutions and implementing regulations governing the management and offerings of securities, including but not limited to the following:

a the Rules on the Offer of Securities and Continuing Obligations, which govern the offering of securities in Saudi Arabia on both a private and public basis;

b the Capital Market Institutions Regulations (previously named the Authorised Persons Regulations), which govern the establishment of asset managers, their conduct of business, systems and controls and handling of client money and assets;

c the Rules for Special Purpose Entities, which are intended to promote *sukuk* and the offering of other debt instruments in addition to the establishment of investment funds as separate entities;

d the Rules for Qualified Foreign Financial Institutions Investment in Listed Shares, which govern investment by foreign investors in shares listed on the Tadawul and the Parallel Market;
e the Investment Funds Regulations, which govern public funds, listed non-real estate funds, private equity funds, hedge funds, money market funds and private real estate funds;
f the Real Estate Investment Funds Regulations, which govern publicly placed real estate funds including REITs;
g the Instructions on the Direct Financing Investment Funds, which govern the establishment and operation of credit funds; and
h a resolution issued by the CMA's board of directors (22/12/1441H (corresponding to 12/08/2020G)), which includes allowing residents and non-resident foreigners to invest directly in listed and non-listed debt instruments in the Kingdom.

In late 2017, the CMA issued the Financial Technology Experimental Permit Instructions, which introduce a sandbox accelerator under which certain financial services companies can apply for licences for products and services in new sectors. In addition, the SCB announced the launch of the FinTechSaudi initiative in May 2018, which is also aimed at supporting the fintech ecosystem alongside the efforts of the CMA. On 10 September 2020, the CMA announced the issuance of an experimental permit for Maysan Financial Technology Company to investigate social trading technology; a number of permits followed, with the latest being issued to Tahaluf Capital to establish an equity crowdfunding platform, Ezdehar Osool to establish an investment and real estate funds distribution platform and Tarmeez to establish a platform to offer and invest in debt instruments.

The SCB acts as the central bank of Saudi Arabia and is responsible for issuing currency and regulating the insurance industry. It is also responsible for encouraging the development of the Saudi Arabian banking system in both the public and commercial sectors. Additionally, the SCB is Saudi Arabia's investment authority, and is responsible for managing the country's assets, both inside and outside of the country, although this role is being largely transferred to and handled by the PIF.

With few exceptions, individuals who are not citizens of a GCC country and non-GCC corporate entities (including Saudi entities with direct or indirect non-GCC ownership) must register with MISA (previously known as the Saudi Arabian General Investment Authority) prior to owning non-listed shares or real property in Saudi Arabia. The MISA registration process adds expense and time to any transaction. The primary exemptions to MISA registration are ownership in a CMA fund and investment in listed shares (or units in exchange-traded funds or REITs) through the qualified foreign investor (QFI) framework, under the CMA-regulated swap regime and potentially pursuant to the Instructions for the Foreign Strategic Investors' Ownership in Listed Companies.

To date, the MISA rules have not governed foreign ownership in a CMA fund. Accordingly, there is no requirement that non-GCC investors in a CMA fund obtain MISA approval. Moreover, GCC nationals and companies that are majority-owned by GCC nationals (and partly owned by non-GCC nationals) are permitted to invest directly in listed securities in Saudi Arabia. Additionally, financial institutions that register with the CMA as a QFI are permitted to buy and sell shares of publicly listed companies in Saudi Arabia on their own behalf and on behalf of their clients without MISA approval, and other foreign corporate investors may own shares under the Instructions for the Foreign Strategic Investors' Ownership in Listed Companies.

As part of the CMA's efforts in revamping the existing financial services regulations, the CMA has introduced a number of amendments to the above-mentioned rules and regulations during the past couple years, with the most notable amendments being related to the Investment Funds Regulations, the Capital Market Institutions Regulations (previously called the Authorised Persons Regulations) and the Rules on the Offer of Securities and Continuing Obligations.

Among other things, the amendments to the Investment Funds Regulations introduced a number of developments with respect to the establishment and operation of private funds. Investors in private funds must be institutional clients or qualified clients as defined by the CMA, or retail clients investing a maximum amount of 200,000 riyals. In addition, a fund manager that is not licensed to operate or administer funds by the CMA must appoint a separate administrator for the fund. The CMA has also taken active steps to reduce the number of distressed funds in the market by placing a number of affirmative obligations on fund managers with respect to liquidating funds and distributing proceeds to investors. The amendments aim to codify a number of CMA practices and also introduce a number of significant changes. In terms of private funds, the amendments introduce a number of amendments concerning investor eligibility and corporate governance and also aim to resolve certain ambiguities in the market regarding the permissibility of capital commitment structures by clearly permitting them under the amendments. With regard to public funds, the amendments touch on a number of areas including investment restrictions and governance. Pursuant to the amendments, REITs and certain non-real estate funds that are currently able to list on the Tadawul are also given the right to list on the Parallel Market.

The amendments to the Capital Market Institutions Regulations introduce certain amendments to the defined scope of securities activities, the types of licences and the minimum capital required to carry out these activities. They also introduce new classifications for the types of clients for CMA-regulated entities whereby clients are retail clients, qualified clients or institutional clients, and reduce requirements for applicants to obtain a management licence whereby the required share capital has been reduced in some cases to as little as one year of expenses.

The amendments to the Rules on the Offer of Securities and Continuing Obligations introduce a number of changes that impact the offering of securities in the Kingdom. Most notably, the amendments provide additional protection to unsophisticated investors who were previously required to invest a minimum amount of 1 million riyals in a private placement done on a limited offer basis (i.e., limited to a maximum of 100 offerees), but are now restricted from investing more than 200,000 riyals.

Similar to the CMA, the Ministry of Commerce (MOC) announced draft amendments to the Companies Regulations in July 2020, which were announced in their final form in June 2022. Under the amendments, a number of new concepts (which are typical in offshore and other common law jurisdictions) have been introduced. Such features and concepts include the introduction of drag-along and tag-along rights in addition to the introduction of multiple classes of shares with different rights.

III COMMON ASSET MANAGEMENT STRUCTURES

For tax and other regulatory reasons, the majority of structures used in Saudi Arabia are domestically based. The primary structures for asset management in Saudi Arabia are managed accounts and investment funds regulated by the CMA. As opposed to other Saudi Arabian vehicles, a CMA fund is relatively inexpensive to establish and maintain and allows for significant structuring flexibility. Further, a manager can structure the fund so that investors are truly passive, unlike many other vehicles where investors actually have statutory veto rights and other substantial minority protections.

The Saudi CMA fund is arguably the most efficient vehicle for structuring investments into Saudi Arabia. If properly structured, they create the ability to minimise restrictions from MISA and can also provide certain tax efficiencies not available with other structures.

Before the rise in popularity of CMA funds, most collective investment vehicles in Saudi Arabia took the form of limited liability companies. However, they are relatively inflexible vehicles that statutorily provide substantial rights to their shareholders, which makes it hard for managers to enforce any default provisions or even to exit investments or wind down a fund. For example, structuring and enforcing a capital commitment structure in a Saudi limited liability company is very complex. Although the new Companies Regulations have introduced a number of new, welcomed concepts that are akin to those embedded within corporate laws in other Western jurisdictions, it is unlikely that any corporate structure will surpass the popularity of CMA funds, although the SMEA, MOC and CMA are jointly collaborating to explore the legal and regulatory framework for companies necessary to nurture start-ups and small businesses.

There has been a recent upsurge in the utilisation of asset management and investment structures in the Abu Dhabi Global Market (ADGM) in relation to assets in Saudi Arabia. The ADGM is a financial free zone based in the Emirate of Abu Dhabi, United Arab Emirates (UAE), which has a legal regime based on English law. Companies domiciled in the ADGM can be deemed 'GCC' when conducting business in Saudi Arabia and potentially would not need to be registered with MISA depending on their shareholding structure. As such, owing to various regulatory, legal and practical considerations, managers and investors have increasingly explored using ADGM for Saudi business and investment ventures. There are potential tax benefits using ADGM (as opposed to other offshore jurisdictions) and, in certain circumstances, ADGM companies can elect to be treated as Saudi tax residents with the Saudi tax authorities – however, due to economic substance rules in both the UAE and Saudi Arabia and the recent double taxation treaty adopted between Saudi Arabia and the UAE, professional tax advice should be sought before implementing any cross-border transaction.

IV MAIN SOURCES OF INVESTMENT

With over 500 domestic funds currently in operation, Saudi Arabia has the largest number of funds domiciled in the Middle East by a large margin. Historically, investment funds in Saudi Arabia were offered to retail clients and invested in traditional asset classes such as listed equities, money market instruments and corporate and sovereign debt. More recently, the private funds market has thrived. Private funds have tended to invest in real estate, which has been the asset of choice for high-net-worth and institutional Saudi investors and is easier to structure in order to be shariah-compliant than many alternative assets. More recently, there has been a surge in private equity and venture capital funds due to the encouragement of the CMA, SMEA and other government authorities and various incentive programmes. In early

2018 the government introduced a draft framework for credit funds, which was eventually formalised in June 2022 under the Instructions on the Direct Financing Investment Funds, which regulate credit funds in Saudi Arabia.

While the vast majority of investors in Saudi Arabian funds are Saudi nationals, Saudi-domiciled institutions and family offices, and government-backed entities and organisations, there is also a significant level of investment from GCC nationals and institutions in such funds.

V KEY TRENDS

i Equity capital markets

The government is encouraging significant investment into the economy from both local and foreign investors. There have been many IPOs in the past decade, including the IPO of the National Commercial Bank (NCB), which was the largest ever regional IPO, and the second-largest globally in 2014. In the first half of 2022, the CMA announced the approval of five IPOs in Saudi Arabia, including those for Arabian Drilling Company, Alamar Foods Company and Naqi Water Company. It has been speculated that a number of prominent Saudi companies, including units of Saudi Arabian Airlines, Bateel International and Dar Al-Arkan Properties, are preparing for listing in the near future on the main market of the Tadawul.

In June 2015, foreign investors were permitted to directly own shares listed on the Tadawul through the QFI framework. Only foreign institutions that have a minimum of US$500 million in assets under management and five years of experience will be permitted to register with the CMA as a QFI. Once registered, a QFI can purchase or arrange for its clients to purchase shares of companies listed on the Tadawul (except for certain companies that have substantial real estate holdings in Mecca and Medina, where ownership of real property is limited to Saudi Arabian nationals). Holdings in a single company by a QFI or its clients will be limited to 10 per cent, and holdings in a single company by QFIs in the aggregate will be limited to 49 per cent.

Prior to June 2015, foreign investors could participate in listed companies through swap arrangements only, which allowed investors to participate in the profits of the companies but did not provide for voting rights. It is expected that, as a result of the QFI framework, foreign investment in the Saudi Arabian stock market has grown from US$7 billion to nearly US$93 billion as of April 2022. In addition to the QFI framework, the CMA announced on 26 June 2019 the introduction of the Instructions for the Foreign Strategic Investors' Ownership in Listed Companies, which were widely welcomed as they pave the way for relaxing the regulatory framework for foreign investment in Saudi listed companies. The newly introduced instructions allow non-financial entities to invest in Saudi listed companies, and it is hoped that foreign strategic shareholders will be permitted to own shares in excess of 49 per cent of a company's share capital without being subject to overly restrictive lock-up periods.

In February 2017, the CMA and Tadawul created the Parallel Market to allow for alternative and small-cap listings. This move was widely anticipated and well received, improves small and medium-sized enterprises' access to capital and encourages better corporate governance. As of July 2022, 31 companies were listed on the Parallel Market, with a number of companies that have been approved to list on the Parallel Market in recent months, the latest being Sure International Technology, whose approval for listing on the Parallel Market was announced by the CMA in June 2022.

In October 2016, the CMA's Real Estate Investment Traded Funds Instructions (REIT Regulations) were introduced, which allow managers to list certain public real estate funds on the Tadawul. As of the end of July 2021, the Tadawul is host to 17 listed REITs, and it is widely expected that the REIT Regulations will further spur the real estate market in Saudi Arabia. Furthermore, the REIT Regulations were consolidated with the Real Estate Investment Funds Regulations as of 1 May 2021.

In October 2018, the CMA issued the Closed-Ended Investment Traded Funds Instructions, which govern the establishment and listing of certain non-real estate funds on the Tadawul. The first fund to be established pursuant to these regulations is the Alkhabeer Diversified Income Traded Fund, followed by the Alkhabeer Growth and Income Fund, which was listed in April 2022. It is anticipated that listing of private equity funds under these instructions will gain traction as retail investors are given exposure to privately held companies with minimal investment. Furthermore, the Closed-Ended Investment Traded Funds Instructions were consolidated with the Investment Funds Regulations as of 1 May 2021.

In addition, the market has witnessed in recent years signs of consolidation among various sectors, in particular the banking and insurance sectors, which already saw the successful merger between the Saudi British Bank and Alawwal Bank earlier in 2019 in addition to the recent merger between National Commercial Bank and SAMBA Bank, approved by the CMA on 31 May 2021, which created a combined group with more than US$200 billion in assets. In line with the consolidations in the banking sector, there have also been a few announcements regarding consolidations in the insurance sector, with the latest being between Al-Ahlia Insurance Company and Gulf Union Cooperative Insurance Company, and Aljazira Takaful Taawuni Company and Solidarity Saudi Takaful Company.

ii Debt capital markets

Historically, the majority of debt issues from Saudi Arabia have been in the form of *sukuk*. While it is expected this trend will continue in the long term, the government has recently launched several large conventional bond programmes – including a €1.5 billion bond sale in 2021 (only the second ever time the country has issued sovereign debt denominated in euros).

Sukuk and bond issuances are regulated by the CMA. It is expected that the CMA will issue regulations in the near future governing the process to list and trade *sukuk* and bonds on the Tadawul.

iii Investment funds

The CMA has increasingly scrutinised blind pool investment funds and real estate development funds. Owing to this heightened scrutiny and the relative ease with which managers can establish private CMA funds, there has been a significant shift toward single asset funds, particularly single asset real estate funds with very limited numbers of investors. However, an exception to this has been the rise in venture capital and private equity funds that are supported by the government through Jada or Saudi Venture Capital Company, which support and encourage blind pool funds as they are pushing for the development and growth of the asset management industry in Saudi Arabia.

Investors in Saudi Arabia are increasingly looking outside of Saudi Arabia (and the wider Middle East and North Africa (MENA) region) towards the more established markets of Europe and the United States, which, despite the geopolitical events in those jurisdictions, are widely seen as significantly more stable than Saudi Arabia. This sentiment has not gone unnoticed by foreign asset managers, who are increasingly approaching high-net-worth individuals, families, sovereigns and institutions and marketing their foreign funds as being better alternative investment vehicles to those available in Saudi Arabia. Noting this trend, Saudi-based asset managers are increasingly setting up investment funds whose investment strategies are focused on investing mainly in the United States and Europe, with a particular focus on the real estate sector, and foreign asset managers are becoming increasingly interested in offering their funds to Saudi investors. Saudi-based asset managers have also been seen setting up various structures that give local investors access to late stage venture capital opportunities in the United States and Europe.

Foreign funds may only be offered in Saudi Arabia as a private placement to qualified clients or institutional clients, and the minimum amount payable per offeree is not less than 200,000 riyals or an equivalent amount. In addition, the CMA has mentioned on its website that direct cross-border offerings and reverse solicitation will be considered tolerated practices under certain circumstances.

VI SECTORAL REGULATION

i Insurance

The SCB regulates the insurance industry in Saudi Arabia. In particular, insurance companies are governed by the Cooperative Insurance Companies Control Law and its Implementing Regulations, and the Investment Regulations issued by the SCB.

Every insurance company must adopt an investment policy approved by the SCB. Any material changes to the investment policy must also be approved by the SCB.

If the SCB does not approve an insurance company's investment policy, or an insurance company does not have any investment policy, then the insurance company must adhere to the investment standards set out in Table 1 of the Implementing Regulations (see below), provided that investments outside Saudi Arabia will not exceed 20 per cent of the total investments and are in accordance with Article 59(2) of the Implementing Regulations. Article 59(2) provides that the insurance company must invest 50 per cent of its total invested assets in Saudi Arabian riyals. The SCB's written approval is required if the insurance company wishes to reduce this percentage.

The Regulations are silent on what constitutes investments outside Saudi Arabia.

Investment type	Percentage for general insurance	Percentage for protection and savings insurance
Saudi authorised banks	20 maximum	10 maximum
Saudi government bonds	20 maximum	10 maximum
Saudi riyal-denominated investment funds	10 maximum	15 maximum
Foreign currency-denominated investment funds	10 maximum	10 maximum
Foreign government bonds	5 maximum	5 maximum
Bonds issued by domestic companies	5 maximum	5 maximum
Bonds issued by foreign companies	5 maximum	5 maximum
Equities	15 maximum	15 maximum

Investment type	Percentage for general insurance	Percentage for protection and savings insurance
Real estate in Saudi Arabia	zero maximum	5 maximum
Loans secured by real estate mortgages	zero	5 maximum
Loans secured by policies issued by the insurer	zero	5 maximum
Other investments	15 maximum	15 maximum

Insurance companies must take into account the investment concentration risks. Concentration in an investment instrument must not exceed 50 per cent in any one of the investment instruments mentioned in the table above.

Insurance companies are prohibited from investing in derivatives, option contracts, hedge funds, deposits with foreign banks, private equity investments and any off-balance sheet instrument, and these should also not form part of the insurance company's asset allocation unless specifically approved by the SCB, and must be based on efficient portfolio management justification. An insurance company can, with the approval of the SCB, invest in derivatives subject to the following conditions:

a such derivatives must be listed on a stock exchange, capable of being readily closed out and based on underlying admissible assets, and must have a prescribed pricing basis;

b the insurance company must set aside assets that can be used to settle any obligations under these derivatives, and set out adequate provisions for any adverse changes to the derivatives and their coverage; and

c the counterparty must be reputable and in an acceptable financial condition.

Investment in *sukuk* is allowed provided they are equivalent to bonds and the percentage allocation in them does not conflict with those outlined in the table above. The maximum limit of allocating *sukuk* that are issued by local companies in which the government has a significant ownership is 20 per cent, and the solvency margin is equivalent to the government's participation in the capital.

ii Pensions

There are two large government institutions in Saudi Arabia focused on pensions and payments of employee benefits: the Public Pension Agency (PPA) and the General Organisation for Social Insurance (GOSI). It has been recently announced that both bodies will be merging into a single pension agency. Additionally, Saudi Aramco Investment Management Company (SAIMCO), which invests the capital for the Saudi Aramco pension and retirement plans, is a big player. Otherwise, private pension plans are not particularly active players in asset management in Saudi Arabia.

PPA

Government employees in Saudi Arabia are entitled to pensions of up to 80 per cent of their final salary. The PPA, which is a division of the Saudi Arabian Ministry of Finance, manages all retirement programmes for civil and military pensioners.

The PPA primarily invests in shares of Saudi Arabian companies listed on the Tadawul, and it is believed that its local stock market holdings are worth more than 40 billion riyals. However, the PPA also has substantial investments in real estate and fixed income products.

GOSI

All employers in Saudi Arabia are obligated to register with the GOSI, and to enrol all Saudi and non-Saudi employees in the GOSI. The payment obligations to the GOSI are as follows:

a Saudi employees are required to be registered under the Annuities Branch of the GOSI subject to the payment of 18 per cent of the employee's wage. The employer shall pay 9 per cent of the subscription amount, and the remaining 9 per cent must be deducted from the employee's salary on a monthly basis; and

b Saudi and non-Saudi employees are required to be registered under the Occupational Hazards Branch of the GOSI. The employer shall pay the subscription amount of 2 per cent of the employee's wage for Saudi and non-Saudi employees.

Over six million individuals and corporate bodies are covered by this regime. GOSI investments are distributed among a number of major investment fields such as cash investments, bonds, loans, shares and real estate investments, but the GOSI is primarily focused on international private equity investments. The GOSI follows a long-term investment management strategy that aims to avoid risks, seeks large revenues that enable it to meet its liabilities towards its contributors and beneficiaries, and concentrates on profitable local investments. Although the direct objective of GOSI investments is to maintain fund sustainability to cover contributors' insurance benefits, they also indirectly support development projects in Saudi Arabia. These investments are usually directed to developmental projects that play an important role in containing labour force and developing human and material resources.

It is estimated that the GOSI has US$116 billion in assets under management, invested primarily in Saudi Arabian listed equities with additional investments in other securities and financial instruments and real estate.

Saudi Aramco

Another active player is Saudi Aramco, the government-owned oil and gas company. Saudi Aramco is quite different from the government entities described above, as it is primarily an industrial operating company, and less frequently associated with the financial services and asset management industries. However, with annual revenues of over US$300 billion, Saudi Aramco is an active investor in technology, energy and venture capital investments both in Saudi Arabia and worldwide. Through its investment management division, SAIMCO, Saudi Aramco invests a substantial portion of its revenues for the benefit of its retirement and pension plans. Saudi Aramco's energy investments division, Saudi Aramco Energy Ventures, is also an active investor both in Saudi Arabia and abroad. More recently, Saudi Aramco acquired a 70 per cent stake in Saudi Arabian Basic Industries Corporation (SABIC) from the PIF for a total purchase price of 259.125 billion riyals.

iii Real property

The Real Estate Finance Regulations were passed in July 2012 and provide a provisional framework for secured and structured finance transactions pertaining to real estate assets. This is a positive development for the potential growth of an asset-backed securitisation market in Saudi Arabia.

Listed and unlisted public real estate funds are governed by the Real Estate Investment Funds Regulations implemented by the CMA. All privately placed real estate funds are governed by the private placement rules in the Investment Funds Regulations, which are significantly more comprehensive and provide managers with much greater flexibility. The vast majority of private funds in Saudi Arabia are real estate-focused.

In July 2012, Saudi Arabia released the long-anticipated Real Estate Registered Mortgage Regulations (Mortgage Regulations). The Mortgage Regulations provide the foundation for the creation of all mortgages in Saudi Arabia. The legislation represents a significant milestone in the registration, prioritisation and enforcement of security rights within Saudi Arabia. Many asset managers believe this will increase liquidity for potential home buyers in Saudi Arabia, and as a result are keen to acquire and develop properties. Most banking transactions have not yet complied with the Mortgage Regulations; however, the SCB has recently issued circulars requiring banks to start registering mortgages under the Mortgage Regulations, and has issued various incentives for mortgage holders.

iv Hedge funds

Hedge funds are regulated by the Investment Funds Regulations, which provide specific requirements regarding the diversification parameters and amount of leverage a fund can incur. Further, the regulations require that all open-ended funds allow for sales and redemptions at least twice a week. These subscription and redemption requirements apply unless formally waived by the CMA. However, the CMA has taken the position that such requirements do not apply to private placed funds.

v Private equity

Saudi Arabia witnessed a considerable decrease in private equity deal value and volume between the years 2018 and 2020 (compared to prior years) driven by consistently low oil prices (which began to rebound more recently), uncertainty regarding the impact of regulatory, legal and fiscal reform (which included a major anti-corruption campaign in November 2017) and the occurrence of several geopolitical events in the region. A number of investors have commented that this makes forecasting potential investees' future results more difficult, resulting in a lower level of deals in Saudi Arabia.

As previously mentioned, the proposed amendments to the Investment Funds Regulations were implemented as of May 2021, allowing Saudi-domiciled funds to implement many of the terms utilised by managers based in more developed markets that are prevalent in private equity funds in traditional funds jurisdictions.

While we continue to see an increase in the use of single asset funds for private equity deals, there has also been a slight increase in government-backed blind pool private equity and venture capital funds in the Kingdom. Privately placed CMA funds offer a means to pool Saudi, GCC and foreign investors in a vehicle to acquire an asset, while avoiding the challenges involved in partly foreign-owned limited liability companies making private equity investments in Saudi Arabia.

The SMEA, the PIF fund of funds and Saudi Venture Capital Company are spearheading a review of the private and equity and venture capital environment in Saudi Arabia in an effort to make it easier for entrepreneurs to establish small businesses and for investors to comfortably provide capital to Saudi-domiciled companies.

vi Other sectors

Most investment in Saudi Arabian funds and other vehicles comes from two investor classes: family offices and investment companies, and government entities.

Family groups such as SEDCO, Olayan, Bugshan, Al Fozan, Muhaideb, Bin Saedan, Al Rajhi and MASIC are major players in the asset management field in Saudi Arabia. Many of these groups are now CMA-licensed themselves or substantial shareholders in CMA-licensed entities, and are moving from their traditional roles of investing family money to a new role of raising and managing third-party funds.

While Saudi Arabian government investment vehicles historically have not been as prominent as some of the sovereign wealth funds elsewhere in the GCC (such as the Abu Dhabi Investment Authority, the Qatar Investment Authority and the Kuwait Investment Authority), the government is a major player in the asset management and investment arenas, particularly with the astronomical growth of the PIF over the recent years. The SCB, the GOSI, the PPA, the PIF and other government-owned organisations are estimated to have over US$1 trillion under management (not including Saudi Aramco, which is majority-owned by the PIF and which is estimated to have a value of approximately US$2 trillion). The majority of that sum is deployed in non-Saudi investments, although there has been a strong push for these organisations to increase the amounts of their investments in Saudi Arabia. The PIF in particular is expected to dramatically grow in size in the foreseeable future, as the government intends to convert it into Saudi Arabia's primary sovereign wealth fund and has moved its stake in Saudi Aramco to the fund.

The growth of the PIF comes on the heels of the government establishing two sovereign wealth funds: Sanabil Al-Saudia in 2008 and Hassana Investment Company in 2009. Sanabil and Hassana were established to manage the assets and investments of the PIF and the GOSI, respectively. The intention of these organisations is to diversify the existing investments of the PIF and the GOSI within the various industries of Saudi Arabia, and also to provide training and expertise to Saudi nationals. The Islamic Development Bank (IDB) is a multilateral development financing institution owned and funded by 56 primarily Islamic countries spread across the globe and headquartered in Jeddah, Saudi Arabia. IDB has long invested in infrastructure projects and educational programmes, but is also becoming a more active investor in both regional and international shariah-compliant private equity funds, real estate funds and other alternative investments. Further, IDB, as a highly rated supranational body, has become an important issuer of *sukuk*, in addition to being an increasingly important and active investor in funds.

While endowments of universities and colleges are not major institutional investors generally in Saudi Arabia, King Abdullah University for Sciences and Technology (KAUST) is a powerful exception. KAUST, which opened in 2009, is an international, graduate-level research university in Saudi Arabia dedicated to inspiring a new age of scientific achievement in Saudi Arabia. With an endowment of approximately US$20 billion, KAUST is a respected, and frequently approached, institutional investor. Its focus is on the advancement of science and technology to improve the lives of people in Saudi Arabia and the world, but it invests across asset classes both inside and outside Saudi Arabia.

VII TAX LAW

Taxation in Saudi Arabia is administered by the Zakat, Tax and Customs Authority (ZTCA). The main taxes levied on businesses in Saudi Arabia are income tax on business profits and *zakat* (i.e., mandatory Islamic charitable giving).

i Zakat and income tax

The tax exposure of wholly Saudi-owned and GCC-owned entities formed in Saudi Arabia is limited to *zakat* and, for entities formed in other GCC jurisdictions, a withholding tax on dividends and capital gains. A Saudi Arabian corporate vehicle will only be subject to *zakat* at 2.5 per cent on the higher of its net worth or its profits so long as it is wholly owned by Saudi or GCC shareholders, or both.

To the extent that a portion of a Saudi-domiciled corporate entity is owned by non-GCC foreigners, a corresponding portion of the entity's profits will be subject to tax at a rate of 20 per cent on such profits. The portion of the entity's profits corresponding to the ownership by Saudi and GCC shareholders will continue to be subject to *zakat* at a rate of 2.5 per cent.

The Saudi Arabian tax and *zakat* regulations provide for the look through of ownership shareholdings in a Saudi Arabian company from a GCC state to determine whether such shareholding should be subject to income tax. This means that if any of the corporate shareholders in a Saudi-domiciled corporate structure that targets Saudi investments has any non-GCC foreign shareholders, the Saudi-domiciled company will be liable to pay income tax to the extent that its ultimate owners are non-GCC foreigners.

Additionally, in June 2016, the Cabinet approved the introduction of a tax on undeveloped real estate that imposes a 2.5 per cent annual tax on the value of undeveloped urban land.

ii Withholding tax

A withholding tax is payable on payments for income derived from Saudi Arabia made to non-Saudi nationals and companies. Withholding tax will not apply to non-Saudis who are resident in Saudi Arabia or have a permanent establishment in Saudi Arabia.

If a Saudi company or individual makes a payment that is from a source in Saudi Arabia to a non-Saudi, then such payment is subject to withholding tax at various rates depending on the nature of the payment. The withholding tax will not apply to payments made on contracts for goods, but will apply to payments made for services and on interest payments under loan agreements.

A dividend paid by a Saudi Arabian company to a non-Saudi resident shareholder results in withholding tax at a rate of 5 per cent. This tax will apply to dividends attributable to non-Saudi GCC shareholders and non-GCC foreign shareholders.

Capital gains on the sale of shares in an unlisted company in Saudi Arabia by a non-resident shareholder result in withholding tax at a rate of 20 per cent on the amount of the gain. This tax will apply to non-Saudi GCC shareholders and non-GCC foreign shareholders.

iii Value added tax

In January 2018, value added tax (VAT) of 5 per cent became effective in Saudi Arabia on most transactions. This is currently only assessed on transactions between Saudi parties. As such, a foreign manager or adviser would not be assessed for VAT on fees charged to Saudi clients. However, fees payable to a Saudi manager or adviser by a Saudi client would be subject to VAT. Effective as of 1 July 2020, VAT was increased to 15 per cent to help counter the unprecedented economic fallout caused by the covid-19 pandemic.

iv Effect of Saudi tax issues on structuring

To avail itself of the least tax exposure, any corporate vehicle organised in, or conducting business within, Saudi Arabia should be structured so that it is Saudi-domiciled and wholly owned by Saudi or GCC nationals, or both (i.e., foreign investment should not be sought at the Saudi or GCC level) to avoid exposure to income tax at a rate of 20 per cent (on the portion of profits relating to its foreign shareholders); and the exit of the shares in the target company in Saudi Arabia from the investment should be done by a holding entity in Saudi Arabia.

A 100 per cent Saudi or other GCC-owned entity incorporated outside the GCC (e.g., in the Cayman Islands) will be treated as a foreign entity for the purposes of the regulations in Saudi Arabia.

v Exceptions

Saudi funds are extremely tax-efficient vehicles. To date, the ZTCA has not assessed any taxes on Saudi funds, their investments or unitholders in a Saudi fund; however, it has reserved the right to tax funds in the future and on a retroactive basis, and in fact the Shura Council, an influential advisory body to the government, has recommended that closed-ended investment funds be subject to tax. Therefore, it is recommended that parties closely consult with tax advisers in Saudi Arabia and take into consideration the fact that a tax may be applied retroactively.

VIII OUTLOOK

Saudi Arabia has the largest economy in the Middle East. Following the recovery from a significant slump in the price of oil, the government is maintaining aggressive plans to grow, modernise and diversify its economy. Accordingly, this is an exciting time for the asset management industry, particularly with the opening of the Tadawul to foreign investors and the introduction of new regulations intended to spur foreign investment and new products in the country. Additionally, the funds industry in Saudi Arabia has been a success story compared with the rest of the region, and locally domiciled funds have flourished. The CMA and other regulators have encouraged this growth and stability, and have been revolutionising the structuring of private equity, venture capital and real estate deals in Saudi Arabia. Finally, the extensive activity of the PIF and other government bodies has created many opportunities for those operating in the asset management industry and other investment sectors. As such, it is expected that Saudi Arabian markets will continue to expand in the coming year.

Appendix 1

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