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Editor
Paul Dickson

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Chapter 14

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 and in 2022 was the fastest growing G20 economy at 8.7 per cent. 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 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 – increasing by 4.8 per cent in 2022.

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 at the end of December 2022, Saudi Arabia's total outstanding direct indebtedness amounted to US$264 billion of external indebtedness.

The government is also focusing on increasing foreign investment into the country. In a long-awaited and very welcomed 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 country. 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 64 listings to date at July 2023. 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 19 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 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

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fund will spur the development of exchange-traded private equity funds. In early 2022, the CMA also introduced regulations for credit funds (known as direct financing investment funds), which was the first credit fund regime adopted in the region, and seven credit funds have been launched under the regime up to July 2023.

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, which were adopted in January 2023, in a step that was widely welcomed by companies and investors operating in the country. 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 real estate development, infrastructure, 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), Tourism Development Fund (TDF), National Infrastructure Fund (NIF) 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 REGULATORY FRAMEWORK

The CMA and the Saudi Central Bank (SAMA) 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 a 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 Foreign Investment in Securities, which govern investment by foreign investors in listed securities, debt instruments and investment funds;

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; and

g the Instructions on the Direct Financing Investment Funds, which govern the establishment and operation of credit funds.

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, SAMA announced the launch of the Fintech Saudi 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 40 fintech licences having been issued to date, which range from robo-advisory to crowdfunding to distribution platforms to offer and invest in debt instruments.

SAMA acts as the central bank of Saudi Arabia and is responsible for issuing currency and regulating the insurance industry (although the Saudi Arabian government approved the establishment of the Insurance Authority in August 2023, which will become responsible for regulating this sector). It is also responsible for encouraging the development of the Saudi Arabian banking system in both public and commercial sectors. Additionally, SAMA is Saudi Arabia's investment authority and is responsible for managing the country's assets, both inside and outside 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 and obtain a foreign investment licence 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) pursuant to the CMA's regulatory framework or under the CMA-regulated swap regime. The CMA published Rules for Foreign Investment in Securities in March 2023, which further relaxed the restrictions on foreign investment in listed securities.

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 qualified foreign investor (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. In November 2021, the CMA announced that CMA-regulated real estate funds and companies listed on Tadawul that had foreign ownership would be permitted to own real property in the holy cities of Mecca and Medina – an activity that had historically been limited to Saudi nationals. In March 2023, the Real Estate General Authority announced that it would relax its rules governing foreign investment into real estate and allow foreigners to invest in properties of any kind, including commercial, residential and agricultural – including in the holy cities of Mecca of Medina.

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 of years, with the most notable amendments relating 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 have an impact on the offering of securities in Saudi Arabia. Most notably, the amendments provide additional protection to unsophisticated investors that were previously required to invest a minimum amount of 1 million riyals in a private placement 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 and formally adopted in January 2023. 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 new form of company (the simplified joint-stock company) and a number of new, welcomed concepts that are akin to those embedded within corporate laws in other Western jurisdictions, it remains to be seen whether 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 real estate development, 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 (now known as Saudi National Bank), which was the largest ever regional IPO and the second largest globally in 2014; Saudi Aramco in 2019, which raised US$25.6 billion and was the world's largest IPO ever; ACWA Power in 2021; Saudi Tadawual itself, which raised US$1 billion in 2021; and Americana Restaurants International in 2022, the first company to be dual listed on Tadawaul and a foreign exchange. In addition, the CMA recently approved the IPO of Osool & Bakheet Investment Company as the first regulated asset manager to list in Saudi Arabia. In early 2023, Tadawul announced that there were 23 further approved applicants that were waiting to list and another 77 applicants that were currently under review to be listed 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 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. 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 grew from US$7 billion to nearly US$93 billion as at April 2022. In March 2023, the CMA announced the Rules for Foreign Investment in Securities, which were widely welcomed as they pave the way for relaxing the regulatory framework for foreign investment in Saudi listed companies.

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 at July 2023, 64 companies were listed on the Parallel Market, with a number of companies being approved to list on the Parallel Market in recent months.

In October 2016, the CMA's Real Estate Investment Traded Funds Instructions (the REIT Regulations) were introduced, which allow managers to list certain public real estate funds on the Tadawul. As at the end of July 2021, the Tadawul is host to 19 listed REITs, and it is widely expected that the REIT regulatory framework 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, in recent years, the market has witnessed 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 recent mergers, including between Al-Ahlia Insurance Company and Gulf Union Cooperative Insurance Company and between Aljazira Takaful Taawuni Company and Solidarity Saudi Takaful Company.

ii Debt capital markets

Saudi Arabia has issued the largest amount of debt of the countries in the Middle East and North Africa region – raising US$5 billion in 2022. Historically, the majority of debt issues from Saudi Arabia have been in the form of *sukuk*. While it is expected that this trend will continue in the long term, the government has recently launched several large conventional bond programmes, including PIF's first issuance in October 2022, a US$3 billion green bond traded on the London Stock Exchange, which was followed by a second US$5.5 billion green bond issued in February 2023.

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 towards 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.

Foreign funds may be offered in Saudi Arabia as a private placement only 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

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

In August 2023, the Saudi Arabian government approved the establishment of the Insurance Authority, which will become responsible for regulating this sector. It is expected that the legal framework will be revamped and that amended regulations governing the sector will be announced in due course.

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

If SAMA 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. SAMA'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
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. These should also not form part of the insurance company's asset allocation unless specifically approved by SAMA, and they must be based on efficient portfolio management justification. An insurance company can, with the approval of SAMA, 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 that 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

Historically, there were 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). In June 2021, it was announced that both bodies would be merging into a single pension agency – with GOSI surviving with an estimated US$320 billion in assets as at July 2023. Additionally, Wisayah Investment Company, 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.

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, Wisayah Investment Company, 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 (the 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 that this will increase liquidity for potential home buyers in Saudi Arabia, and as a result are keen to acquire and develop properties.

In addition, the government approved a Real Estate Contributions Law in July 2023, which aims to regulate certain collective investment schemes into real property in Saudi Arabia, and it is expected that the Real Estate General Authority and the CMA will be issuing further guidance in this regard.

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

As mentioned previously, 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 Saudi Arabia. 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.

The years 2022 and 2023 have witnessed the return of a steady flow of private equity transactions in Saudi Arabia after a lull of several years from 2018 onwards due to lower oil prices, regulatory reform and various geopolitical events. There has been a swell of regional private equity funds to hit the market, and many international managers are now including an allocation for the GCC (and, in particular, Saudi Arabia) due to the strong performance and modernisation of its economy and potential growth opportunities.

vi Other sectors

Most investment in Saudi Arabian funds and other vehicles comes from two investor classes: (1) family offices and investment companies and (2) government entities.

Family groups such as SEDCO, Olayan, Alhokair, Alesayi, 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. SAMA, the GOSI, 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 in excess of 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 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$23.5 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.

In 2006, the General Authority of Awqaf (GAA) was established to manage various endowments, charitable endeavours and Saudi Arabia's societal development. The GAA currently has in excess of US$11 billion in assets.

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 be subject to *zakat* at 2.5 per cent on the higher of its net worth or its profits only as 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 assessed only 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.

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.