

Client Alert

May 2020

Proposed Amendments to the CMA Securities Business Regulations and Authorised Persons Regulations in Saudi Arabia

The Capital Market Authority (the "CMA") continues to drive the development of the Saudi capital markets in furtherance of the Saudi Vision 2030's Financial Sector Development Program with the issue of its draft proposed amendments to some of its key implementing regulations on 23 December 2019.

The proposed changes are to its Securities Business Regulations ("SBRs") and the Authorised Persons Regulations ("APRs"), which will presumably become known as the 'Capital Market Institutions Regulations' with the proposal to change 'Authorised Person' to 'Capital Market Institution'.

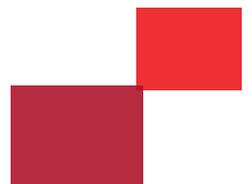
Although it has been some time since these draft amendments were published, prevailing conditions offer a good opportunity to take pause and consider the proposed changes and their potential implications.

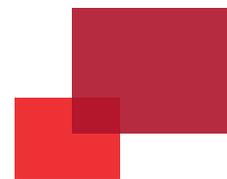
In summary the key changes include the following:

- changes to scope of 'Securities Activities', types of authorizations and minimum capital requirements;
- development of requirements for CMA authorizations to carry on 'Securities Business';
- the introduction of a new client classification regime;
- the narrowing of the Securities Advertisement Exemption to exclude investment institutions;
- more robust suitability and risk assessment requirements; and
- new notification, disclosure and reporting requirements.

The APRs were last updated in September 2017 with limited amendments to the capital requirements of regulated firms. The SBRs have not been updated since its issue in June 2005 (other than by virtue of amendments throughout the years to the CMA's Glossary).

Accordingly, the proposed changes represent the first comprehensive revision to these regulations for some time and the purpose of this article is to explore the key proposed changes and their potential implications, noting that these remain subject to final review by the CMA.





We have outlined a sample of such proposed changes below :

1. Proposed Changes to the scope of 'Securities Activities', types of authorizations and minimum capital requirements

Of the changes to the scope of certain categories of 'Securities Activities', perhaps the most significant is the expansion of the 'Advising' activity to include "*financial planning or wealth management*". However, no definitions have been proposed for these terms. The concepts of financial planning and wealth management have generally been taken to include activities such as structuring advice in relation to establishing trusts and other investment vehicles, as well as succession and taxation planning, which has been understood not to involve securities. Accordingly, the proposed expansion of 'Advising' may have significant implications for those who have previously understood that such services were not regulated by the CMA. Further clarification from the CMA will be needed in this regard.

Whilst the minimum capital of SAR 20 million for 'Managing Investments and Operating Funds' will be retained, a minimum annual expenditure based capital requirement is proposed for 'Managing Investments'. The proposed removal of 'Managing' activity licenses for 'Managing Private Non-Real Estate Investments Funds' and 'Managing Sophisticated Investor Portfolios' (introduced in October 2017 to encourage 'Managing' license activities) mentioned above, would also see the removal of the minimum capital requirement for SAR 5 million for those activities.

The minimum annual expenditure requirement is also proposed to apply to 'Arranging' (currently SAR 2 million) and 'Advising' (currently SAR 400,000).

2. Development of Requirements for CMA Authorizations to carry on Securities Business

The proposed amendments to Annex 3.1 (which outline license/authorization requirements) remove a significant number of requirements for authorization for those applicants whose activities will be limited to 'Managing Investments', 'Arranging' and 'Advising'. These include terms of business, systems and controls requirements (other than anti-money laundering and anti-terrorism financing procedures) and outsourcing agreements, amongst others.

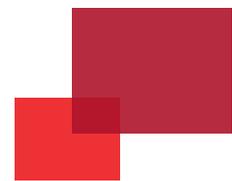
The proposed amendments to Annex 3.1 also includes the addition of a number of new requirements such as (i) the availability of appropriate technical systems, (ii) the availability of appropriate work facilities, including offices and support services, and (iii) a website in Arabic language disclosing any information specified by the CMA.

Whilst the Arabic language website requirements marks a clear new change which Authorised Persons that are branches of foreign (i.e. non-Saudi) companies may particularly need to address, it remains to be seen what will constitute the CMA's expectations with regards to "*appropriate*" technical systems and work facilities.

3. Proposed Change to Client Classification and potential implications

One of the most significant changes, with perhaps some of the most far reaching practical implications, is the proposed change to the client classification. It is now proposed that clients be classified as either:

- **a retail client** - any client who is not a qualified client or an institutional client;



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- **a qualified client** - includes a natural person who is a 'professional investor' (as per the current CMA definition), legal persons with net assets of between SAR 10 and 50 million or any person (natural or legal) which is a client of an Authorised Person who is managing the person's investments on a discretionary basis (provided the offer is made to the Authorised Person); or
- **an institutional client** - defined as the Government of Saudi Arabia, any recognized supranational authority (recognized by the CMA), Government-owned companies (whether as direct clients or through a portfolio managed by a Capital Market Institution), legal persons with net assets of more than SAR 50 million, investment funds and 'Counterparties', which is defined to include 'Capital Market Institution', Exempt Person, a local SAMA-regulated bank, a SAMA-regulated insurance company, a Qualified Foreign Investor (QFI), or a non-Saudi financial services firm.

Under the proposed changes, with a few exceptions, all requirements in the APRs which are currently limited in application to clients classified as 'customers' would be applicable to all clients regardless of classification. These include KYC obligations (including the completion of the Annex 5.3 Form, some of which is noted as 'indicative' only), fiduciary duties and client principles and conflicts of interest.

If the above changes to client classification and the consequential changes to other provisions are implemented, this could have some potentially far reaching consequences for Authorised Persons. In particular, the re-classification of all clients in accordance with the new regime could be administratively burdensome for Authorised Person with large client bases. Moreover, Authorised Persons whose client basis has historically been limited to 'Counterparties' will likely have to develop new processes, procedures and documentation to apply the requirements that were previously only applicable to 'customers' to their clients. The draft amendments do not provide for any indication or guidance on a grace period for these changes to be implemented.

4. Narrowing the Securities Advertisement Exemption

A significant proposed development is the suggested amendment to Article 20(4) of the SBRs, often referred to as the 'Securities Advertisement Exemption'. Currently, this provision excludes 'Securities Advertisements' from needing to either be made or approved by a Authorised Person when directed only at other CMA Authorised Persons, Exempt Persons or Investment Institutions. With the proposed removal of Investment Institutions from this exemption, those relying on the current provision to market to family offices, corporates and even large corporate subsidiaries of governmental entities on a cross-border basis, would potentially be affected.

5. Other Proposed Changes relating to Conduct of Securities Business by Authorised Persons

There are a number of other key proposed changes to the APRs, which include amendments to close links, notifications and disclosures, registrable functions, outsourcing and various suitability and risk-related provisions.