

Amendments to the Investment Funds Regulation & Real Estate Funds Regulation

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The Capital Market Authority (the “CMA”) is the regulator of investment funds in Saudi Arabia. The CMA announced on 17/7/1442H (March 1, 2021) the amendments of the Investment Funds Regulation and the Real Estate Investment Funds Regulation (the “Regulations”), according to the resolution of the board Number (2/22/2021) in 12/7/1442H (February 24, 2021). The amendments to the Regulations will be effective as of 19/9/1442H (May 1, 2021), except for some amendments that will be effective as of other dates stipulated in the Regulations.

Introduction about Investment Funds

The CMA defines the investment fund as: “a collective investment scheme aimed at providing investors therein with an opportunity to participate collectively in the profits of the scheme which is managed by a fund manager for specified fees.”

According to the CMA’s regulations, Investment funds have many types. In terms of the nature of the fund there are two types:

1. Open-Ended Investment Fund: “an investment fund with changing capital, the units of which would increase with the issuance of new units and decrease with redemption by unitholders of some or all of their units. Unitholders are entitled to redeem the value of their units at their net asset value on dealing days set in the fund’s terms and conditions in accordance with the Investment Funds Regulations.” Examples of open-ended funds include equity funds, money market funds, and debt instruments funds.
2. Closed-Ended Investment Fund: “any investment fund which is not an open-ended investment fund.” Rather, it is often capital-specific, and units are only allowed to be recovered at the end of the fund’s term disclosed in its terms and conditions or when the units are sold to other investors. Closed-ended investment funds may increase their capital by inviting participation in the fund if conditions and provisions permit. The closed-

ended investment fund may or may not be traded. An example of a closed-ended investment fund is a real estate investment fund.

In terms of offering there are 3 types of funds:

1. Public Fund: an investment fund which is established in Saudi Arabia and its units may be offered to investors in Saudi Arabia in any way other than a private placement.
2. Private Fund: a non-public investment fund which is established in Saudi Arabia and its units may be offered by a private placement to investors in Saudi Arabia.
3. Foreign Fund: an investment fund, which is established in a jurisdiction outside Saudi Arabia and its units may be offered by a private placement to investors in Saudi Arabia.

Funds can also be classified by nature of assets to:

1. Equity Fund: is a fund that invests mainly in listed companies' stocks.
2. Money Market Fund: is a fund that invests in short-term securities and money market deals. It is characterized with high liquidity, short-term maturity, and low-risk rates compared to other funds.
3. Debt Instruments Fund: is a fund that invests in debt instruments such as Sukuk and bonds issued by companies, government and semi-government entities or any other entity that can issue any kind of debt instruments.
4. Multi-asset Fund: is a fund that invests in several types of assets, such as stocks, debt instruments, money market deals, and other investment funds.
5. Fund of Funds: is a fund that invests all its assets in other investment funds.
6. Feeder Fund: is a fund that invests all its assets in another investment fund.
7. Balanced Fund: is a fund that combines between equities and debt instruments in its assets and devotes part of its investments to short-term financial instruments.
8. Index Fund: is an investment fund that tracks the performance of a specific market index.

These funds can be traded funds or non-traded funds. Traded investment funds are subjected to the same trading rules in the stock exchange, and investors can trade investment fund units like any security. The Investment Funds Regulation stipulates investment restrictions on the various types of investment funds.

9. Real Estate Investment Fund: "a collective real estate investment scheme aimed at providing investors with an opportunity to participate collectively in the profits of the scheme." The objectives of real estate investment funds include:
 - Initial development then selling.

- Construction development then selling.
- Initial or constructional development to leasing for a specified period then selling.
- Ownership of properties to leasing for a specified period then selling.

If the real estate fund is traded, the value of its investments in developed real estate, capable of generating periodic rental income, must not be less than 75% of the total value of the fund's assets. The fund must distribute no less than 90% of its net profits to the unitholders annually.

The New Amendments

- **The Fund as a Special Purpose Entity**

Prior to the new amendments, the contracting has been entered into between the fund manager and the unitholders directly. The new amendments have enabled investment fund managers to establish a special purpose entity so that the investment fund has a legal personality that can be contracted with. This reduces the risk to investors. Keeping the contracting between fund managers and unitholders is still an option. All provisions applicable to investment funds generally apply to investment funds in the form of a special purpose entity.

- **Investment Funds Governance**

The amendments included several aspects related to governance, to raise the level of governance in line with international best practices and standards. For example:

Strengthening the role of the board of directors of public funds and real estate private funds in monitoring and supervising the fund manager and protecting the unitholders. According to the Regulations, each fund is supervised by a board of directors, which must have no less than three directors. The number of its independent directors must be no less than two or one third of the total number of the directors, whichever is greater.

The amendments enhanced the definition and the role of the independent director, which contributes to a higher level of governance of these funds. Independent fund director has been defined to be fully independent of the fund manager. The fund manager does not have the right to remove any independent director. Independent directors may only be removed by unitholders. The board must also conduct an annual assessment of the extent to which the independence of each independent director has been achieved and ensure that there are no relationships or circumstances that affect or may affect its independence. A director who has any direct or indirect interest in a matter may not vote on any board resolution on this matter, and any such interest shall be disclosed to the board.

The amendments also raised the level of transparency and disclosure in the investment funds' periodic reports, with a uniform time limit for the disclosure of financial statements and annual reports.

- **Regulating Termination and Liquidation Proceedings**

The amendments also included regulating the procedures for the termination and liquidation of public and private investment funds in line with international best practices and standards. As of 28/07/1443 AH (March 1, 2022), the fund manager must specify the fund's termination provisions in the fund's terms and conditions. For the termination and liquidation of a fund, the board must approve the termination and liquidation proceedings.

- **Offering in the Parallel Market ("Nomu")**

Traded Investment funds are offered in the main market exchange (the "Exchange"). Nomu is the parallel stock exchange market in Saudi Arabia, with lighter listing requirements, and the investment in which is restricted to qualified investors. When the new amendments come into force, it will also be possible for the following funds to be offered in the parallel market (Nomu): 1) Real estate investment traded funds (REITs), 2) Closed-ended investment traded funds, and 3) Exchange traded funds, provided that the offering of their units is restricted to qualified investors.

- **Buyback of Investment Funds' Units**

The new amendments enable close-ended investment traded funds and real estate investment traded funds to buy back its units through the market with the goal of keeping them as treasury units or cancelling them, in accordance with the specific provisions stipulated in the Regulations. These funds can also sell their treasury units through the Exchange under specific provisions. However, the sale is not required to take place through the Exchange if the treasury units are intended for use in exchange for the purchase of an asset in accordance with the fund's terms and conditions.