

# Saudi Capital Market Rules and Regulations – Asset Managers

Edition 1

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This workbook relates to syllabus version 1.0 and will  
cover exams from **1 February 2023** to **10 July 2024**



APPROVED WORKBOOK

Welcome to the Chartered Institute for Securities & Investment's Saudi Capital Market Rules and Regulations – Asset Managers study material.

This workbook has been written to prepare you for the Chartered Institute for Securities & Investment's Saudi Capital Market Rules and Regulations – Asset Managers examination.

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Workbook version: 1.1 (October 2022)

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It is estimated that this workbook will require approximately 50 hours of study time.

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## Chapter One

# Investment Fund Regulations

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**This syllabus area will provide approximately 14 of the 25 examination questions**







## Introduction

This chapter covers the regulations placed on investment funds in the Kingdom of Saudi Arabia (the Kingdom) that are laid down by the Capital Market Authority (the Authority) under Capital Market Law (the Law) and the **Investment Fund Regulations**.

There are a number of distinctions between investment funds from a regulatory standpoint, and perhaps the most important of these relates to whom a fund's **unit** can be marketed and offered to. Some funds restrict their target investors to qualified and institutional investors and are referred to as 'private funds'. Others can be marketed more widely to all investors including the general public and are referred to as 'public funds'.

## 1. Fund Management

### Learning Objective

- 1.1.1 Know the duties of the fund manager (Part 2, Article 9)
- 1.1.2 Know requirements for financial statements (Part 2, Article 11)
- 1.1.3 Know requirements relating to investment policies and practices (Part 2, Article 14)
- 1.1.4 Know requirements regarding special commission arrangements (Part 2, Article 16)
- 1.1.5 Know requirements regarding: services (Part 2, Article 19); commissions (Part 2, Article 19); management fees (Part 2, Article 19)
- 1.1.6 Know regulatory requirements for the liquidation of a fund (Part 2, Article 22)

### 1.1 Duties of the Fund Manager

The firm that establishes and runs an investment fund is referred to as the fund manager and, under the Investment Fund Regulations, the fund manager is required to:

- Act for the benefit of the investors in the fund (the unitholders) and in accordance with the regulations. The fund manager must also comply with the terms and conditions of each particular investment fund managed.
- Act in a fiduciary capacity for the unitholders which includes the duty to act in the best interests of the unitholders and to exercise care and skill.
- Take primary responsibility for the following:
  - **managing** the fund
  - offering the units in the fund
  - ensuring the accuracy of the terms and conditions of the fund, and
  - verifying that the terms and conditions are complete, clear, accurate and not misleading, and
  - the fund operator shall be responsible for operating investment funds.

The fund manager can delegate any of the above, but any delegation will not in any way limit, reduce or satisfy the fund manager's responsibilities under the regulations. Importantly, the fund manager will be responsible to unitholders for losses incurred by the investment fund which are caused by the fund manager engaging in fraud, negligence, misconduct or wilful default.

All disclosures by the fund manager must be complete, clear, accurate and not misleading.

- Developing policies and procedures that detect risks affecting the fund's investments and ensure treatment of those risks as soon as possible. These policies and procedures must include conducting risks assessment, at least, once a year.
- Unless the Authority determines otherwise, the fund manager may not limit the eligibility of the investment in the fund to nationals of any state or group of states. However, this clause does not prevent the fund manager from rejecting investment from any person or entity that is deemed unqualified for such investment by any other relevant law.
- Implementing a compliance monitoring program for every fund under its management. The fund manager must provide the Authority with the results of the implementation of the program upon its request.

## 1.2 The Fund's Financial Statements

Each fund is required to prepare financial statements in Arabic, and these are required at least every half year for public funds and private real estate funds. The half yearly statements must be reviewed in accordance with the standards issued by the Saudi Organisation of Certified Public Accountants (SOCPA) and the annual financial statements should also be audited in accordance with SOCPA standards. Further copies in languages other than Arabic can be presented, but in the event of any conflict, it is the Arabic text that shall prevail. Copies of the financial statements for an investment fund must be included in the fund reports prepared by the fund manager as required under the regulations.

## 1.3 Investment Policies and Practices

The investment decisions of the fund manager must conform to prudent investment practice in relation to the investment objectives of the fund that are laid down in fund's terms and conditions. These practices should include the fund manager using its best efforts to ensure:

1. in the case of an open-ended fund, that the investment fund is sufficiently liquid to meet anticipated redemption requests
2. that the investment fund does not unduly concentrate investments in a certain **security** or securities, in a country, geographic area, industry or sector, except to the extent any such concentration is disclosed in the fund's terms and conditions, and
3. that the investments of the fund provide a prudent spread of risk whilst having due regard to the investment objectives, investment policies and terms and conditions of that investment fund.

## 1.4 Special Commission Arrangements

Special commission arrangements are arrangements where a **Capital Market Institution** receives goods or services in addition to trade execution services from an intermediary in return for the commission paid on transactions directed through that intermediary. This could involve the brokerage firm giving goods and services to the fund manager in return for executing transactions and generating commission

payments. These are referred to as 'special commission' arrangements and the nature of the goods and services provided is only permitted to be either related to the execution of transactions on behalf of an investment fund, or comprise the provision of research for the benefit of that investment fund. Furthermore, any special commission arrangement entered into by a fund manager must be disclosed in the fund's terms and conditions. Special commission arrangements that involve the payment of cash to the fund manager are specifically disallowed with the regulations specifying that the fund manager may not obtain direct sums of money under special commission or any other arrangements.

## **1.5 Services, Commissions and Management Fees**

Any fees, commissions or charges charged to the fund for its management must be on arm's length terms and at least equivalent to the terms entered into by persons dealing independently. Furthermore, in no circumstances, shall such charges exceed the limit specified in the fund's terms and conditions.

## **1.6 Termination and Liquidation of the Fund**

The fund manager must specify the termination provisions of a fund in the fund's terms and conditions. The unitholders (and the Authority) must then be provided with details of the plan and procedures for the termination at least 21 days before the intended termination date. The fund manager should then be able to complete the process of selling the fund's assets and distributing the amounts due to unitholders prior to the end of the fund's term. In the event that the fund manager has not completed the sale of the fund's assets before the expiry of the fund's term, the fund manager must liquidate the assets and distribute the amounts due to unitholders within a period of six months from the date of the expiry of the fund's term.

Where the fund's terms and conditions provide that the fund will be terminated upon the occurrence of specified events, the fund manager must terminate the fund immediately upon the occurrence of such event and notify the Authority and unitholders in writing within five days from the occurrence of a specified event triggering the termination of the fund.

The fund manager must provide the unitholders with a fund termination report within a period not exceeding 70 days from the date of the completion of its termination or liquidation, including the final audited financial statements of the fund for the period subsequent to the last annual audited financial statements.

## 2. Custody

### Learning Objective

- 1.2.1 Know regulations relating to the: appointment of a custodian (Part 3, Article 24); ownership and custody of the assets of the investment fund (Part 3, Article 25); responsibilities of the custodian (Part 3, Articles 26 & 28) (Real Estate Investment Funds Regulations Articles 29 & 30)

**Custodians** are an important constituent for funds, keeping the fund's assets separate from the fund manager and thereby providing a check and safety mechanism that the assets are held for the benefit of the unitholders. This sub-section details the major regulations that, amongst other things, require the custodian to be independent, authorised to provide custody services by the Authority and able to segregate the assets appropriately.

### 2.1 Regulations Concerning Custodians

#### 2.1.1 Appointment of the Custodian

The fund manager must appoint, by written contract, one or more custodians in the Kingdom to take custody of the assets of the investment funds which the fund manager manages. The custodian must not be a fund manager or a fund sub-manager to the relevant fund, or an affiliate of the fund manager or to the fund sub-manager. The custodian must be a Capital Market Institution licensed to conduct custody activity.

#### 2.1.2 Ownership of the Assets of the Investment Fund

The custodian is effectively holding the assets of the fund on behalf of the fund's unitholders. The assets of an investment fund are not owned by the custodian – they are owned collectively by the unitholders in that fund. A fund manager, fund sub-manager, fund operator custodian, sub-custodian, adviser or distributor shall not have any interest in, or claims against, such assets, other than when one of the aforementioned is a **unitholder** (within the limits of its ownership), or for claims permitted under the regulations and disclosed in the fund's terms and conditions.

#### 2.1.3 Segregation of Assets

The custodian must, in relation to each investment fund to which it acts as custodian, open a separate account in a local bank under its name with the account designated as being for the benefit of the relevant investment fund. The custodian must deposit all cash belonging to the investment fund into the relevant bank account and can deduct from the relevant bank account and must deduct from the relevant bank account payments for investments and expenses incurred in the management and operation of the investment fund in accordance with the regulations, the fund's terms and conditions and the contract by which the custodian was appointed by the fund manager.

The custodian must segregate each investment fund's assets from its own assets and from the assets of its other **clients**, and it must separately identify the securities and other assets of each investment fund by registration in the name of the custodian for the benefit of the relevant investment fund. The custodian must register the real estate assets of the fund in the name of a subsidiary of the custodian. The custodian must register the real estate assets of the fund and the ownership in unlisted companies that are not deposited at the Depository Center in the name of a company fully owned by the custodian. The custodian must also maintain all necessary records to support the performance of its contractual responsibilities. The real estate assets of a fund can be pledged to an entity licensed to provide loans that extended a loan to the fund.

Where the investment fund takes the form of a Special Purposes Entity (SPE), the custodian must segregate the assets by registering the securities and other assets in the name of the SPE.

#### **2.1.4 Responsibilities of the Custodian**

The custodian takes custody and protects the fund's assets on behalf of the unitholders. It also takes all necessary administrative measures in relation to the custody of the fund's assets. The custodian is responsible to the fund manager and to the unitholders for any losses caused to the investment fund due to that custodian's fraud, negligence, misconduct or wilful default.

The custodian may appoint one or more third parties or affiliates as a sub-custodian by contract in writing. The remuneration of the fund sub-custodian must be paid by the custodian out of its own resources and the fund sub-custodian must either be a Capital Market Institution licensed to conduct custody activity or, for the fund's foreign investments, a fund sub-custodian operating in another jurisdiction that employs regulatory standards and requirements at least equivalent to those of the Authority. The custodian remains fully responsible for its obligations whether the custodian carries out its duties on its own or assigns them to a third party.

For real estate assets, all related documents and records to the fund must be maintained by the custodian, which includes, for example, the title deeds and accredited valuers' reports.

## 3. Public Funds

### Learning Objective

- 1.3.1 Know the difference between closed-ended funds and open-ended funds
- 1.3.2 Know the responsibilities of the: public fund board (Part 4, Article 38); members of the fund board (Part 4, Article 39)
- 1.3.3 Know regulatory requirements for (Investment Funds Regulations): investment areas (Part 4, Article 40), investment limitations (Part 4, Article 41), subscription limitations (Part 4, Article 37)
- 1.3.4 Know regulatory requirements for (Investment Funds Regulations): index funds (Part 4, Article 45); exchange-traded funds (Part 4, Article 46); specialised public funds (Part 4, Article 53); money market funds (Part 4, Article 54); feeder funds (Part 4, Article 55); fund of funds (Part 4, Article 56); capital protected funds (Part 4, Article 57); endowment funds (Part 4, Article 58)

### 3.1 Closed-Ended versus Open-Ended Funds

An **open-ended fund** can be described as an investment fund that can issue and redeem units at any time. Each investor has a *pro rata* share of the underlying portfolio and so will share in any growth, or loss of the fund. The value of each unit is in proportion to the total value of the underlying investment portfolio, known as the **net asset value (NAV)**.

If an investor wishes to invest in an open-ended fund, they should approach the fund manager directly and provide the money they wish to invest. The fund can then create new units in response to this demand, issuing them to the investor at a price based on the NAV.

In contrast, if an investor decides to sell, they approach the fund manager, which will redeem the units and pay the investor the value of them, based on the value of the underlying portfolio (the NAV).

An open-ended fund can, therefore, expand and contract in size based on investor demand to join the fund (subscriptions) or sell (redemptions), which is why it is referred to as open-ended.

When a **closed-ended fund** is established, a set number of units are issued to investors. If the investor wishes to subscribe in the closed-ended fund, they can only do so during the fund's offering period (the primary market) or by purchasing it at a later time during the life of the fund through the fund's investors wishing to sell (the secondary market). The number of shares in the fund is, therefore, fixed, and does not expand or contract in the same way as with open-ended funds. For this reason, these funds are referred to as closed ended.

So, for traded closed-ended funds, the price of a share in the investment fund is driven by demand and supply as with other traded shares. The resultant share price may be at a premium to the assets that support that price or at a discount:

- Units in an open-ended fund are bought and sold by the fund manager at a price that is based on the underlying value of the constituent investments. So, new units are created, or old units cancelled at their NAV.

- The unit price of a traded closed-ended investment fund is not necessarily the same as the value of the underlying investments. The fund will value the underlying portfolio regularly and provide details of the NAV to the stock exchange on which it is traded. The traded price, however, will be determined by demand and supply for the units, and may be above or below the NAV.

When the unit price is above the NAV, it is said to be trading at a premium. When the unit price is below the NAV, it is said to be trading at a discount.

## 3.2 Public Funds

Funds can be divided into those that are made available to investors generally (public funds) and those that are restricted and can only be marketed by way of a so-called private placement to qualified and institutional clients (private funds). A **public fund** is defined as an investment fund which is established in the Kingdom and the units can be offered by the fund manager to Kingdom-based investors by ways other than that of a private placement. As a public fund might attract a wider and potentially less sophisticated group of investors than a private fund, there are more requirements placed on public funds.

### 3.2.1 The Public Fund Board

A public fund must be supervised by a fund board appointed by the public fund manager and approved by the Authority.

The number of directors on the public fund board must not be less than three directors. The number of independent fund directors of a fund board must not be less than two, or one third of the total number of directors (whichever is greater).

It is the unitholders and not the fund manager that have the right to remove an independent board member. The fund manager must remove any member of the fund's board of directors if the unitholders request the fund manager remove that member.

When more than one public fund is managed by the same fund manager, those public funds may be supervised by a single fund board unless the number of public funds is estimated by the fund manager to be too high to be supervised effectively by a single fund board. The fund board and the fund manager must review annually the number of public funds supervised by that board and assess whether the number is such that effective supervision would be compromised and a different board should be appointed for one or more of those public funds. The Authority reserves the right to require a fund manager to appoint another fund board if it considers that the number of public funds the fund board supervises is too high.

The fund board shall conduct an annual assessment for each independent member to ensure that there are no relationships or circumstances that affect, or may affect, their independence. Furthermore, a fund board director may not vote on any resolution where that fund board director has any direct or indirect interest and must disclose any such interest to the fund board.

Any person appointed by the fund manager as a member of the fund board shall fulfil the following eligibility requirements:

1. the person must not be bankrupt, subject to any bankruptcy or insolvency proceedings
2. the person must not have committed an offence involving fraud or acted in breach of integrity and honesty, and
3. the person must possess the necessary experience and expertise.

If a member of the fund board ceases to meet the eligibility requirements set out above, the fund manager must:

1. notify the Authority immediately, and
2. replace a member of the fund board with another person who fulfils the eligibility requirements.

If any board director resigns or ceases to provide services, the fund manager must:

1. notify the Authority, and
2. replace the member of the fund's board of director with another person.

The fund manager must also provide all necessary information about the public fund to all members of the fund's board in order to enable them to carry out their duties efficiently, including providing any other information or documentation requested by the fund's board to enable it to do so.

### **3.2.2 Responsibilities of the Members of the Fund Board**

The responsibilities of the members of the fund board include the following:

1. Approving material contracts, decisions and reports involving the public fund, including, but not limited to, contracts for the provision of fund management services, contracts for the provision of custody services, but excluding contracts entered into pursuant to investment decisions regarding underlying investments made or to be made by the fund.
2. Approving a written policy with regards to the voting rights related to the public fund assets.
3. Overseeing and, where appropriate, approving or ratifying any conflicts of interest the fund manager has identified.
4. Meeting at least twice annually with the fund manager's compliance committee or its compliance officer to review the fund manager's compliance with all applicable rules, laws and regulations.
5. Approving all fundamental and non-fundamental changes before the fund manager obtains the approval or notification of the unitholders and the Authority (as applicable).
6. Confirming the completeness and accuracy of the terms and conditions and of any other document, contractual or otherwise, that includes disclosures relating to the public fund and/or the fund manager and its conduct.
7. Ensuring that the fund manager carries out its obligations in the best interests of the unitholders, in accordance with both the regulations and the fund's terms and conditions.
8. Reviewing the report that includes assessment of the performance and quality of services provided by the parties involved in providing significant services to the fund.
9. Assessing the mechanism of the fund manager's handling of the risks related to the fund's assets in accordance with the policies and procedures that detect the fund's risks and how to treat such risks.
10. Having a fiduciary duty to unitholders, including a duty to act in good faith, a duty to act in the best interests of the unitholders and a duty to exercise all reasonable care and skill.



11. Taking the minutes of meetings that provide all deliberations and facts of the meetings, and the decisions taken by the fund's board of directors.
12. Reviewing the report containing all complaints and the measures taken in order to ensure that the fund manager carries out its responsibilities in a way that serves the interest of unitholders in accordance with the fund's terms and conditions, and the regulations.

### 3.3 Areas and Limitations on Investments

Public funds face regulatory restrictions in terms of the way in which they invest the fund's money (the investment areas) and, within the acceptable areas of investment they face certain regulatory limitations. These areas and limitations are detailed in this subsection. It is useful to bear in mind the rationale for restricting the investment options available to the managers of public funds, which is to protect the unitholders (the investing public). The unitholders are being protected by preventing the fund from investing in inappropriate assets, investing in too few securities and also restricting the likelihood of conflicts of interest.

The Investment Fund Regulations specify that the fund manager of a public fund must invest in accordance with the fund's terms and conditions, and can only invest in the following types of investments:

- securities
- money market transactions – these must relate to transactions concluded with a party subject to Saudi Central Bank supervision in the Kingdom, or an equivalent regulator in a jurisdiction elsewhere
- bank deposits with a local bank or institution regulated by Saudi Central Bank or an equivalent regulator in a jurisdiction elsewhere
- real estate assets, or
- commodities.

A public fund is permitted to invest in another fund – which must be either registered with the Authority or investment funds outside the Kingdom subject to an equivalent regulatory oversight in a jurisdiction recognised by the Authority as having equivalent regulation. The Authority shall have the discretion to assess whether the jurisdiction has regulatory standards and requirements at least equivalent.

To minimise any likely conflicts of interest, the fund manager must not invest the money and assets of a public fund in securities issued by the fund manager (or its affiliates), unless this is permitted by the terms and conditions of the relevant public fund. Furthermore, any subscription monies received from unitholders must not be placed on deposit with an affiliate of the fund manager other than on those terms and conditions equivalent to, at least the terms entered into, by persons dealing at arm's length.

There is also a general restriction that prevents a fund manager from investing the public fund's money and assets in any investment that would result in the fund assuming, guaranteeing, endorsing or otherwise become directly or contingently liable for any obligation or indebtedness of any person.

A public fund is not permitted to lend the fund's assets or money to any person, except in the cases of lending of securities by:

1. a closed-ended public fund, or
2. an open-ended public fund up to a maximum of 30% of the fund's NAV.

The Investment Fund Regulations place certain limitations on investments. In the absence of a fund being established as a specialised public fund or having a specific waiver, the following investment restrictions apply.

<b>10% restrictions</b>	<ul style="list-style-type: none"> <li>• Not more than 10% of the issued securities of any single issuer.</li> <li>• Not more than 10% of the public fund's NAV may be invested in a class of securities (such as debt instruments) issued by any single issuer. Not more than 10% of the public fund's NAV can be invested in illiquid assets.</li> </ul>
<b>15% restrictions</b>	<ul style="list-style-type: none"> <li>• Borrowing cannot be more than 15% of the public fund's NAV.</li> <li>• Derivatives exposure cannot exceed 15% of a public fund's NAV.</li> </ul>
<b>20% restrictions</b>	<ul style="list-style-type: none"> <li>• Not more than 20% of the NAV of the units of another investment fund may be held for the benefit of a public fund.</li> <li>• Not more than 20% of the public fund's NAV may be invested in all classes of securities issued by any single issuer.</li> </ul>
<b>25% restrictions</b>	<ul style="list-style-type: none"> <li>• Not more than 25% of the public fund's NAV may be invested in the units of another investment fund, or units of different investment funds issued by the same capital market institution.</li> <li>• Not more than 25% of the public fund's NAV may be invested in different parties belonging to the same group, including securities, money market instruments and bank deposits.</li> </ul>

There are limited exceptions to the above restrictions as follows:

1. Investment in debt instruments issued by the Government of the Kingdom in the currency of the fund, and if its currency is other than the currency of the fund, investment may not comprise more than 35% of the NAV of the public fund.
2. Investment in debt instruments issued by sovereign issuer other the Government of the Kingdom, which may comprise not more than 35% of the NAV of the public fund.
3. Investment of more than 10% of the public fund's NAV in one class of listed debt instruments issued by a single issuer is permitted, but must not comprise more than 20% of the NAV of the fund.
4. Investment of more than 10% of the public fund's NAV in shares issued by any single issuer listed on the Exchange or any other regulated exchange (provided that the issue's percentage of market value does not exceed the total market value of all listed shares on the relevant exchange). This is for a public fund that aims to invest in shares listed on the Exchange or any other regulated exchange, provided that investment in such does not exceed 20% of the fund's NAV.
5. Investment of more than 10% of the public fund's NAV in shares listed on the Exchange or any other regulated exchange by any single issuer affiliated with a field or sector that the fund's general objective is to invest in (provided that the market value of the issue percentage does not exceed the total market value of that particular field or sector). Such investments must not exceed 20% of the fund's NAV.

There is a final general limitation that the portfolio of a public fund may not include any security where a call is to be made for any sum unpaid on that security unless it is feasible to pay the entire amount of cash or securities that can be converted into cash from the portfolio of the fund within five days.

### 3.3.1 Restrictions on Specialised Public Funds wishing to Subscribe to New Public Offers of Securities

Public funds are only permitted to subscribe to new offers of securities where:

1. The securities are being offered in a public offer within the Kingdom or elsewhere. If the public offer is made in a jurisdiction other than the Kingdom, the offer must be subject to regulatory standards and requirements at least equivalent to those applied to a Saudi public offering. It is at the Authority's discretion as to whether the regulatory standards and requirements applied to the offer are at least equivalent.
2. Except for initial public offerings (IPOs) that use a book-building approach, the securities must be subscribed for by the public fund at a price which is no more than the offering price.
3. A public fund may subscribe for debt instruments offered by way of private placement with the following conditions:
  - i. The debt instruments must be issued by a listed company on the Exchange.
  - ii. The debt instruments must be rated 'investment grade' by an authorised credit rating agency, an authorised foreign credit rating agency or by a foreign credit rating agency authorised, or registered in a jurisdiction whose regulatory standards and requirements are at least equivalent to those of the Authority, or
  - iii. Such debt instruments shall be guaranteed by the government of the Kingdom.

## 3.4 Regulations Regarding Specific Types of Funds

In the Investment Fund Regulations, there are a number of specific regulations which only apply to particular types of fund. Each of these is covered below, alongside an explanation of the logic of the regulation.

### 3.4.1 Index Funds

An **index fund** is a passively managed fund that tracks a particular index, like TASI, MT30 and other indices. There is a risk that, without the following regulations, a fund manager could set up an index fund that tracks an excessively risky, inappropriately constructed index or on one that lacks transparency.

The Regulations specify the following:

- An index fund can only invest in constituent securities of a specified index which for these purposes, is an index that:
  - is published in a manner and place which enables it to be accessed by the public
  - represents an adequate and appropriate benchmark for the market to which it refers, clearly defined, and has a sufficiently diversified and liquid composition, and
  - is solely comprised of securities traded on the Exchange or any other exchange which is subject to at least equivalent regulatory standards and requirements.

### 3.4.2 Exchange-Traded Funds (ETFs)

**ETFs** have been established in developed markets like the US for some time. Market professionals might describe them as a type of open-ended investment fund that is listed and traded on a stock exchange. Liquidity is provided to the investors by market makers. ETFs typically track the performance of an index

and trade very close to their NAV. The reason for ETFs trading at, or very close to, their NAV is that certain 'authorised participants' are able to enter into in-kind transactions that either create units in exchange for the index constituents, or redeem units for the underlying exchange constituents. This enables any premium or discount to be arbitrated away to the NAV.

The following regulations concentrate on requirements surrounding transparency, the market makers and the authorised participants with the aim of making sure nothing is hidden and that roles are fulfilled appropriately.

The Regulations specify the following:

- The units of an ETF are deposited at the Depository Center.
- Units in an ETF issued and cancelled for in-kind transactions may be processed in a pre-determined block size or multiples thereof.
- The custodian of an ETF must ensure that any units issued or cancelled in the ETF (and the value of such units) match the underlying assets received (and their value) pursuant to any transfer, and must rectify any mismatch between ETF units and its underlying assets.
- The fund manager of an ETF must appoint one or more Capital Market Institutions to deal as principal to act as **market maker** for the ETF.
- The market maker must, at all times, comply with the market making requirements agreed with the fund manager and/or disclosed in the fund's terms and conditions.
- The total indicative NAV and indicative NAV per unit for an ETF must be regularly calculated by the fund manager during a trading day and must be disclosed on the Exchange on a real-time basis or at any other frequency acceptable to the Authority.
- The fund manager must calculate the total NAV and NAV per unit, and disclose this information on the market at the end of each trading day.
- The ETF's component securities and their respective weightings must be disclosed by the fund manager on the Exchange.

### 3.4.3 Specialised Public Funds

Investment limitations do not apply to specialised public funds. However, such funds have additional requirements under the Investment Fund Regulations. They typically come in the following forms:

1. Money market funds.
2. Feeder funds.
3. **Fund of funds.**
4. **Capital-protected funds.**
5. Endowment funds.

However, in addition to these specialised public funds, applications may be made to the Authority to consider other types of specialised investment funds. Such applications will be considered on a case-by-case basis.

## Money Market Funds

**Money market funds** have been important in places like the US and Europe for some time. Unsurprisingly, they are funds that invest in money market instruments. They enable investors to gain access to a diversified pool of money market instruments which typically offer a competitive return over short-term horizons and with little risk of capital loss. These attributes can be vital in times of market turbulence. The specific requirements in the Investment Fund Regulations for public money market funds focus on maintaining a diverse portfolio and is sufficiently liquid.

The requirements state the following:

- A money market fund manager must invest the fund's assets and money only in the following types of investments:
  - money market transactions concluded with a party regulated by the Saudi Central Bank, or equivalent regulator in another jurisdiction
  - debt instruments
  - derivatives
  - bank deposits with financial institutions regulated by the Saudi Central Bank, or equivalent regulator in another jurisdiction
  - units of money market funds with a similar strategy, or
  - units of debt instruments funds with fixed income.
- A money market fund must not invest in derivatives contracts except for the purposes of hedging, the value of such investment must not exceed 5% of the fund's NAV, and the issuer of the derivative contracts must be subject to prudential rules issued by an equivalent regulator to the Authority.
- The value of a money market fund's investments in securitisation must not exceed 10% of the fund's NAV.
- The investments of a money market fund with, or in, a single counterparty, or with or in parties belonging to the same group, must not exceed 25% of the fund's net assets.
- The money market fund's average date of maturity must not exceed 180 calendar days.
- The money market fund manager must ensure, at all times, that it has liquidity equal to at least 10% of the fund's NAV. This can be made up of investments that have a maturity, or a remaining maturity, period of not more than seven days.
- A money market fund manager must carry out stress testing at least twice a year to detect risks related to the fund and ensure treatment of these risks as soon as possible.

## Feeder Funds

It is not unusual for funds to attract as wide a group of investors as possible by adopting a feeder fund to master fund structure. A **feeder fund** simply takes in investment and then redirects it into another master fund. This enables the 'master' fund to maximise investment proceeds. However, the potential issue that might be harmful to the investor relates to charges – the investor suffers fees in both the feeder fund and in the master fund.

The Investment Fund Regulations restrict the possibility of excessive fees by stating that:

- a public fund which is a feeder fund must not invest in another feeder fund, and
- a public fund which is a feeder fund must not invest in more than one investment fund.

## Fund of Funds

A fund of funds is a fund that makes investments in other funds. This potentially delivers diversification benefits alongside the expertise of the funds' managers. However, as with feeder funds, there is the possibility of the investor incurring excessive levels of fees.

The restrictions within the Investment Fund Regulations placed on public funds of funds are as follows:

- A fund of funds may retain up to 5% of its assets as cash or cash equivalents.
- A fund of funds must invest in a minimum of three investment funds. The minimum investment in each of the three investment funds is 5% of the fund of fund's NAV, however, this minimum percentage does not apply to the fund's investments in additional investment funds.
- Not more than 50% of a fund of funds' NAV may be invested in a single investment fund.
- A fund of funds may invest its money and assets in private funds, provided that it does not exceed 10% of the fund's NAV.

## Capital-Protected Funds

Capital protection is the objective of minimising the possibility of the investors not getting back what they have invested. Capital-protected funds try to do exactly that, and the requirements laid down by the Investment Fund Regulations are primarily aimed at achieving clarity of the fund's objectives and removing the possibility of the capital protection being over reliant on any single counterparty.

The detailed requirements that apply to public capital-protected funds are as follows:

- The name of a capital-protected fund must include the phrase 'capital protected' in all the fund's relevant documents.
- All investments within the capital-protected fund must be consistent with the investment objectives of the fund for the protection of the capital invested by the unitholders and to returning their capital to them on a predetermined future date.
- The investments of a capital-protected fund with, or in, a single counterparty, or with, or in, parties belonging to the same group, must not exceed 25% of the fund's net assets. These investments include money market instruments, debt instruments and banks deposits.

## Endowment Funds

An endowment fund is an investment fund funded by donations often used by educational establishments like universities or other non-profits.

In the Kingdom, the endowment fund manager must comply with the requirements set by the General Authority of Awqaf without prejudice to the requirements contained in the Law and its Implementing Regulations.

Furthermore, an endowment fund may invest its money and assets in private funds, provided that it does not exceed 25% of the fund's NAV.

## 4. Private Funds

### Learning Objective

- 1.4.1 Know the definition of private funds (Glossary)
- 1.4.2 Know the responsibilities of: private real estate fund board (Part 5, Article 84); members of the private real estate fund's board (Part 5, Article 85)
- 1.4.3 Know general rules and restrictions for private funds (Part 5, Article 86)
- 1.4.4 Know requirements for valuation and pricing (Part 5, Article 90)

### 4.1 Introduction to Private Funds

As noted above, funds can be divided into those that are made available to investors generally (public funds) and those that are restricted and can only be marketed to qualified and institutional clients (**private funds**). A private fund is defined as an investment fund which is established in the Kingdom and which is not a public fund, and the units in which may be offered by the fund manager, in accordance with Part Five of the Investment Funds Regulations, to investors in the Kingdom. The offer and sale of units in a private fund is carried out through a mechanism called a '**private placement**'. This subsection looks at the regulations surrounding issuing units in private funds.

If the private fund is not being managed and offered by a Capital Market Institution from the Kingdom, then the fund is considered to be a '**foreign fund**'. Further detail on foreign funds is provided in section 5 of this chapter.

#### 4.1.1 Private Placement

Units in a private fund can only be offered in the Kingdom by way of private placement. The offerees must be investors categorised as institutional and qualified clients and the maximum amount payable per offeree (from investors of the retail clients' category) must not be more than SAR 200,000 or an equivalent amount.

The term 'qualified and institutional' clients includes any of the following:

- **Institutional clients:**
  - a. The Government of the Kingdom or any supranational authority recognised by the Authority.
  - b. Companies fully owned by the Government or any Government entity, either directly or through a portfolio managed by a Capital Market Institution authorised to do so.
  - c. Any Legal Person acting for its own account that meets any of the following:
    1. a company which owns, or is a member of a group which owns, net assets of more than SAR 50 million
    2. an unincorporated body, partnership company or other organisation which has net assets of more than SAR 50 million, or
    3. a person acting in the capacity of director, officer or employee of a Legal Person and responsible for its securities activity, where that Legal Person falls within the defined criteria.

- d. A company fully owned by a Legal Person who meets the defined criteria.
  - e. An investment fund.
  - f. A counterparty.
- **Qualified client** widens the above to include:
    - a. A Natural Person who meets at least one of the following criteria:
      1. Has carried out at least ten transactions per quarter over the last 12 months of a minimum total amount of SAR 40 million on securities markets.
      2. Has net assets of not less than SAR 5 million.
      3. Works, or has worked for, at least three years in the financial sector in a professional position related to investment in securities.
      4. Holds a professional certificate in securities business and accredited by an internationally recognised entity.
      5. Holds the General Securities Qualification Certificate that is recognised by the Authority, and has an annual income that is not less than SAR 600,000 in the last two years.
      6. Being a client of a Capital Market Institution authorised by the Authority to conduct managing activities, provided that the following is fulfilled:
        - a. The offer shall be made to the Capital Market Institution, and that all related communications be made by it.
        - b. The Capital Market Institution has been appointed on terms which enable it to make investment decisions on the client's behalf without obtaining prior approval from the client.
      7. Registered persons of a Capital Market Institution if the offer is carried out by the Capital Market Institution itself.
    - b. A Legal Person, which meets at least one of the following criteria:
      1. Any legal person acting for its own account and be any of the following:
        - a. A company which owns, or which is a member of a group which owns, net assets of not less than SAR 10 million and not more than SAR 50 million.
        - b. Any unincorporated body, partnership company or other organisation which has net assets of not less than SAR 10 million and not more than SAR 50 million.
        - c. A person acting in the capacity of director, officer or employee of a Legal Person and responsible for its securities activity, where that Legal Person falls within the defined criteria.
      2. Clients of a Capital Market Institution are authorised by the Authority to conduct managing activities, provided that the following is fulfilled:
        - a. the offer shall be made and communicated to the Capital Market Institution
        - b. the Capital Market Institution has been appointed on terms which enable it to make investment decisions on the client's behalf without obtaining prior approval from the client, and
        - c. a company fully owned by a Natural Person or Legal Person who meets one of the relevant defined criteria.



### 4.1.2 Private Placement Requirements

A Capital Market Institution may not offer units in a private fund unless the following conditions are met:

1. notification to the Authority in writing in the required format at least 15 days prior to the proposed date of an offer
2. submission of the required declaration to the Authority
3. submission to the Authority of copies of the fund's terms and conditions, and any offering documents to be used in advertising the offer
4. the provision of details of the organisational structure of the fund manager, including a description of the investment decision-making process of fund manager or sub-fund manager, and the name and function of any registered person in that decision-making process to the Authority
5. providing a compliance monitoring programme for the relevant investment fund
6. paying such registration fees as the Authority may prescribe, and
7. providing any other information that the Authority requires.

If, after having received a private placement notification and the relevant information and documents, the Authority considers that the proposed offer of units may not be commensurate with the fund manager's ability or may result in a breach of the Law or its Implementing Regulations, then it may take the following actions:

1. carry out any enquiries which it considered appropriate including requiring the concerned person or its representative to appear before the Authority to answer questions and to explain any matters considered relevant to the private placement offering, or
2. require the concerned person or others to provide additional information or to confirm, in such manner as the Authority may specify, that the information provided is accurate.

Where the Authority determines that the private placement may not be commensurate with the fund manager's ability or may result in a breach of the Law or its Implementing Regulations, it may issue a 'notification' to the Capital Market Institution stating that the private offer is not to be made or publish a 'notice' prohibiting the offer.

Where the Authority has not taken any of the actions stated above, it shall, at the request of the Capital Market Institution, issue a notice stating it has no objection to offering units in the private fund.

In all instances, the Capital Market Institution must provide the Authority with the results of the offer in prescribed form, within ten days of the end of the offer period of the private fund.

Where the offer is not completed by the proposed offer end date, the Capital Market Institution must provide the Authority with a notification in writing signed by the Capital Market Institution within ten days, confirming that the offer has failed to complete. The Capital Market Institution must return to the unitholders their full subscriptions monies together with any returns generated from investing the subscriptions monies without any deduction.

### **4.1.3 Valuation and Pricing**

It is the fund operator that is responsible for valuing the fund's assets, as well as pricing and dealing in the units of the private fund in accordance with a clear policy. This policy must be disclosed by the fund manager in the fund's terms and conditions and annual reports. The policy must also establish a similar method for pricing when issuing, transferring or redeeming units in the fund.

The fund manager must notify the unitholders of any amendments to the valuation, pricing and dealing policy in the private fund units within a period not exceeding five days.

The fund manager of a private real estate fund must, before purchasing or selling any real estate assets, obtain valuation from at least two accredited valuers. These valuers must meet the following conditions:

1. Be independent from all related parties (such as the fund manager and the custodian).
2. Hold the Saudi Authority for Accredited Valuers fellowship.

At the time of the purchasing or selling of the real estate asset, the accredited valuers' valuation report must not be more than three months old.

Furthermore, if the investment goals of the fund includes initial development or structural development, the fund manager of a private real estate fund must appoint a developer, and an engineering office that is independent of any of the relevant parties, after ensuring that they have obtained the necessary approvals and licences to carry out their business and activities from the relevant governmental bodies, and the engineering office shall – at least – oversee the implementation of the fund's business plan, and the approval of disbursements to the developer and contractor.

### **4.1.4 Private Real Estate Fund Board Requirements**

A private real estate fund must be supervised by a fund board appointed by the fund manager.

The number of directors in a private real estate fund board must not be less than three directors, and the number of independent fund directors of the fund board must not be less than two, or one third of the total number of directors (whichever is greater).

The fund manager will disclose any material information to the unitholders and other stakeholders.

## 5. Foreign Funds

### Learning Objective

1.5.1 Know the process of issuing units in foreign funds (Part 6, Articles 97, 98 & 99a)

Foreign funds are investment funds that are established in a jurisdiction outside the Kingdom. When a foreign fund is offered to investors in the Kingdom it must be made through a distributor that is a licensed Capital Market Institution and, as with private funds, the offer must utilise the private placement mechanism. Additionally, the fund manager of the foreign fund must be suitably authorised in a jurisdiction that employs regulatory standards and requirements at least equivalent to those of the Authority.

As with the private funds, the private placement of a foreign fund must be restricted to offerees categorised as institutional and qualified clients, and the maximum amount payable per offeree (from investors of the retail clients' category) must not be more than SAR 200,000, or an equivalent amount.

## 6. Reporting to Unitholders

### Learning Objective

1.6.1 Know the reporting requirements by the fund manager to investment fund unitholders (Investment Funds Regulations): public funds (Part 4, Articles 75 & 76, Annex 3), private funds (Part 5, Article 93), foreign funds (Part 6, Article 103–1)

Fund reports are provided to unitholders to give them regular and relevant information to enable them to evaluate fund performance. This section highlights the reporting requirements generally and then the particular requirements placed on public funds, private funds, foreign funds and real estate investment funds. It also covers the potential requirement for meetings of unitholders that can be called by the fund manager, custodian or unitholder in a public fund.

### 6.1 Reporting Requirements

The financial reports that must be provided by the fund manager are divided into the following two types:

- **The annual report** – which includes the full audited financial statements for the fund.
- **Interim reports** – more regular reports that cover sub-periods in between the annual reports.

All reports must be provided by the fund manager to unitholders on request and without charge.

## Contents of Fund Financial Reports

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Each of the two types of financial report must include the minimum content specified in the regulations. Clearly more is included in the full annual report than in interim reports. The following outlines some of the more important contents of the reports:

a. **Investment Fund Information**

- The name and objectives of the investment fund.

b. **Fund Performance**

- A comparative table covering the last three financial years (or since inception), highlighting:
  - the fund's NAV at the end
  - the fund's NAV per unit at the end of each financial year
  - the highest and lowest NAV per unit for each financial year
  - the number of units in issue at the end of each financial year
  - the income distribution per unit (where applicable), and
  - the expense ratio.
- A performance record that covers the following:
  - the total return for one year, three years and five years (or since inception)
- The annual total return for each of the last ten financial years (or since inception). A table showing the actual fees and fund expenses paid by the investment fund during the year.

c. **Key Personnel**

- The name and address of the fund manager, the custodian, fund operator and auditor.
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The time period within which the reports must be made available are as follows:

- **Annual reports** – no later than three months from the end of the period to which the report relates.
- **Interim reports** – within 30 days from the end of the period to which the report relates.

There are also ongoing expectations for fund managers of public funds to disclose their NAVs. The fund manager must make the current and historical NAV of the public funds available for inspection by unitholders free of charge, at its registered offices.

### 6.1.1 Quarterly Disclosures for Public Funds

The fund manager must disclose information on its website and on the Exchange's website or by any other means specified by the Authority. The information includes:

- Price information at the end of the quarter.
- The percentage of total fees and charges in the quarter to the average NAV of the fund.
- The amount and percentage of profits distributed in the quarter (if any).
- The standards and index used to measure the risks.
- The fund's performance versus its benchmark.

### **6.1.2 Public Funds – Meetings of Unitholders**

The fund manager of a public fund may call for a meeting of unitholders on its own initiative and must call for a meeting of unitholders within ten days of receiving a written request from the custodian, or from the unitholder or unitholders that own collectively or individually at least 25% of the units in the fund.

The meeting of unitholders is called by the fund manager announcing it on its website and any other website available to the public (according to the controls set out by the Authority). A notice in writing must be sent to all unitholders and the custodian giving not less than ten days' prior notice of the meeting and not more than 21 days' notice before the meeting. The announcement and notice must specify the date, place, time and agenda of the meeting and the resolutions proposed. The fund manager must send a copy of any such notice to the Authority.

The fund manager must reflect the matters that unitholders wish to consider in the agenda for the meeting and unitholders holding no less than 10% of the public fund units are entitled to add one or more items to the unitholders meeting's agenda, provided that the proposed items do not overlap with the regulatory duties and responsibilities of the fund manager.

The quorum required to conduct a meeting of the unitholders shall be such a number of unitholders that collectively own at least 25% of the units in the public fund, unless the terms and conditions of the fund specify a greater percentage. If the quorum requirements are not met, the fund manager must call for a second meeting by announcing it on its website and send a notice in writing to all unitholders and the custodian giving not less than five days' notice of the second meeting. The second meeting is considered valid regardless of the percentage of units represented in the meeting.

Unitholders are entitled to exercise one vote at the meeting of the unitholders for each unit held, and every unitholder is entitled to appoint a proxy to represent them at a meeting of the unitholders.

### **6.1.3 Private Fund Reporting Requirements**

As with public funds, private funds must prepare and provide annual reports (including audited financial statements) on request and without charge. Annual reports should be made available to unitholders no later than 90 working days from the end of the period to which they relate by such means as specified in the fund's terms and conditions.

Interim reports for private real estate funds must be prepared every six months and made available to unitholders within 35 days from the end of the reporting period.

### **6.1.4 Foreign Fund Reporting Requirements**

The distributor of units of a foreign fund must send all reports and documentation issued by the foreign fund manager to the unitholders in the Kingdom, ensuring that all unitholders within the Kingdom will be directly entitled to the rights prescribed in the fund documentation.

## 7. Subscription, Pricing, Valuation and Redemption

### Learning Objective

- 1.7.1 Know the pricing, valuation and redemption of investment funds (Investment Funds Regulations): initial offer period (Article 64), public funds (Part 4, Articles 65, 71, 72 & 73, Annex 5), private funds (Part 5, Article 90)
- 1.7.2 Know regulations regarding secondary trading of closed-ended funds (Investment Funds Regulations: Part 5, Article 96 & Part 6, Article 105)

### 7.1 Pricing, Valuation and Redemption of Investment Funds

The regulations surrounding the way the price of a unit in an investment fund is arrived at are vital. Every unit that is bought or sold should be undertaken at a price that is fair to both the buyer and the seller. This section details the requirements of the Investment Fund Regulations in terms of pricing and valuation.

#### 7.1.1 The Initial Offer

At the initial offer stage, the terms and conditions of the fund are produced and provided to potential investors in a public fund. It must include details of the initial offer, including the duration of the initial offer period and the initial price of the units. During the initial offer period, the fund manager is required to only offer units at the initial price.

The duration of the initial offer period shall not exceed 60 days. The fund manager must specify a minimum amount that must be raised through investors' subscriptions during the initial offer period. Until the end of the initial offer period the fund manager should not invest the subscription monies raised except by placing it on deposit or in money market transactions concluded with a party subject to supervision by the Saudi Central Bank (or an equivalent regulator in a jurisdiction other than the Kingdom).

Where the minimum amount is not raised during the initial offer period, the fund manager must return the full subscription monies to investors, together with any returns generated from investing the money, without any deduction.

At the end of the offer period, the fund manager must disclose the offer results on its website and provide them to the Authority within ten days.

#### 7.1.2 Subscriptions and Redemptions in Public Funds

Once the initial offer is over, there are ongoing requirements for public funds to enable further subscriptions and redemptions on 'dealing days'. Open-ended public funds must have a minimum of two dealing days each week. A closed-ended public fund is required to have such dealing days as the fund manager specifies in the fund's terms and conditions.

The deadlines for submission of requests for subscriptions and redemptions for a public fund must be specified in the public fund's terms and conditions. The fund operator must then process requests for subscriptions or redemption at the price calculated at the next valuation point following the request for subscription or redemption.

The fund operator is required to pay the unitholder the proceeds of redemption no later than the close of business on the fifth day following the valuation point at which the price for the redemption was determined.

### **7.1.3 Valuation of Units in Public Funds**

It is the fund operator that is responsible for valuing the assets of the public fund, and this valuation must be conducted in a full and fair manner.

The assets of the public fund must be valued each dealing day at such time as specified in the terms and conditions and the valuation point must not exceed one day from the deadline for the request for subscription or redemption.

The fund manager must, in the fund's terms and conditions, document the basis of the valuation of units and, where appropriate, any valuation methodology, and must ensure that the valuation methodology and procedures are applied in a fair and consistent manner.

The fund manager must develop, maintain and state in the terms and conditions of the public fund a clear policy covering valuation, valuation points, pricing and dealing in units. The fund manager must adopt a consistent approach to the valuation of units for the purposes of meeting the subscription and redemption requests and transfer of ownership of units.

### **7.1.4 Pricing of Units in Public Funds**

The fund operator must price the units for subscriptions and redemptions on any dealing day by reference to the NAV per unit of the public fund at the valuation point on the relevant dealing day. These unit prices must be expressed to at least four decimal places and must be published on the business day following the dealing day on the fund manager's website, the Exchange's website and any other websites available to the public (according to the controls set out by the Authority).

If the valuation or pricing is performed incorrectly, the fund operator must record this fact and compensate all harmed unitholders (including former unitholders) as soon as reasonably practicable. For valuation or pricing errors of 0.5% or more, the fund manager must immediately report to the Authority and disclose the error on its website, on the Exchange's website or any other website available to the public (as per the Authority's Regulations and in the public fund's reports).

The fund manager's reports to the Authority must provide a summary of all valuation and pricing errors.

## Valuation Methodologies for Public Funds

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### Assets to be included in the Valuation:

- All of the investment fund assets must be part of the valuation.
- The assets of the investment fund are deemed to include all assets of every kind and nature, including but not limited to:
  - cash or deposits, including interest owing thereon:
  - dividends and distributions payable in stocks, cash or other property received by the investment fund:
  - all investments and other assets owned, and
  - any interest accrued on any assets or investments.
- The liabilities of the investment fund are deemed to include all liabilities of every kind and nature, including but not limited to:
  - all loans, and accounts payable, and
  - all accrued or payable expenses and fees chargeable to the investment fund.
- Method of Valuation:
  - The investment fund must be valued on each valuation day. The valuation will be currency based and will be determined in respect of all the assets of which the portfolio comprises less the liabilities attributable to the investment fund at that time.
  - The method of valuing the assets will depend on the type of the asset and the fund manager may rely upon any trustable system for the determination of values, prices or exchange rates.
  - The following principles shall be followed to value the fund's assets:
    - If the assets are securities which are listed or traded on any regulated securities exchange or automated quotation system, the most recent transaction price may be used.
    - Where the securities are suspended, they should be valued at the suspended price, unless there is conclusive evidence to indicate that the value of such securities has gone below the suspended price.
    - Non-listed bonds and *sukuk* must be valued at book value plus accrued interest or profit.
    - For listed bonds and *sukuk*, where market conditions do not allow the most recent transaction price to be used, the book value plus accrued interest or profit may be used as long as it is disclosed in the terms and conditions of the fund.
    - Investment funds must be valued at the last published NAV per unit.
    - Deposits must be valued at nominal value plus accrued interest/profit.
    - Any other investments must be valued at fair value, as determined by the fund manager based on methods and bases agreed by the custodian and having been verified by the auditor of the fund.

The NAV per unit = (Total Assets – Liabilities – Accrued Expenses) / Number of outstanding units at the point of valuation

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### 7.1.5 Pricing of Units in Private Funds

For private funds, the fund manager must develop, maintain and disclose in the terms and conditions of the fund a clear policy covering valuation, pricing and dealing in units. The fund manager must also keep unitholders informed of any amendments to the policy.



## 7.2 Secondary Trading of Private and Foreign Funds

In order to maintain the limitations to the investor base for private and foreign funds that are specified in the private placement provisions, any subsequent trading must be restricted to qualified and institutional clients, as detailed below.

Subsequent transfers of units in a private fund or a foreign fund originally made available in a private placement can only be made to any of the following:

- existing unitholders
- qualified and institutional clients, or
- where the maximum amount payable for such units is not more than SAR 200,000 (or its equivalent).

## 8. Closed-Ended Investment Traded Funds

This section relates to closed-ended investment funds. They are much like normal companies, but companies with the specific purpose of buying investments. The unitholders of closed-ended investment funds gain exposure to that portfolio of investments. If the fund is listed, then the unitholders have the additional benefit of liquidity – being able to buy or sell units in the closed-ended investment fund through the Exchange’s systems. It is worth noting that a fund being listed is described as the fund being traded – hence the term ‘closed-ended investment traded funds’ for listed closed-ended investment funds in the Kingdom. This section outlines the provisions in relation to closed-ended investment funds in the Kingdom, drawn from the Investment Fund Regulations as issued by the Authority.

### 8.1 General Provisions

#### Learning Objective

1.8.1 Know the general provisions for closed-ended investment traded funds (Part 4, Article 47)

Part 4 of the Investment Funds Regulations details certain general provisions relating to closed-ended investments issued in the Kingdom. The general provisions include the following:

- **Offerings** – the general provisions allow units in closed-ended traded investment funds to be paid for in either cash or in-kind contributions. Certain special regulations are laid down to prevent the potential for abuse of the ability to pay for units using in-kind contributions.
  - The first of these requires the value of the consideration to be assessed by two independent and appropriately licensed valuers.
  - The second places a restriction on those that have purchased units for in-kind consideration by specifying that ownership of the in-kind contributions must be transferred to the fund, and that subscribers owning 5% or more of the fund units paid for using in-kind contributions are not allowed to dispose of their units within one year of their trading commencement.

- **Independent Board members** – to be classified as an independent board member and to be able to practice his duties, express opinions and vote on decisions with no bias, objectivity is required. The following are examples that would negate such independence and objectivity:
  - Holding 5% or more of the fund’s units or the units of another fund under the management of the same fund manager, or being a first degree relative of someone who owns such a percentage:
  - Being a first degree relative of any member of the board of the fund or any other fund under the management of the same fund manager.
  - Working, or have been working, during the preceding two years, for the fund manager or any party related to the fund, or holding or having held, during the preceding two years, a controlling interest in any of these parties.
  - Receiving financial consideration from the fund in addition to the remuneration for membership of the board.

The Board must conduct an annual assessment of a member’s independence and ensure that there are no relationships or circumstances that affect or may affect that independence.

## 8.2 Offering Closed-Ended Investment Traded Funds

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### Learning Objective

- 1.8.2 Know the conditions for offering closed-ended investment traded funds (Part 4, Article 48)
  - 1.8.3 Know the disclosure requirements (Part 4, Article 52)
- 

### 8.2.1 Offering Conditions

The following four conditions must be satisfied to offer units in a closed-ended investment fund in the Main Market:

1. The fund’s total assets must be at least SAR 300 million at establishment to be included on the Main Market of the Exchange, or SAR 100 million to be included on the Parallel Market of the Exchange.
2. The nominal value per unit must be SAR 10.
3. Public unitholders may only subscribe by way of cash contributions.
4. The minimum subscription must not exceed 1,000 units per unitholder.

### 8.2.2 Disclosure Requirements

#### General Requirement

There is a general requirement for the fund manager of a closed-ended investment traded fund to disclose to both the Authority and to the unitholders any material developments that are not public knowledge and that may affect the fund’s assets and liabilities, financial position or general course of business. This disclosure is required ‘without delay’.

## Specific Events

The Regulations also list several specific events that need to be disclosed in any event. These include the following:

- **Large transactions and fluctuations in value** – this includes transactions to buy, sell, mortgage or lease at a price equal to, or greater than, 10% of the fund's NAV. Losses equal to, or greater than, 10% of the fund's NAV and increases or decreases in the NAV of the fund of 10% or more also require disclosure.
- **Significant disputes and judgements** – disclosure is required of any dispute, including litigation, arbitration or mediation where the value involved is equal to, or greater than, 5% of the fund's NAV. Similarly, the issuance of any judgement, decision, order or declaration by a court or judicial body which may adversely affect the fund's ability to utilise a portion of its assets that is equal to, or greater than, 5% of the fund's NAV must be disclosed.
- **Related party transactions** – disclosure is required for any transaction or arrangement between the fund and a related party if such a transaction or arrangement is equal to, or greater than, 1% of the fund's gross revenues.

## Unitholder Dealings

The unitholder must notify the Authority if they own, or have, an interest in (5%) or more of the fund's units. This disclosure is required within a maximum period not exceeding the end of the third trading day following the execution of the transaction or the occurrence of the event which results such ownership or interest. The notification must also include a list of persons who have an interest in the units that they own or control. The Exchange will then make the information public unless the fund manager successfully requests that the Authority requires that the data is kept confidential as to disclose it would be 'unduly detrimental to the fund'.

It is important to note that when determining the size of the stake, a person is deemed to hold not just the units in their own name, but also those units held by relatives, controlled companies and parties with whom the person is working in concert. This is made clear in the regulation which states:

*'...in calculating the total number of the fund's units in which a person is interested, that person will be deemed to be interested in any units owned or controlled by any of the following persons:*

- a. a relative of that person*
- b. a company controlled by that person, or*
- c. any other persons with which that person has agreed to act in concert to acquire an interest in the fund units'.*

## End of Chapter Questions

Think of an answer for each question and refer to the appropriate section for confirmation.

1. Name three primary responsibilities of a fund manager?  
*Answer Reference: Section 1.1*
2. When appointing a custodian, what conditions must be met?  
*Answer Reference: Section 2.1.1*
3. How do closed-ended funds differ from open-ended funds?  
*Answer Reference: Section 3.1*
4. What are the regulatory restrictions on what a public fund can invest in?  
*Answer Reference: Section 4.3*
5. What sort of funds offer units in the form of a private placement, and who is eligible to subscribe?  
*Answer Reference: Section 4.1*
6. What are the two forms of financial report produced by funds and how soon do they need to be made available?  
*Answer Reference: Section 6.1*
7. What is the method for arriving at the net asset value (NAV) of the units in a fund?  
*Answer Reference: Section 7.1.4*
8. What are the requirements in relation to minimum total assets and nominal value per unit of a closed-ended investment traded fund?  
*Answer Reference: Section 8.2.1*
9. The general requirement placed on closed-ended investment traded funds is to disclose material developments when? Furthermore, specific events need to be disclosed when they reach 1%, 5% and 10% thresholds. What are those events?  
*Answer Reference: Section 8.2.2*
10. Unitholders are required to disclose their stakes in closed-ended investment traded funds to the Exchange when they reach what level and when? Stakes held by whom are considered to be part of a unitholder's stake for disclosure purposes?  
*Answer Reference: Section 8.2.2*

## Chapter Two

# Real Estate Investment Funds Regulations (Public Real Estate Funds)

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**This syllabus area will provide approximately 8 of the 25 examination questions**





## Introduction

The previous chapter set out the principal provisions of the Investment Funds Regulations issued by the Capital Market Authority (the Authority). Regulated investment funds can take many forms and they can invest in a wide range of underlying assets. However, certain types of fund have distinctive characteristics, and as a result are subject to different regulatory requirements. This chapter explores the specific obligations imposed on investment funds investing in real estate (such as residential and commercial property) and sets out the principal provisions of the Authority's Real Estate Investment Funds Regulations.

## 1. Organisational Structure

### Learning Objective

- 2.1.1 Know the types of real estate investment funds and their objectives (Real Estate Investment Funds Regulations: Part 3, Article 10)
- 2.1.2 Know governance requirements relating to (Real Estate Investment Funds Regulations): oversight (Part 3, Article 11), directors' responsibilities (Part 3, Article 12)

### 1.1 Types of Real Estate Investment Fund

**Real estate investment funds**, like other types of funds, can have varying objectives. There are five specific purposes upon which real estate funds can be based:

1. Initial development then selling. Such funds own undeveloped land, develop it, divide it into residential or commercial plots, then sell it and terminate the fund.
2. Construction development then selling. Such funds own a piece of raw or developed land with the purpose of constructing residential or commercial units, then sell it and terminate the fund.
3. Initial or construction development with the intention of leasing it for a certain period, then selling it and terminating the fund.
4. Owning real estate that is constructionally developed with the intention of leasing it for a certain period of time then selling it and terminating the fund.
5. Investing in constructionally developed real estate to enable the generation of periodic rental income.

It is also possible for funds to have other structures and objectives, if all of the Authority's requirements are met.

### 1.2 Governance Requirements

Effective and robust governance arrangements play a vital role in ensuring that an **investment fund** is managed appropriately, and that the interests of investors are protected. The Real Estate Investment Funds Regulations imposes certain requirements in relation to the supervision of real estate funds,

including requiring that a fund is governed by a fund board (appointed by the fund manager after gaining Authority approval). The number of directors of the fund must not be less than three, and the number of independent fund directors of a fund board must be at least two, or one third of the total number of directors if greater.

The fund board must conduct an annual assessment for each independent director to ensure that there are no relationships or circumstances that affect, or may affect, independence.

The fund manager may not remove any independent board member, removal can only be made by the unitholders after a special fund resolution.

When more than one real estate investment fund is managed by the same fund manager, those real estate investment funds may be supervised by a single fund board unless the fund manager estimates that the number of funds is too high to be supervised effectively by a single fund board. The fund board and the fund manager must annually review the number of real estate investment funds supervised by that board and assess whether the number is such that effective supervision would be compromised and a different board should be appointed for one or more of those real estate investment funds. The Authority reserves the right to require a fund manager to appoint another fund board if it considers that the number of real estate investment funds the fund board supervises is too high.

Any person appointed by the fund manager as a member of the fund board must fulfil the following eligibility requirements:

1. the person must not be bankrupt, or subject to, any bankruptcy or insolvency proceedings
2. the person must not have committed an offence involving fraud or acted in breach of integrity and honesty, and
3. the person must possess the necessary experience and expertise.

If any member of the fund board ceases to meet the eligibility requirements, the fund manager must:

- notify the Authority immediately, and
- replace the member of the fund board with another person who fulfils the eligibility requirements within 45 days.

Similarly, if any board director resigns or ceases to provide services, the fund manager must:

- notify the Authority within ten days, and
- replace the member of the fund board with another person within 45 calendar days from the day the fund manager becomes aware of such resignation or cessation of service.

There are also general requirements that the fund manager must immediately disclose any change in the membership of the fund's board of directors on its website and the Exchange's website or any other website available to the public according to the controls set out by the Authority.

The fund manager is also required to provide all necessary information about the public fund to all members of the fund's board in order to enable them to carry out their duties efficiently, as well as to provide any other information or documentation requested by the fund's board to enable it to perform its duties.



### 1.2.1 Responsibilities of the Fund's Board of Directors

The Government specifies that the board of directors of a fund have the following responsibilities:

1. Approving material contracts, decisions and reports involving the fund, including, but not limited to, contracts for the provision of fund management services, contracts for the provision of custody services but excluding contracts entered into in relation to the investments made, or to be made, by the fund.
2. Reviewing the report that includes assessment of the performance and quality of services provided by the parties involved in providing significant services to the fund.
3. Adopting a written policy regarding voting rights on the fund's assets.
4. Supervising, and where appropriate, approving or ratifying any conflict of interest disclosed by the fund manager.
5. Meeting at least twice a year with the fund manager's compliance committee or with the compliance officer to review the fund manager's compliance with all applicable rules, laws and regulations.
6. Approving all fundamental and non-fundamental changes (as defined in the regulations) prior to the fund manager obtaining the unitholders' and the Authority's approval, or prior to notifying them (where applicable).
7. Confirming the completeness, accuracy and compliance with the Real Estate Investment Fund Regulations, the terms and conditions and any other document that includes disclosures relating to the fund and/or the fund manager, and its conduct of the fund.
8. Ensuring that the fund manager carries out its obligations in the best interests of the unitholders, in accordance with the Real Estate Investment Fund Regulations and the terms and conditions of the fund.
9. Assessing the risk management mechanism adopted by the fund manager.
10. Generally recognising its fiduciary duty to unitholders, including a duty to act in good faith, a duty to act in the best interests of the unitholders and a duty to exercise all reasonable care and skill.
11. Taking minutes of meetings that record all the deliberations and facts of the meetings, and the decisions taken by the fund board.
12. Reviewing the report that includes all complaints and the measures taken to address them.

## 2. Fund Management and Disclosure

### Learning Objective

- 2.2.1 Know requirements relating to (Real Estate Investment Funds Regulations): fund managers (Chapter 2, Articles 13), disclosure (Chapter 3, Article 24)

In addition to the responsibilities of the board of directors set out above, the Real Estate Investment Fund Regulations imposes a series of duties on the fund manager of a real estate fund. These specify that the fund manager must comply with all principles and duties required under the Capital Market Institutions Regulations, including the fiduciary duty towards unitholders which incorporates the duty to act in the best interests of the unitholders and duty to exercise all reasonable care and skill. Furthermore, the fund must be managed by a portfolio manager working for the fund manager, and the portfolio manager must be a registered person with the Authority.

Further duties placed on the fund manager include:

1. To set out the decision-making procedures that should be followed when executing technical and administrative issues for the fund.
2. To comply with all laws and regulations valid in the Kingdom related to the fund's business.
3. To implement a compliance monitoring programme for every real estate fund it manages, and to provide the Authority with the results of the programme upon request.
4. To develop policies and procedures that detect risks affecting the fund's investments and ensure treatment of these risks as soon as possible. These policies and procedures must include conducting risk assessments, at least, once a year.
5. To cooperate with all persons concerned with the performance of tasks for the fund, including the custodian and the auditor. The fund manager must provide them with whatever is necessary for them to perform their duties and tasks.
6. To prepare an annual report that includes an assessment of the performance and quality of services provided by the parties involved in providing material services to the fund – including the custodian, developer and property manager as applicable – and the fund manager must submit the report to the fund's board of directors.
7. To manage the fund's assets for the unitholders' benefit according to the fund's terms and conditions.
8. To ensure the legality and validity of all contracts concluded for the benefit of the fund.
9. The fund manager has the primary responsibility for compliance with the Real Estate Investment Fund Regulations. Any delegation of the fund manager's responsibilities and duties to any other person will not in any way limit, reduce or satisfy the fund manager's responsibilities under the regulations. The fund manager will be responsible to unitholders for any losses incurred by the investment fund which are caused by fraud, negligence, misconduct or wilful default of the fund manager.
10. The fund manager must comply with the provisions of the Real Estate Investment Fund Regulations when applying for approval from or when making a notification to the Authority.
11. The fund manager must always comply with the fund's terms and conditions.
12. The fund manager must prepare an annual report that includes all complaints and the measures taken to address them, and it must submit the report to the fund's board.

The Regulations also include provisions relating to required disclosures. The fund manager must provide sufficient information regarding the fund's investment goals, conditions, risks and any other information to enable unitholders to make their investment decisions. The information about the fund must not contain any incorrect or misleading information.

The fund manager must also disclose all expenses related to the offer of the real estate investment fund's units, if such expenses were incurred by the fund in the fund's terms and conditions.

In the event of the fund manager making any amendments to the fund's terms and conditions, the fund manager must submit an updated version to the Authority within ten days of making any amendments, and also provide the custodian with the updated version immediately. The fund manager must also publish a copy of the fund's new terms and conditions on their website and the Exchange's website or any other acceptable website available to the public within ten days of making any changes to it. This must also be included in the annual update of the fund's performance.

## 3. Fund Asset Requirements

### Learning Objective

- 2.3.1 Know requirements relating to (Real Estate Investment Funds Regulations): fund assets (Chapter 5, Article 28), custody of fund assets and related documents (Chapter 5, Article 29), segregation of fund money (Chapter 5, Article 30), register of unitholders (Chapter 5, Article 37), subscription and offering (Chapter 5, Article 38)

The Real Estate Investment Fund Regulations include a series of provisions relating to the assets of the fund, and the means by which the assets are held. The Regulations require that the fund's ownership of its real estate is supported by valid title deeds, and all real estate owned by the fund must have approval evidenced by an official document from the competent body for its design and construction. For income-generating real estate assets, the fund manager must have proof that the assets are ready for legal use. Furthermore, all lease agreements must be legally documented to ensure the rights of all parties and the fund manager must ensure the fairness and integrity of the lease agreements for income-generating real estate assets.

The Real Estate Investment Fund Regulations also include specific provisions relating to the custody of the fund's assets. The Regulations require that one or more Capital Market Institutions authorised to conduct custody activity must undertake the custody of the fund's assets. The custodian must maintain all relevant documents including, but not limited to:

- title deeds
- records of investment decisions
- all material contracts related to the operation of the fund
- fund board meeting minutes, and
- accredited valuers' reports.

The custodian is permitted to appoint one or more third parties or affiliates as a fund sub-custodian for any real estate investment fund, contracted in writing. The remuneration of the fund sub-custodian must be paid by the custodian out of its own resources and the fund sub-custodian must be Capital Market Institution authorised to conduct custody activity.

There is an exception to the above which permits the appointment of an overseas sub-custodian for the foreign assets of the fund. Again, the contract between the custodian and the overseas sub-custodian must be in writing, and the overseas sub-custodian must be established, authorised and supervised in a jurisdiction that employs regulatory standards and requirements at least equivalent to those of the Authority.

To avoid conflicts of interest, the custodian appointed must not be a fund manager or a fund sub-manager to the relevant fund, or an affiliate of the fund manager or the fund sub-manager.

The custodian must segregate each real estate investment fund's assets from its own assets and from the assets of its other clients. They must also separately identify, by registration in the name of the custodian, the securities and other assets of the investment fund. The custodian must register the ownership of the real estate assets of the fund, and any unlisted company shares that are not deposited at the Depository Center, in the name of a fully owned company of the custodian.

However, by way of an exception to the above, where the real estate investment fund takes the form of a Special Purposes Entity (SPE), the registered ownership must be in the name of that SPE.

The custodian must also maintain all necessary records and other documents that support the performance of its contractual obligations.

The custodian is fully responsible for its obligations regardless of whether the custodian carries out its duties on its own or assigns it to a sub-custodian. The custodian remains liable towards the fund manager and the unitholders for losses incurred by the investment fund, which are caused by fraud, negligence, misconduct or wilful default of the custodian.

It is important to appreciate that the custodian is responsible for maintaining and protecting the real estate investment fund assets for the benefit of unitholders. The net assets of the fund are owned collectively by the unitholders. A fund manager or custodian does not have any interest in, or claims against, such assets, other than when the fund manager is a unitholder, or for claims permitted under the regulations and disclosed in the fund's terms and conditions.

An important safety mechanism for funds is that the assets of the fund are held separately and segregated from any other assets of the fund manager. This will mean that the assets will not be subject to any claim from the creditors of the fund manager in the event of the fund manager getting into any financial difficulties. This is the case for client money as well as real estate assets and the Real Estate Investment Fund Regulations specifies that:

- the custodian must open a separate local bank account in the custodian's name for each fund, and the account must be in favour of the related real estate investment fund, and
- the custodian must deposit all cash belonging to the investment fund into the relevant bank account, and must deduct from the relevant bank account the amounts used to finance the investments, and the real estate investment fund management and operations expenses in accordance with the regulations, the fund's terms and conditions, and the contract by which the custodian was appointed by the fund manager.

Where a real estate investment fund takes the form of a special purpose entity, the custodian must open a separate account with a local bank in the name of that special purpose entity.

There are also several provisions in the Real Estate Investment Fund Regulations surrounding the subscription process for real estate investment funds and the requirements to maintain a register of unitholders.

The Regulations concern the subscription and offering process. On establishment, a subscription period must be specified, and if the capital is not fully covered during that period, the fund manager has the right to extend the subscription period after obtaining the Authority's approval. If the capital is not covered, all amounts should be returned to the unitholders without any deductions within a period not exceeding five days from the date of ending the offer.

The fund's units should be fully paid during the subscription period and subscriptions must be through the fund manager, who should ensure, before accepting any subscriptions, that each unitholder is provided with a copy of the fund's terms and conditions and signs it. The fund manager must then issue a confirmation notice to the unitholder.

The fund manager can invest its own cash by purchasing units in the fund upon establishment, but this should be disclosed in the fund's terms and conditions.

The offering period must not exceed a maximum period of 60 days and the fund manager must submit, to the Authority, a statement of the offering results within ten days of the end of the offering period.

There are special provisions in relation to unitholders who subscribe with an in-kind contribution. Such persons may only reduce their ownership of the fund's units to a minimum of 50% of the number of units issued to them after one year has elapsed after the date of subscription in the fund, unless the relevant fund's terms and conditions state a longer period.

After subscription, the total value of the fund's assets may be increased according to the following mechanisms:

1. The fund manager must obtain approval from both the unitholders and the Authority to offer additional units in the fund by accepting in-kind contributions or by accepting cash contributions, or both.
2. The fund manager must commence offering the additional fund's units within a period not exceeding six months from the date of the Authority's approval, otherwise the approval is deemed to be cancelled.

The Regulations require the fund manager to establish and maintain a register of unitholders. However, it does allow them to engage a third party or parties to do this via a contract in writing. In either case, the fund manager remains responsible for all of the duties in relation to the register under the Real Estate Investment Fund Regulations.

The unitholders' register is conclusive evidence as to a person's ownership entitlement.

The register must include, at a minimum, the following information:

- the name address and contact number of each unitholder
- the national identification number, *iqama* number, passport number or company registration number of the unitholder
- the nationality of the unitholder
- the number of units held by each unitholder, and
- the date on which the unitholder was registered in the register.

The register of unitholders must be made available for inspection by the Authority at its request. Furthermore, the fund manager must provide any unitholder, free of charge upon request, an extract that shows all the information relevant to the subject unitholder only.

## 4. General Requirements

### 4.1 Restrictions

#### Learning Objective

- 2.4.1 Know the restrictions that relate to (Real Estate Investment Funds Regulations): using the fund's assets (Chapter 5, Article 40a), borrowing (Chapter 5, Article 40b), trading (Chapter 5, Article 41), advertising (Chapter 5, Article 42), termination of the fund (Chapter 5, Article 43)
- 2.4.2 Know requirements relating to (Real Estate Investment Funds Regulations): commissions services and management fees (Chapter 2, Article 22), conflicts of interest (Chapter 2, Article 19)
- 2.4.3 Know requirements relating to (Real Estate Investment Funds Regulations): valuation (Chapter 5, Article 35), calculation of asset value (Chapter 5, Articles 35 & 36), unit price (Chapter 5, Article 36)
- 2.4.4 Know financial reporting requirements for (Real Estate Investment Funds Regulations): presenting reports to unitholders (Chapter 3, Article 25), financial statements (Chapter 3, Article 25)

Unsurprisingly, there are several restrictions laid down in the Real Estate Investment Funds Regulations, for example to prevent excessive borrowing or misleading advertising. The major restrictions are as follows:

1. **Using the fund's liquid assets** – the fund manager must manage the available liquidity for the benefit of the unitholders in low-risk investment channels and without deducting any additional management fees from the invested amounts.
2. **Borrowing** – the fund may only borrow up to the specified percentage of its net assets. For example, real estate investment funds, including real estate investment traded funds (REITFs) listed on the main market, are not permitted to borrow more than 50% of their total asset value, based on the latest set of reviewed financial statements.
3. **Trading** – once the subscription period has ended, the fund manager and any related parties may not purchase or sell any units in the fund. However, the fund manager and custodian are required to take all necessary steps to facilitate unitholders' trading by enabling transfer and re-registration. This will include the fund manager maintaining a register of all purchase orders, requests and sales offers in the fund's units. The fund manager is required to inform those investors wishing to purchase or sell, about the purchase orders and sales offers register, including the benchmark price of the unit and the date of the order or offer.
4. **Advertising** – the fund manager must provide any advertisement, brochure, marketing leaflet or any other methods used for the offering or selling of the fund units before it is used by the Authority. The advertisement of the fund should include the following details:
  - how to obtain a copy of the fund's terms and conditions, and its financial reports
  - the fund's purpose, total asset value and period
  - the fund manager's licence number and its authorised activities

- a statement that the value of an investment in the fund is variable and that it may be subject to increases, decreases or total loss, and
- a reference to the disclosure mentioned in the terms and conditions on the major risks associated with investment in the fund.

Any advertisement of the fund must not include any forecast of the future performance of the fund.

5. **Termination or liquidation of the fund** – the fund manager must specify the termination provisions of a fund in the terms and conditions, and complete the process of selling the fund's assets and distributing the proceeds to the unitholders prior to the end of the fund's term. The fund manager must prepare a plan and procedures for the termination or liquidation of the fund consistent with the unitholders' interests and must obtain the fund board of directors' approval of the plan prior to implementation.

If the terms and conditions of the fund provide that the fund will be terminated upon the occurrence of specified events, the fund manager must terminate the fund immediately upon the occurrence of such event and notify the Authority and the unitholders in writing within five days from the occurrence of the event that required the termination of the fund. The Authority and unitholders must be notified in writing within ten days from the end of the fund liquidation or termination and the fund manager must treat all unitholders equally during this process. Extending the term of the fund to complete the sale of the fund's assets is possible, but would be considered a 'fundamental change' and as such would need the approval of both the unitholders and the Authority. Any extension must see the fund manager liquidate the fund's assets and distribute the unitholders' dues within a maximum period of six months from the date of the expiry of the fund's term.

## 4.2 Fees and Conflicts

Transparency is vital in any investment but it is particularly important for funds. The Real Estate Investment Fund Regulations require transparency and clarity of fees and any service commissions to be included in a fund's terms and conditions. This includes fees charged by the fund manager and related parties, and must specify whether they are charged on unitholder transactions or to the fund. The Authority can impose a cap on the fees and commissions charged by the fund manager where it is necessary.

There is a risk that the interests of a fund manager (or its related parties) may conflict with those of the fund's unitholders. The Real Estate Investment Fund Regulations do not allow any **deals** where the fund manager (or any of its affiliates) acts as principal with the fund. Furthermore, the fund manager must disclose and obtain approval for any material conflict of interest from the fund's board of directors.

## 4.3 Valuation and Pricing

Valuing real estate is often considered subjective, where different parties could come up with materially different valuations. Clearly, the more reliable valuations will be obtained from those with the relevant experience and expertise and this is reflected in the way that fund managers are required to utilise at least two accredited valuers to place a value on real estate assets, both when considering buying or selling for the fund and when arriving at a net asset value (NAV) per unit.

The Real Estate Investment Fund Regulations require the real estate investment fund manager to obtain a valuation from two valuers, accredited by the Saudi Authority for Accredited Valuers, who are known for their experience, honesty and knowledge of real estate activity in the area under investment before purchasing or selling any of the fund's assets. These evaluators must be independent from the fund manager and its related parties, and the valuation report must contain the following as a minimum:

- the valuation method, mechanisms and assumptions on which the valuation is based
- an analysis of the variables related to the real estate market, such as the demand, supply and market trends
- details and descriptions of the real estate, and
- the risks related to the real estate subject to the valuation.

On purchasing or selling any of the fund's assets, the fund manager must not rely on a valuation report that has been prepared three months or more before purchasing or selling.

The Regulations concern the calculation of asset values and the unit price. This is the responsibility of the fund manager and must be undertaken at least once every six months and based on a valuation prepared by two accredited valuers and calculated by subtracting the fund's total liabilities from its total assets, then dividing the result by the number of the fund's units. The accredited valuers' report must also be published on the fund's website, the Exchange's website or any other website available to the public according to the controls set out by the Authority within a period that does not exceed 15 days from the report's issue date.

## **4.4 Reporting to Unitholders**

Fund managers of real estate public investment funds must provide unitholders with regular reports on their investments. Real estate investment fund managers must publish semi-annual statements for their funds, and the managers of a REITF must publish quarterly statements. Such reports are required within a period not exceeding ten days from the end of the relevant half or quarter. These reports include various details such as the unit price at the end of the period, the total expenses, fees and charges incurred in the period, the total asset value and the unit net asset value. The publication must be on the fund manager's website, the Exchange's website and any other website available to the public according to the controls set out by the Authority.

The fund manager of a real estate investment fund must also make financial statements available to the public. The annual financial statements must be made available free of charge, within a period not exceeding three months after the end of the reporting period, on websites and via channels as specified in the fund's terms and conditions, and on the fund manager's website, the Exchange's website or any other website available to the public according to the controls set out by the Authority. Interim financial statements reflecting the first six months of the year must be made available free of charge, within a period not exceeding 30 days after the end of the interim financial statements period.



## 5. Real Estate Investment Traded Funds (REITFs)

### Learning Objective

- 2.5.1 Know the general provisions (Part 4, Article 45)
- 2.5.2 Know the conditions for offering REITFs (Part 4, Article 46)
- 2.5.3 Know the disclosure requirements for REITFs (Part 4, Article 49)

The requirements that apply to REITFs are included within the Real Estate Investment Fund Regulations. The general provisions, offering conditions and the disclosure requirements that follow have been selectively extracted from those regulations.

### 5.1 General Provisions

The general provisions include the following:

- **Avoiding conflicts** – no person or group of persons owning 5% or more of the fund’s units that were acquired through in-kind contributions at subscription is permitted to dispose of any of those units during the first year of trading. Additionally, the fund manager must ensure that when acquiring the assets of an existing real estate investment fund that is managed by the same fund manager, that any such assets acquired for the constructionally developed and income generating real estate portfolio have achieved rental net profit after deducting all expenses for the last three years.
- **Independent board members** – an independent director of a REITF must be objectively able to express opinions and vote on decisions with no bias. The following are examples that would negate such independence and objectivity:
  - holding 5% or more of the fund’s units or the units of another fund under the management of the same fund manager or being the first degree relative of someone who owns such percentage
  - being a first degree relative of any member of the board of the fund or any other fund under the management of the same fund manager
  - being an employee or having been an employee during the preceding two years, of the fund manager or any party related to the fund, or holding or having held, during the preceding two years, a controlling interest in any of these parties
  - receiving financial consideration from the fund in addition to the remuneration for membership of the board.

### 5.2 Conditions for Offering REITFs

A number of conditions must be satisfied for a REITF before it can be offered to investors. These are detailed in the Real Estate Investment Fund Regulations and include the following:

- **The fund type** – the REITF must be a closed-ended fund.
- **The minimum size** – the fund’s total assets value must be at least SAR 500 million at establishment to access the Main Market, and not less than SAR 100 million to access the Parallel Market.
- **Nominal value per unit** – the nominal value per unit must be SAR 10.
- **Subscription consideration** – public unitholders may only subscribe by way of cash contributions.
- **Subscription limit** – the minimum subscription must not exceed 1,000 units per unitholder.

The regulations also place certain restrictions and requirements on the fund manager of a REITF. These include:

- **Investment policy** – at least 75% of the fund’s investments by value must be in constructionally developed real estate and qualify to generate periodic rental income (according to the latest audited financial statements).
- **Distributions** – the profits distributed to unitholders must not be less than 90% of the fund’s annual net profits.
- **Asset restrictions** – the fund manager must not invest in white lands (land that is not permitted to be developed). However, the fund manager is allowed to invest up to 25% of the fund’s total assets value, according to the last audited financial statements, in any of the following:
  - real estate development, whether the real estate is owned by the fund manager or not
  - renovation and redevelopment of real estate
  - real estate repurchase agreements
  - cash and units of investment funds licensed by the Authority and real estate companies
  - for Main Market REITFs, usufruct rights. Usufruct rights are not restricted for REITFs accessing the Parallel Market
  - Treasury units, or
  - debt instruments.

The fund manager is prohibited from investing more than 25% of the fund’s total asset value in real estate outside the Kingdom. Furthermore, a REITF may not own a percentage exceeding 20% of the NAV of another fund.

- **Leverage** – the borrowing of the fund must not exceed 50% of the fund’s total asset value, according to the latest audited financial statements.
  - It also places certain additional requirements on the fund’s assets. It specifies that the fund manager must ensure it provides valuation reports for the real estate, prepared by two accredited valuers, and publishes them during the offer period on its website and the Exchange’s website. The reports must include an assessment of market rents and the assessment must be within no more than three months of the offering commencement date.

Where more than two accredited valuers were appointed, the fund manager must publish all of the accredited valuers’ reports.

## 5.3 Disclosure Requirements

### 5.3.1 General Requirement

There is a general requirement for the fund manager of a REITF to disclose to both the Authority and the unitholders any material developments that are not public knowledge and that may affect the fund’s assets and liabilities, financial position or general course of business. This disclosure is required ‘without delay’ and to class something as material and necessary for disclosure, the fund manager should assess whether it has an impact on the fund’s assets, liabilities and financial position.

### 5.3.2 Specific Events

To avoid any doubt in deciding and judging what may or may not be material, and in an identical manner to closed-ended investment funds considered in the preceding chapter, the Real Estate Investment Fund Regulations also list several specific events that need to be disclosed in any event. These include the following:

- **Large transactions and fluctuations in value** – this includes transactions to buy, sell, mortgage or lease at a price equal to, or greater than, 10% of the fund's NAV. Losses equal to, or greater than, 10% of the fund's net assets and increases or decreases in the net assets of the fund of 10% or more also require disclosure.
- **Significant disputes and judgements** – disclosure is required of any dispute, including litigation, arbitration or mediation where the value involved is equal to or greater than 5% of the fund's net assets. Similarly, the issuance of any judgement, decision, order or declaration by a court or judicial body which may adversely affect the fund's ability to utilise a portion of its assets that is equal to, or exceeds, 5% of the fund's net assets must be disclosed.
- **Related party transactions** – disclosure is required for any transaction or arrangement between the fund and a related party if such a transaction or arrangement is equal to, or greater than, 1% of the fund's gross revenues.

### 5.3.3 Unitholder Dealings

In the same way as seen in the previous chapter for closed-ended funds, persons reaching a stake of 5% or more in a REITF must notify the Exchange. When determining the size of the stake, a person is deemed to hold not just the units in their own name, but also those units held by relatives, controlled companies and parties with whom the person is working in concert.

## End of Chapter Questions

Think of an answer for each question and refer to the appropriate section for confirmation.

1. What are the three major types of closed-ended real estate investment funds?  
*Answer Reference: Section 1.1*
2. What are the responsibilities of the fund manager of a real estate investment fund?  
*Answer Reference: Section 2*
3. When can a fund manager extend the subscription period?  
*Answer Reference: Section 3*
4. What needs to be included in an advertisement for a real estate investment fund?  
*Answer Reference: Section 4.1*
5. What are the maximum periods within which interim and annual financial reports need to be published?  
*Answer Reference: Section 4.4.2*
6. What is the minimum size for a REITF to access the Main Market? How does this change for the Parallel Market?  
*Answer Reference: Section 5.2*
7. Describe significant disputes and judgements in relation to specific events.  
*Answer Reference: Section 5.3.2*

## Chapter Three

# Market Conduct Regulations

### 1. Capital Market Institutions' Conduct

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**This syllabus area will provide approximately 3 of the 25 examination questions**





# 1. Capital Market Institutions' Conduct

Financial institutions which are authorised to operate in the financial markets, together with their employees, have particular obligations in relation to market conduct. These obligations relate not only to their own conduct, but also to the conduct of clients.

## 1.1 Market Conduct Regulations

### Learning Objective

3.1.1 Know how a Capital Market Institution should act in the event of (Market Conduct Regulations): market manipulation (Part 5, Article 11) and insider trading (Part 5, Article 11)

Abuse of the financial markets can take many forms and can be categorised in different ways. However, a basic distinction can be made between two principal forms of market abuse, namely market manipulation and insider trading.

<b>Market manipulation</b>	Trading in a security for the purpose of creating: <ul style="list-style-type: none"> <li>• a false or misleading impression of trading activity, or interest in the purchase or sale of the security, or</li> <li>• an artificial bid price, ask price or trade price for the security, or any related security.</li> </ul>
<b>Insider trading</b>	Trading, whether directly or indirectly, in a security on the basis of <b>inside information</b> which: <ul style="list-style-type: none"> <li>• relates to a security</li> <li>• has not been disclosed to the general public, and that is not otherwise available to the general public, and</li> <li>• that a normal person would realise that in disclosing it, or making it available to the public, would have a material effect on the price or value of the security.</li> </ul>

In simple terms, the principal distinction between market manipulation and insider trading relates to the use of inside information. Market manipulation involves employing trading techniques which will give other market participants a false impression of the supply, demand or value of a security. This includes, for example, trading which results in no change to the ultimate ownership of the security (perhaps by trading through other accounts which are ultimately owned by the same individual). Such trading, sometimes known as 'wash' trading, can be used to give a false impression of the level of trading activity for a security.

By contrast, insider trading involves the misuse of inside information. For example, a senior manager within a **listed company** may have access to sensitive financial information which has not yet been released to the market (such as financial results). Anticipating that the release of the information will cause a rise in the value of the company's shares, the managers could buy shares, gaining an advantage over other investors who are not aware of this information. Both forms of conduct are prohibited by the **Market Conduct Regulations**, as is disclosure of inside information (since this would allow the recipient of the information to commit insider trading).

In addition to being accountable for their own conduct, Capital Market Institutions also have certain responsibilities in relation to the conduct of their clients. The Regulations prohibit a firm from accepting or executing a client order if it has reasonable grounds to believe that the client is engaging in market manipulation or insider trading.

Where a Capital Market Institution decides not to accept or execute such an order it must document the circumstances, and the reasons for its decision, and notify the Authority of their decision within three days. The Capital Market Institution must retain records of such decisions for ten years from the date of the decision.

## 1.2 Direct and Indirect Trading

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### Learning Objective

3.1.2 Know the difference between (Market Conduct Regulations): direct trading (Part 3, Article 4, a3) and indirect trading (Part 3, Article 4, a4)

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The prohibition on market manipulation applies whether the individual concerned is trading directly, or indirectly. In this context:

A person is considered to be directly trading in a security in either of the following two situations:

1. if they execute a trade in the security for any account in which they have an interest, or
2. if they make a bid or offer on the Exchange for the security.

A person is considered to be indirectly trading in a security in any of the following situations:

1. if they execute a trade as an attorney-in-fact for another person
2. if they arrange a trade to which a relative or person with whom they have a business or a contractual relationship is party, or
3. if they arrange for an attorney-in-fact or any other person acting on their behalf or at their direction to trade in the related securities.



## 1.3 Liability for Others

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### Learning Objective

- 3.1.3 Understand regulations concerning liability for the actions of others (Market Conduct Regulations: Part 6, Article 20)
- 

Where a person is found to have breached the provisions of the Law or the Market Conduct Regulations on market manipulation, insider trading or untrue statements while acting on behalf of another person, that other person is liable and subject to the same sanctions as the person carrying out the relevant acts. For example, an investor could be held liable for the actions of an agent acting on their behalf, if the agent committed market manipulation or insider trading.

The only exception is where the person on whose behalf the act is carried out:

- took reasonable steps to prevent the violation of the law, or
- did not authorise the actions.

It is, therefore, important that market participants take care to ensure that those carrying out transactions on their behalf are aware of, and are committed to following, the relevant provisions of the Law and Regulations.

## 1.4 Investment Research

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### Learning Objective

- 3.1.4 Know the conduct expected of a Capital Market Institution in relation to the publication or announcement of research or an investment recommendation (Market Conduct Regulations: Part 5, Article 18)
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In addition to imposing obligations relating to market manipulation and insider trading, the Market Conduct Regulations also include provisions relating to the issue of investment research and recommendations.

Many Capital Market Institutions issue investment research and recommendations to their clients, or to the market. Such material performs a valuable function, in that it allows the specialist expertise of the institution to be shared with clients, either in exchange for a specific fee or as part of a broader package of products and services for which a client is charged. High quality investment research can help investors to understand the particular characteristics of a company's securities, including both the potential rewards and the associated risks.

However, there is a potential conflict of interest for Capital Market Institutions which issue such research, particularly for larger firms whose research and recommendations may be disseminated to a wide range of clients. If a firm issues research which, for example, is highly positive about a particular listed company and the potential value of its shares, then clients receiving this research may decide to buy the shares. A small number of such trades is unlikely to affect the market price but if the firm has many clients, and its research has a reputation for being accurate, the resulting transactions may be sufficient to cause a significant change in the market price of the shares involved.

In such cases, the Capital Market Institution may be tempted to purchase shares prior to the issue of the research, anticipating that the price of the share will rise once the research is released. However, such conduct, known as 'dealing ahead', is prohibited by the Regulations since it would result in the Capital Market Institution benefitting at the expense of its clients and would effectively be a form of market manipulation.

A Capital Market Institution which intends to issue an investment recommendation, or research relating to a security, must not trade in that security for its own account until the clients for whom the recommendation or research is intended have had a reasonable opportunity to react to it. The only exception is where the recommendation or research could not reasonably be expected to affect the price of the security concerned, or any related security.

## **1.5 Conduct that is Prohibited whilst an Investment Recommendation is in Place**

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### **Learning Objective**

3.1.5 Know conduct that is prohibited whilst an investment recommendation is in place (Market Conduct Regulations: Part 5, Article 19)

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In addition to the prohibition on dealing ahead of research, the Regulations also prohibit dealing in a manner which is contrary to a recommendation. It may not initially be obvious why such a prohibition is required – surely a Capital Market Institution would not choose to trade in a way that is contrary to its own recommendations. However, this is to ignore the potential conflicts of interests which can arise within a Capital Market Institution.

For example, a financial institution may have a large corporate client, whose shares are listed. The financial institution may not want to jeopardise its relationship with the client and so it may choose to issue research to its other clients which recommends that they purchase shares in the corporate client. However, the financial institution's own view may be that, for example, the shares are over-valued and, hence, it may wish to sell its own holding. In such a case, the financial institution would be misleading its clients since it would not be providing an honest and objective valuation of the corporate client's securities.

The Regulations specifically prohibit a Capital Market Institution which issues research or an investment recommendation from trading contrary to the research or recommendation, whether for its own account or on behalf of clients, unless it has reasonable grounds to do so.



## End of Chapter Questions

Think of an answer for each question and refer to the appropriate section for confirmation.

1. What is meant by 'market manipulation'?  
*Answer Reference: Section 1.1*
2. What is meant by 'insider trading'?  
*Answer Reference: Section 1.1*
3. What is expected of a Capital Market Institution that suspects a client is engaged in insider trading or market manipulation?  
*Answer Reference: Section 1.1*
4. What is the difference between direct and indirect trading?  
*Answer Reference: Section 1.2*
5. What is the significance of breaking the law on behalf of another?  
*Answer Reference: Section 1.3*
6. In what circumstances may a financial institution carry out a trade which is contrary to a recommendation it has issued to its clients?  
*Answer Reference: Section 1.5*

# Glossary





**Capital Market Institution**

A person authorised by the Authority to carry out securities business.

**Capital-Protected Fund**

An investment fund whose primary investment objective is to protect and return the capital invested by unitholders at a pre-determined date in the future.

**Client**

A person for whom a Capital Market Institution executes securities transactions.

**Closed-Ended Investment Fund**

Any investment fund which is not an open-ended investment fund.

**Custodian**

A person who is authorised under by the Capital Market Institutions Regulations to conduct the securities activity of custody.

**Deal**

To buy, sell, subscribe for or underwrite a security.

**Exchange-Traded Fund (ETF)**

An index fund that the units in which are traded on the Main Market or the Parallel Market.

**Feeder Fund**

An investment fund whose primary investment objective is to invest all of its assets in another investment fund.

**Foreign Fund**

An investment fund, which is established in a jurisdiction outside the Kingdom.

**Fund of Funds**

An investment fund, the main objective of which is to invest all of its assets in other investment funds.

**Index Fund**

An investment fund whose primary investment objective is to track the performance of a specified index.

**Inside Information**

Has the meaning specified at Article 4(c) of the Market Conduct Regulations.

**Investment Fund**

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.

**Investment Fund Regulations**

The Investment Funds Regulations issued by the Board of the Authority.

**Listed Company**

Any company with securities of any kind listed on the Exchange.

**Managing**

Managing securities belonging to another person in circumstances involving the exercise of discretion, or operating investment funds.

**Market Conduct Regulations**

The Market Conduct Regulations issued by the Board of the Capital Market Authority.

**Market Maker**

Means in the Investment Funds Regulations, a capital market institution that is authorised to carry out dealing business where it enters continuous orders, during the trading hours, of buying and selling for the purpose of providing liquidity to the traded units of the exchange-traded fund.

### **Money Market Fund**

An investment fund, the sole objective of which is to invest in short-term securities and money market instruments in accordance with the Investment Funds Regulations.

### **Net Asset Value (NAV)**

For the purposes of the Investment Funds Regulations and the Real Estate Investment Funds Regulations, means; the Fund's Net Assets Value divided by the number of units outstanding.

### **Open-Ended 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 (NAV) on dealing days set in the fund's terms and conditions in accordance with the Investment Funds Regulations.

### **Private Fund**

An investment fund which is established in the Kingdom and which is not a public fund, and the units in which may be offered by the fund manager, in accordance with Part Five of the Investment Funds Regulations, to certain investors in the Kingdom.

### **Private Placement**

For the purpose of the Rules on the Offer of Securities and Continuing Obligations, means an offer of securities which falls within one of the categories of offers listed in Article 8 of the Rules on the Offer of Securities and Continuing Obligations; and for the purposes of the Investment Funds Regulations, means:

1. for private funds, the offer of units in accordance with paragraph (a) of Article 80 of the Investment Fund Regulations, and
2. for foreign funds, the offer of securities in accordance with paragraph (a) of Article 98 of the Investment Fund Regulations.

### **Public Fund**

An investment fund which is established in the Kingdom and the units of which may be offered by the fund manager, in accordance with Part Four of the Investment Funds Regulations, to investors in the Kingdom otherwise than by way of a private placement.

### **Real Estate Investment Fund**

A collective real estate 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.

### **Securities**

Means any of the following:

1. shares
2. debt instruments
3. warrants
4. certificates
5. units
6. options
7. futures
8. contracts for differences
9. long term insurance contracts, and
10. any right to or interest in anything which is specified by any of the paragraphs (1) through (9) above.

### **Unit**

The share of any owner in any fund consisting of units or a part of it. Each unit shall be treated as a common share in the net assets of the Fund.

### **Unitholder**

A person who owns units in an investment fund or a real estate investment fund, which represents a common share in the net assets of the Fund.



# Multiple Choice Questions





The following additional questions are for learning and revision purposes. Whilst they are based on the syllabus, they do not necessarily replicate actual examination standard questions and are included to test your knowledge and understanding of the relevant sections of the workbook.

1. Who must maintain the title deeds for assets in a real estate investment fund?
  - A. The fund
  - B. The custodian
  - C. The Authority
  - D. A person nominated by the board of directors
  
2. If an investor subscribes to 10% of units in a closed-ended investment traded fund during the initial offering via in-kind contributions, they must hold their units for a minimum of:
  - A. three months
  - B. six months
  - C. one year
  - D. three years
  
3. Under the Authority's Investment Fund Regulations, the fund manager of a public fund cannot exceed what level of borrowing expressed as a percentage of net asset value (NAV)?
  - A. 15%
  - B. 20%
  - C. 25%
  - D. 50%
  
4. A public fund wants to maximise the proportion of net assets it invests in debt instruments issued by the Government of the Kingdom. What is the limit under the Investment Fund Regulations?
  - A. 10%
  - B. 20%
  - C. 25%
  - D. 35%
  
5. A public fund of funds wants to invest in the minimum number of other funds that it can, which is:
  - A. one
  - B. two
  - C. three
  - D. five

6. When must the fund manager communicate the details of the liquidation of the fund to its unitholders?
  - A. As soon as the fund manager knows it will liquidate the fund
  - B. At least three working days before it liquidates the fund
  - C. At least 21 days before it liquidates the fund
  - D. On the day of liquidation
  
7. For an established fund, what is the time period within which the annual report must be made available after the end of the reporting period?
  - A. One month
  - B. Two months
  - C. Three months
  - D. Four months
  
8. In an initial offer for a public fund, the offer period cannot exceed what duration?
  - A. 21 days
  - B. 30 days
  - C. 45 days
  - D. 60 days
  
9. A custodian to an investment fund must deposit cash belonging to that fund into:
  - A. the custodian's own account for services rendered
  - B. a pooled account designated as being for the benefit of the custodian's clients
  - C. a separate account under the custodian's name designated as being for the fund's benefit
  - D. the fund manager's account
  
10. A closed-ended real estate investment fund is established by XYZ Fund Managers. To meet the governance requirements of the Real Estate Investment Fund Regulations, the Board must include which of the following?
  - A. At least one half of the Board members must be independent
  - B. At least one third of the Board members must be independent
  - C. At least three independent directors
  - D. At least two real estate practitioners

11. A real estate investment fund holds land earmarked for a development project. What is required in relation to this land?
  - A. Approval evidenced by an official document from the competent body for its design and construction
  - B. Fully developed architectural plans for the site
  - C. That the construction is at least one third complete
  - D. That the development costs are able to be covered by existing liquid funds
  
12. How many accredited valuers are required to report to enable a value to be ascribed to the real estate assets within a real estate investment fund?
  - A. At least one
  - B. At least two
  - C. At least three
  - D. At least four
  
13. The definition of 'inside information' includes which of the following?
  - A. The information is only known to ten people or less
  - B. If disclosed, the information would cause a price rise of at least 5%
  - C. It relates to a security
  - D. The person receiving the information buys or sells shares on an exchange
  
14. A person has arranged a trade in which one of their relatives is involved. This type of trading is known as:
  - A. dealing ahead
  - B. indirect trading
  - C. insider trading
  - D. market manipulation
  
15. An investor is not being held liable for insider trading carried out by their broker. What is the MOST likely explanation for this?
  - A. The trade was carried out on an exchange
  - B. The information had not been disclosed to the public
  - C. The transaction was below the threshold for action by the Authority
  - D. The investor did not authorise the transaction

16. How does the fund manager of a real estate investment fund ensure there are no conflicts of interest between themselves and the fund's unitholders?
- A. By providing fair unit prices
  - B. By reporting proposed trades to the Authority
  - C. By not dealing as principal with the fund
  - D. By having principal trades carried out by an unrelated party
17. Which of the following is TRUE concerning the disclosure requirements of a closed-ended investment traded fund?
- A. The fund must disclose any material changes in the fund to the Authority and the unitholders every three months
  - B. Disclosure is only required in a dispute when the value of the issue involves 5% or more of the fund's net asset value
  - C. In a related party transaction, disclosure is only required when it relates to more than 0.5% of the fund's revenue
  - D. Disclosure is only required for large transactions which concern more than 5% of the net asset value of the fund
18. If the board of a real estate investment fund has six directors, at least how many must be independent?
- A. One
  - B. Two
  - C. Three
  - D. Four
19. If a newly established real estate investment fund does not raise sufficient capital during the subscription period, the fund manager is entitled to:
- A. invest current subscriptions
  - B. proceed with a reduced subscription
  - C. automatically extend the subscription period
  - D. request an extension to the subscription period from the Authority
20. Which of the following is TRUE regarding management fees for a real estate investment fund?
- A. Only the board of directors can approve the fees set by the fund
  - B. The fees must be set only after a discussion with potential unitholders
  - C. The Authority can impose a cap on the fees charged
  - D. The fund manager can charge any amount of fees

21. A Capital Market Institution decides not to deal for a client it suspects may be engaging in insider trading. What is the minimum number of years records of this decision must be kept for?
- A. One year
  - B. Three years
  - C. Five years
  - D. Ten years
22. Public funds are required to prepare financial statements at least every:
- A. month
  - B. quarter
  - C. half year
  - D. year
23. The scale of charges that may be charged to a public fund are:
- A. defined in law
  - B. set by the Authority
  - C. specified in the fund's terms and conditions
  - D. specified in the fund's annual report
24. Before making any acquisition, private real estate fund managers are required to obtain valuations from a minimum of:
- A. one accredited valuer
  - B. two accredited valuers
  - C. three accredited valuers
  - D. four accredited valuers
25. What is the minimum total assets value at establishment for a closed-ended real estate investment fund to access the Main Market?
- A. SAR 10 million
  - B. SAR 100 million
  - C. SAR 200 million
  - D. SAR 500 million

## Answers to Multiple Choice Questions

**1. B Chapter 2, Section 3**

The custodian must maintain all relevant documents including, but not limited to:

- title deeds
- records of investment decisions
- all material contracts related to the operation of the fund
- fund board meeting minutes, and
- accredited valuers' reports.

**2. C Chapter 1, Section 8.1**

The general provisions include the following:

- **Offerings** – the general provisions allow units in closed-ended traded investment funds to be paid for in either cash or in-kind contributions. Certain special regulations are laid down to prevent the potential for abuse of the ability to pay for units using in-kind contributions.
  - The first of these requires the value of the consideration to be assessed by two independent and appropriately licensed valuers.
  - The second places a restriction on those that have purchased units for in-kind consideration by specifying that ownership of the in-kind contributions must be transferred to the fund, and that subscribers owning 5% or more of the fund units paid for using in-kind contributions are not allowed to dispose of their units within one year of their trading commencement.

**3. A Chapter 1, Section 3.3**

<b>15% restrictions</b>	<ul style="list-style-type: none"> <li>• Borrowing cannot be more than 15% of the public fund's NAV.</li> <li>• Derivatives exposure cannot exceed 15% of a public fund's NAV.</li> </ul>
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**4. D Chapter 1, Section 3.3**

Investment in debt instruments issued by a sovereign issuer other the Government of the Kingdom, which may comprise not more than 35% of the NAV of the public fund.

**5. C Chapter 1, Section 3.4.3**

A fund of funds must invest in a minimum of three investment funds.

**6. C Chapter 1, Section 1.6**

The fund manager must specify the termination provisions of a fund in the fund's terms and conditions. The unitholders (and the Authority) must then be provided with details of the plan and procedures for the termination at least 21 days before the intended termination date.



**7. C Chapter 1, Section 6.1**

The time period within which the reports must be made available are as follows:

- **Annual reports** – no later than three months from the end of the period to which the report relates.
- **Interim reports** – within 30 days from the end of the period to which the report relates.

**8. D Chapter 1, Section 7.1.1**

The duration of the initial offer period shall not exceed 60 days. The fund manager must specify a minimum amount that must be raised through investors' subscriptions during the initial offer period.

**9. C Chapter 1, Section 2.1.3**

The custodian must, in relation to each investment fund to which it acts as custodian, open a separate account in a local bank under its name with the account designated as being for the benefit of the relevant investment fund. The custodian must deposit all cash belonging to the investment fund into the relevant bank account and can deduct from the relevant bank account and must deduct from the relevant bank account payments for investments and expenses incurred in the management and operation of the investment fund in accordance with the regulations, the fund's terms and conditions and the contract by which the custodian was appointed by the fund manager.

**10. B Chapter 2, Section 1.2**

Effective and robust governance arrangements play a vital role in ensuring that an investment fund is managed appropriately, and that the interests of investors are protected. The Real Estate Investment Funds Regulations impose certain requirements in relation to the supervision of real estate funds, including requiring that a fund is governed by a fund board (appointed by the fund manager after gaining Authority approval). The number of directors of the fund must not be less than three, and the number of independent fund directors of a fund board must be at least two, or one third of the total number of directors (if greater).

**11. A Chapter 2, Section 3**

The Regulations require that the fund's ownership of its real estate is supported by valid title deeds, and all real estate owned by the fund must have approval evidenced by an official document from the competent body for its design and construction.

**12. B Chapter 2, Section 4.3**

Clearly, the more reliable valuations will be obtained from those with the relevant experience and expertise and this is reflected in the way that fund managers are required to utilise at least two accredited valuers to place a value on real estate assets, both when considering buying or selling for the fund and when arriving at a net asset value (NAV) per unit.

**13. C Chapter 3, Section 1.1**

Trading, whether directly or indirectly, in a security on the basis of inside information, whereas inside information is related to:

- relates to a security
- has not been disclosed to the general public, and that is not otherwise available to the general public, and
- that a normal person would realise that in disclosing it, or making it available to the public, would have a material effect on the price or value of the security.

**14. B Chapter 3, Section 1.2**

A person is considered to be indirectly trading in a security in any of the following situations:

1. if they execute a trade as an attorney-in-fact for another person
2. if they arrange a trade to which a relative or person with whom they have a business or a contractual relationship is party, or
3. if they arrange for their attorney-in-fact or any other person acting on their behalf or at their direction to trade in the related securities.

**15. D Chapter 3, Section 1.3**

For example, an investor could be held liable for the actions of an agent acting on their behalf, if the agent committed market manipulation or insider trading. The only exception is where the person on whose behalf the act is carried out:

- took reasonable steps to prevent the violation of the law, and
- did not authorise the acts in question.

**16. C Chapter 2, Section 4.2**

There is a risk that the interests of a fund manager (or its related parties) may conflict with those of the fund's unitholders. The Real Estate Investment Fund Regulations do not allow any deals where the fund manager (or any of its affiliates) acts as principal with the fund.

**17. B Chapter 1, Section 8.2.2**

**Significant disputes and judgements** – disclosure is required of any dispute, including litigation, arbitration or mediation where the value involved is equal to, or greater than, 5% of the fund's NAV. Similarly, the issuance of any judgement, decision, order or declaration by a court or judicial body which may adversely affect the fund's ability to utilise a portion of its assets that is equal to, or greater than, 5% of the fund's NAV must be disclosed.

**18. B Chapter 2, Section 1.2**

The Real Estate Investment Funds Regulations impose certain requirements in relation to the supervision of real estate funds, including requiring that a fund is governed by a fund board (appointed by the fund manager after gaining Authority approval). The number of directors of the fund must not be less than three, and the number of independent fund directors of a fund board must be at least two, or one third of the total number of directors (if greater).

**19. D Chapter 2, Section 3**

Article 38 concerns the subscription and offering process. On establishment, a subscription period must be specified, and if the capital is not fully covered during that period, the fund manager has the right to extend the subscription period after obtaining the Authority's approval. If the capital is not covered, all amounts should be returned to the unitholders without any deductions within a period not exceeding five days from the date of ending the offer.

**20. C Chapter 2, Section 4.2**

The Real Estate Investment Fund Regulations require transparency and clarity of fees and any service commissions to be included in a fund's terms and conditions. This includes fees charged by the fund manager and related parties, and must specify whether they are charged on unitholder transactions or to the fund. The Authority can impose a cap on the fees and commissions charged by the fund manager where it is necessary.

**21. D Chapter 3, Section 1.1**

Where a Capital Market Institution decides not to accept or execute such an order it must document the circumstances, and the reasons for its decision, and notify the Authority of their decision within three days. The Capital Market Institution must retain records of such decisions for ten years from the date of the decision.

**22. C Chapter 1, Section 1.2**

Each fund is required to prepare financial statements in Arabic, and these are required at least every half year for public funds and private real estate funds.

**23. D Chapter 1, Section 1.5**

Any fees, commissions or charges charged to the fund for its management must be on arm's length terms and at least equivalent to the terms entered into by persons dealing independently. Furthermore, in no circumstances shall such charges exceed the limit specified in the fund's terms and conditions.

**24. B Chapter 1, Section 4.1.3**

The fund manager of a private real estate fund must, before purchasing or selling any real estate assets, obtain valuation from at least two accredited valuers.

**25. D Chapter 2, Section 5.2**

The minimum size – the fund's total assets value must be at least SAR 500 million at establishment to access the Main Market, and not less than SAR 100 million to access the Parallel Market.



# Syllabus Learning Map





Syllabus Unit/ Element		Chapter/ Section
<b>Element 1</b>	<b>Investment Funds Regulations</b>	<b>Chapter 1</b>
<b>1.1</b>	<b>Fund Management</b> On completion the candidate should:	
1.1.1	know the duties of the fund manager (Part 2, Article 9)	1
1.1.2	know requirements for financial statements (Part 2, Article 11)	1
1.1.3	know requirements relating to investment policies and practices (Part 2, Article 14)	1
1.1.4	know requirements regarding special commission arrangements (Part 2, Article 16)	1
1.1.5	know requirements regarding: <ul style="list-style-type: none"> <li>• services (Part 2, Article 19)</li> <li>• commissions (Part 2, Article 19)</li> <li>• management fees (Part 2, Article 19)</li> </ul>	1
1.1.6	• know regulatory requirements for the liquidation of a fund (Part 2, Article 22)	
<b>1.2</b>	<b>Custody</b> On completion the candidate should:	
1.2.1	know regulations relating to the: <ul style="list-style-type: none"> <li>• appointment of a custodian (Part 3, Article 24)</li> <li>• ownership and custody of the assets of the investment fund (Part 3, Article 25)</li> <li>• responsibilities of the custodian (Part 3, Articles 26 &amp; 28) (Real Estate Investment Funds Regulations Articles 29 &amp; 30)</li> </ul>	2
<b>1.3</b>	<b>Public Funds</b> On completion the candidate should:	
1.3.1	know the difference between closed-ended funds and open-ended funds	3
1.3.2	know the responsibilities of the: <ul style="list-style-type: none"> <li>• public fund board (Part 4, Article 38)</li> <li>• members of the fund board (Part 4, Article 39)</li> </ul>	3
1.3.3	know regulatory requirements for: <ul style="list-style-type: none"> <li>• investment areas (Part 4, Article 40)</li> <li>• investment limitations (Part 4, Article 41)</li> <li>• fund subscription limitations (Part 4, Article 37)</li> </ul>	3
1.3.4	know regulatory requirements for: <ul style="list-style-type: none"> <li>• index funds (Part 4, Article 45)</li> <li>• exchange-traded funds (Part 4, Article 46)</li> <li>• specialised public funds (Part 4, Article 53)</li> <li>• money market funds (Part 4, Article 54)</li> <li>• feeder funds (Part 4, Article 55)</li> <li>• fund of funds (Part 4, Article 56)</li> <li>• capital protected funds (Part 4, Article 57)</li> <li>• endowment funds (Part 4, Article 58)</li> </ul>	3

Syllabus Unit/ Element		Chapter/ Section
<b>1.4</b>	<b>Private Funds</b> On completion the candidate should:	
1.4.1	know the definition of private funds (Glossary)	4
1.4.2	know the responsibilities of: <ul style="list-style-type: none"> <li>private real estate fund board (Part 5, Article 84)</li> <li>members of the private real estate fund's board (Part 5, Article 85)</li> </ul>	4
1.4.3	know general rules and restrictions for private funds (Part 5, Article 86)	4
1.4.4	know requirements for valuation and pricing (Part 5, Article 90)	4
<b>1.5</b>	<b>Foreign Funds</b> On completion the candidate should:	
1.5.1	know the process of issuing units in foreign funds (Part 6, Articles 97, 98 & 99a)	5
<b>1.6</b>	<b>Reporting to Unitholders</b> On completion the candidate should:	
1.6.1	know the reporting requirements by the fund manager to investment fund unitholders (Investment Funds Regulations): <ul style="list-style-type: none"> <li>public funds (Part 4, Articles 75 &amp; 76, Annex 3)</li> <li>private funds (Part 5, Article 93)</li> <li>foreign funds (Part 6, Article 103–1)</li> </ul>	4
<b>1.7</b>	<b>Subscription, Pricing, Valuation and Redemption</b> On completion the candidate should:	
1.7.1	know the pricing, valuation and redemption of investment funds (Investment Funds Regulations): <ul style="list-style-type: none"> <li>initial offer period (Article 64)</li> <li>public funds (Part 4, Articles 65, 71, 72 &amp; 73, Annex 5)</li> <li>private funds (Part 5, Article 90)</li> </ul>	5
1.7.2	know regulations regarding secondary trading of closed-ended funds (Investment Funds Regulations: Part 5, Article 96 & Part 6, Article 105)	5
<b>1.8</b>	<b>Closed-Ended Investment Traded Funds</b> On completion the candidate should:	
1.8.1	know the general provisions for closed-ended investment traded funds (Part 4, Article 47)	1
1.8.2	know the conditions for offering closed-ended investment traded funds (Part 4, Article 48)	2
1.8.3	know disclosure requirements (Part 4, Article 52)	2

Element 2	Real Estate Investment Funds Regulations (Public Real Estate Funds)	Chapter 2
<b>2.1</b>	<b>Organisational Structure</b> On completion the candidate should:	
2.1.1	know the types of real estate investment funds and their objectives (Real Estate Investment Funds Regulations: Part 3, Article 10)	1



Syllabus Unit/ Element		Chapter/ Section
2.1.2	know governance requirements relating to (Real Estate Investment Funds Regulations): <ul style="list-style-type: none"> <li>• oversight (Part 3, Article 11)</li> <li>• directors' responsibilities (Part 3, Article 12)</li> </ul>	1
<b>2.2</b>	<b>Fund Management and Disclosure</b> On completion the candidate should:	
2.2.1	know requirements relating to (Real Estate Investment Funds Regulations): <ul style="list-style-type: none"> <li>• fund managers (Chapter 2, Article 13)</li> <li>• disclosure (Chapter 3, Part 3, Article 24)</li> </ul>	2
<b>2.3</b>	<b>Fund Asset Requirements</b> On completion the candidate should:	
2.3.1	know requirements relating to (Real Estate Investment Funds Regulations): <ul style="list-style-type: none"> <li>• fund assets (Chapter 5, Article 28)</li> <li>• custody of fund assets and related documents (Chapter 5, Article 29)</li> <li>• segregation of fund money (Chapter 5, Article 30)</li> <li>• register of unitholders (Chapter 5, Article 37)</li> <li>• subscription and offering (Chapter 5, Article 38)</li> </ul>	3
<b>2.4</b>	<b>General Requirements</b> On completion the candidate should:	
2.4.1	know the restrictions that relate to (Real Estate Investment Funds Regulations): <ul style="list-style-type: none"> <li>• using the fund's assets (Chapter 5, Article 40a)</li> <li>• borrowing (Chapter 5, Article 40b)</li> <li>• trading (Chapter 5, Article 41)</li> <li>• advertising (Chapter 5, Article 42)</li> <li>• termination of the fund (Chapter 5, Article 43)</li> </ul>	4
2.4.2	know requirements relating to (Real Estate Investment Funds Regulations): <ul style="list-style-type: none"> <li>• commissions services and management fees (Chapter 2, Article 22)</li> <li>• conflicts of interest (Chapter 2, Article 19)</li> </ul>	4
2.4.3	know requirements relating to (Real Estate Investment Funds Regulations): <ul style="list-style-type: none"> <li>• valuation (Chapter 5, Article 35)</li> <li>• calculation of asset value (Chapter 5, Articles 35 &amp; 36)</li> <li>• unit price (Chapter 5, Article 36)</li> </ul>	4
2.4.4	know financial reporting requirements for (Real Estate Investment Funds Regulations): <ul style="list-style-type: none"> <li>• presenting reports to unitholders (Chapter 3, Article 25)</li> <li>• financial statements (Chapter 3, Article 25)</li> </ul>	4

Syllabus Unit/ Element		Chapter/ Section
<b>2.5</b>	<b>Real Estate Investment Traded Funds (REITFs) Instructions</b> On completion the candidate should:	
2.5.1	know the general provisions (Part 4, Article 45)	5
2.5.2	know the conditions for offering REITFs (Part 4, Article 46)	5
2.5.3	know disclosure requirements for REITFs (Part 4, Article 49)	5

<b>Element 3</b>	<b>Market Conduct Regulations</b>	<b>Chapter 3</b>
<b>3.1</b>	<b>Capital Market Institutions' Conduct</b> On completion, the candidate should:	
3.1.1	know how a Capital Market Institution should act in the event of market manipulation (Part 5, Article 11) and insider trading (Part 5, Article 11)	1.1
3.1.2	know the difference between direct trading (Part 3, Article 4, a3) and indirect trading (Part 3, Article 4, a4)	1.2
3.1.3	understand regulations concerning liability for the actions of others (Market Conduct Regulations Part 6, Article 20)	1.3
3.1.4	know the conduct expected of Capital Market Institutions in relation to the publication or announcement of research or an investment recommendation (Market Conduct Regulations Part 5, Article 18)	1.4
3.1.5	know conduct that is prohibited whilst an investment recommendation is in place (Market Conduct Regulations Part 5, Article 19)	1.5

## Examination Specification

Each examination paper is constructed from a specification that determines the weightings that will be given to each element. The specification is given below.

It is important to note that the numbers quoted may vary slightly from examination to examination as there is some flexibility to ensure that each examination has a consistent level of difficulty. However, the number of questions tested in each element should not change by more than plus or minus 2.

Element Number	Element	Questions
1	Investment Funds Regulations	14
2	Real Estate Investment Funds Regulations (Public Real Estate Funds)	8
3	Market Conduct Regulations	3
<b>Total</b>		<b>25</b>

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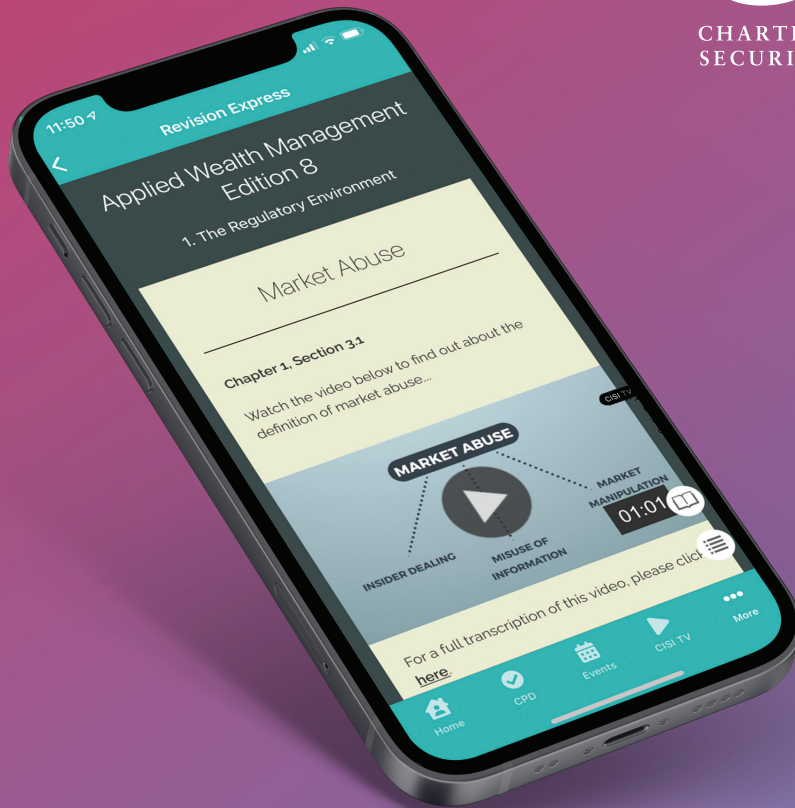
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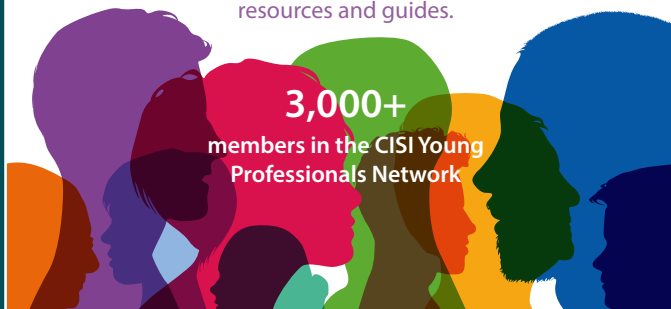
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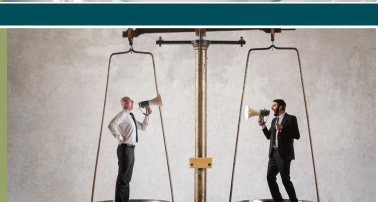
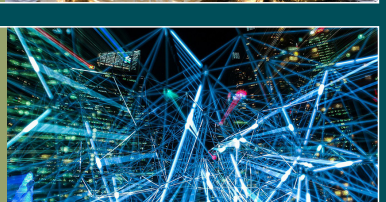




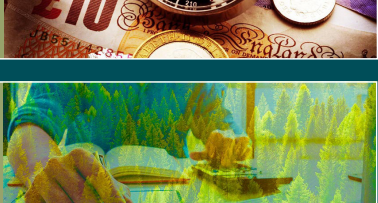



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<p><b>Market Abuse</b></p> <p>Examine offences, penalties, safe harbours, reporting obligations and the relationship with other offences.</p>		<p><b>Neuroscience at Work</b></p> <p>Learn how to work optimally without harming your health when faced with increased workloads and deadlines.</p>	

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