Progress on the liberalisation of the Saudi equity market

The Saudi Stock Exchange (Tadawul) has published, for public consultation, draft rules and regulations in relation to the move from the T+0 to the T+2 cycle for settlement of securities transactions. In this briefing, we aim to provide a succinct overview of these regulatory changes and invite our clients to participate in the public consultation process.

In our Client Briefing of May 2016 we spoke about initiatives announced by the Saudi Capital Market Authority (CMA), which is the Saudi capital markets regulator, to stimulate the development of, and increase foreign participation in, the Tadawul by introducing the T+2 cycle for settlement of securities transactions, and regulations permitting securities lending and covered short selling of Tadawul-listed securities. On 9 January 2017, the Tadawul took an important step towards the implementation of these initiatives by issuing a number of publications, which are available on the Tadawul website.

Proposed T+2 settlement cycle business model

This is a guide to the public on the T+2 settlement cycle which, it is intended, will be brought into effect during the second quarter of 2017. It provides an overview of the structure of the market and describes in detail the way in which the new cycle will work. Matters that are addressed in the guide include the settlement cycle, the functions and duties of custodians, brokers and the Tadawul, failed trade management, securities borrowing and lending transactions and short selling activities.

Securities depository centre rules (amended)

These amended rules, when issued, will regulate matters such as the procedures for depositing securities, the settlement and clearing of securities transactions and the pledging of securities at the Securities Depository Centre (SDC), which is the Tadawul’s central securities depository.

The amended rules will also introduce the regulatory framework for the centre membership which will be separate from the Exchange membership. The former membership will be required for custodians and clearing banks whereas the latter one will be required for brokers. The new rules will also clarify the operations of the independent custody model, setting out the regulatory framework pursuant to which a member of the SDC may offer custody services in respect of Tadawul-listed securities without at the same time offering brokerage services to the relevant client.

The new rules prescribe important requirements and obligations that custodians will be subject to as part of the settlement process including their role in the case of a settlement failure. The rules also deal with the prefunding requirements and set out the categories of investors whom will be subject to such requirements.

Securities borrowing and lending regulations

These regulations have been prepared for the purpose of permitting
and regulating borrowing and lending of Tadawul-listed securities. It is contemplated in the regulations that, among other things, securities borrowing and lending (SBL) transactions may only be entered into in respect of Tadawul-listed securities that have been approved by the SDC; SBL transactions may only be entered into between certain classes of persons (i.e. legal persons, investment funds and clients of Saudi-licensed asset managers where the decision to enter into the transaction was made by the asset manager on behalf of the client); SBL transactions may not last for longer than 12 months; and a written SBL agreement, containing certain prescribed terms and conditions as set out in the regulations, must be entered into.

**Short selling regulations**

These regulations, when issued, will permit and regulate covered short selling of Tadawul-listed securities. It is contemplated in the regulations that, among other things, short selling transactions may only be entered into in respect of securities that have been borrowed pursuant to an SBL concluded in accordance with the Securities Borrowing and Lending Regulations, and that the restrictions in the Securities Borrowing and Lending Regulations in respect of the securities and classes of persons that may be involved in an SBL transaction would apply similarly to a short selling transaction.

**Trading procedures**

These procedures aim to prescribe the obligations of executing brokers with respect to pre-trade verification to ensure that the cash and securities prefunding requirements are satisfied by the relevant clients.

**How can you get involved?**

The draft rules and regulations are open for public consultation until Wednesday, 8 February 2017 and Tadawul is keen to receive comments and observations through email (Tplus2@tadawul.com.sa). We also encourage our clients who may be impacted by these rules to review them and submit their comments to Tadawul. We would be happy to answer any questions regarding the draft rules to assist in understanding their implications.

Please do not hesitate to get in touch with us should you have any query regarding these draft rules and regulations, and we would be happy to discuss.
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This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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