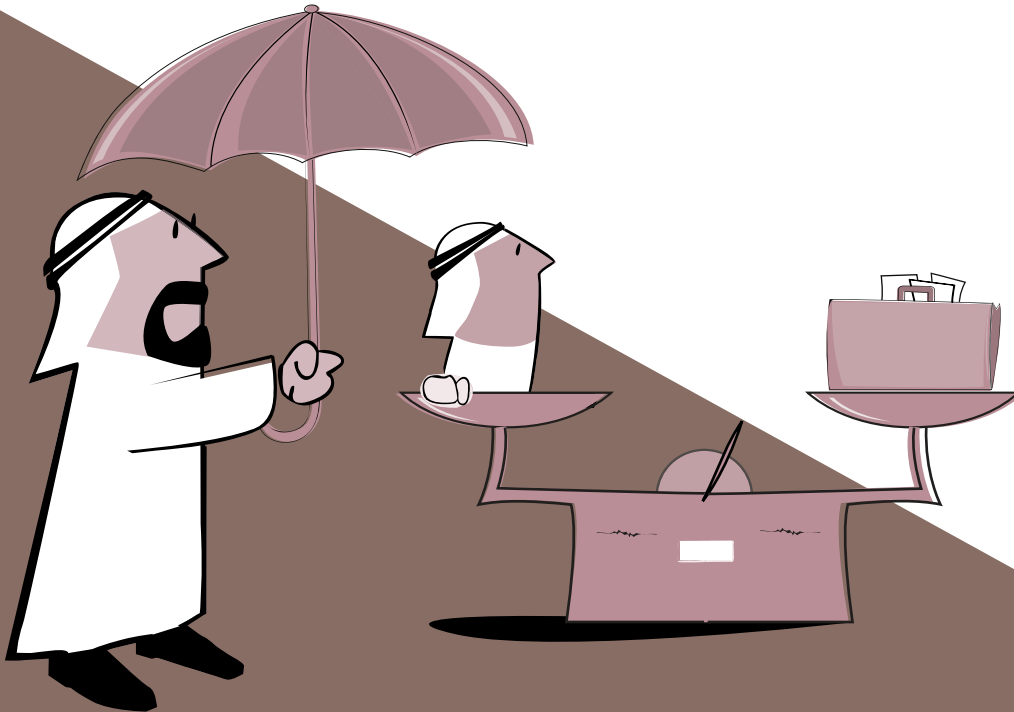




# *Capital Market Law and its Implementing Regulations*





## *Introduction*

The Capital Market Authority was established to achieve a set of goals. The most important goal was to find a fair, transparent and organized financial market that protects investors from illegal practices that include fraud, scam, cheating or manipulation.

To achieve these goals and others, The Capital Market Law has provided CMA with the regulatory and supervisory frameworks to facilitate the completion of the tasks entrusted to it. This manual will briefly explain a number of CMA's tasks according to the Capital Market Law. Issues that matter to investors and mentioned in the implementing regulations will also be explained here.

## *Rules and Regulations*

In addition to investment banks, brokerage firms and individual investors, there are a lot of firms and organizations, in the securities market, that belong to the public and private sector. To fairly regulate the relationship between those parties, it is necessary to apply some rules and regulations.

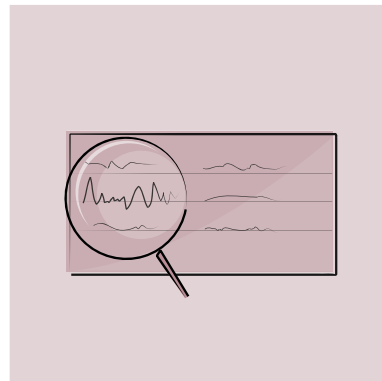
The Capital Market Law, and its implementing regulations, regulate the relationship between the above mentioned parties in the market. It also regulates the offering, listing and registering of securities as well as the regulation and supervision of licensed bodies by the authority. The Capital Market Law and its implementing regulations also protects investors from illegal practices and works to ensure that listed companies comply to fully disclose financial and important information in a timely and accurate matter.

Financial markets are constantly evolving and growing in line with the growth of the national economy and the expansion of its various sectors. Therefore, financial market regulators seek to keep the rules and regulations alive

and in sync with the developing and constantly revised market. Setting these regulations and developing it constantly is enough to give the investor the confidence and encourage market participation.

## *Capital Market Law*

When investors feel that the securities market is a regulated and transparent market that works fairly and equally, they would invest in it with ease. This helps in developing the capital of listed companies in the market and their assets, expand the range of their operational activities and allow investors to gain more profits and returns.



If investing was limited to a small group that dominates and manipulates the market or get insider information on companies before anyone else, then there will not be any interest to invest in the market. Investors might as well abandon the market and this would decrease the levels of the national financial growth.

The Capital Market Law, pursuant to Royal Decree No. (M/30) dated 4/6/1424H - 31/7/2003, was issued to create a transparent, fair and regulated market that keeps pace with the current developments in other international financial markets. The Capital Market Law articles are formulated to regulate and develop the capital market, regulate the issuance of securities and supervise its transactions as well as supervising authorized persons licensed by CMA. In addition, it protects investors and citizens from illegal practices.

## *The Capital Market Authority (CMA)*

The Capital Market Authority was established

according to the Capital Market Law issued by the previously mentioned Royal Decree. CMA is a governmental organization applying full financial, legal, and administrative independence, and has direct links with the Prime Minister.

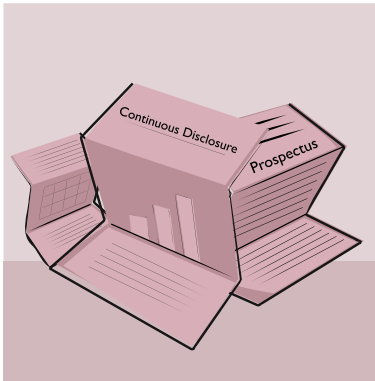
## *The Capital Market Authority's Tasks:*

CMA's major task is to create a regulated, fair and transparent financial market that protects all investors from illegal practices or those that include fraud, manipulation and deceit. We can summarize CMA's tasks and responsibilities as the following:

### *1. Application of Implementing Regulations*

The issuance of the implementing regulations is necessary to carry out CMA's tasks which are set in Articles 5 and 6 of the Capital Market Law. This necessity came as a result of the fact that the Capital Market Law didn't have detailed regulatory provisions for each of the implementing tasks the CMA has to carry out. For example, in Article 5 of the Capital Mar-

ket Law, one of CMA's responsibilities is to regulate the issuance of securities and control trading in it. However, CMA is free to decide which implementing rules and procedures are best to carry out such responsibilities. CMA has issued two separate implementing regulations' lists to regulate the issuance of securities. They are "Offers of Securities Regulations" and "Listing Rules". In them, conditions are set for Public,



Private and Excluded Offering. They also set the terms for the financial advisor and his responsibilities, listing rules, registering terms and conditions, prospectuses rules and other details that were not included in the Capital Market Law. Similarly, CMA issued some implementing regulations to regulate Securities

Business, Authorised Persons, Market Conduct, Investment Funds...etc

## *2. Achieve the Transparency and Disclosure principle without discrimination*

The Capital Market Law and CMA's implementing regulations require transparency and full disclosure on all financial and important information about the listed companies. It should be fully and accurately disclosed at a specific time without discrimination. The investor is entitled to know the full and true picture of any company's performance and to know all the information that might affect the price of its shares. This applies on all companies in different sectors and industries.

The principle of transparency and disclosure is the axis that regulating bodies of the financial markets is based on. It ensures the effectiveness of these market's performance. By improving the levels of transparency and disclosure, risk levels decrease and securities are valued according to their fair prices.

CMA helps in providing a healthy intriguing environment to take the right investment decisions and protect individual investors from taking investment decisions based on false or misleading information, by determining the quality of information that should be available and requiring its publication.

The Capital Market Authority imposes the transparency and disclosure principle in its implementing regulation through two main instruments: the prospectus and Continuous disclosure for companies.

#### *FIRST: Prospectus*

Each company planning to list its shares and make them available for trading is required by CMA to publish a prospectus that includes all the necessary information to help investors assess the company's activities, its assets and liabilities, its opposing parties, its financial position as well as its expected chances of success and its profits and losses. It should also include adequate information on the rights, responsibilities and privileges associated with these securities.

Annex 4 of the "Listing Rules" Regulations specified the minimum information that need to be included in a prospectus. Also Annex 5 specified the minimum information in the prospectus of debt instruments.

CMA requires a prospectus from each company that plans to issue extra securities that are over 10% of securities that were listed before.

For the prospectus to reach most investors, CMA's regulations (Article 16 of the Listing Rules) requires each issuer to issue a prospectus and make its available for the public and free of charge in CMA headquarters and the company's own headquarters. This should be in a period of 14 days prior to admission to the official list. The regulations also require publishing the minimum information available on the prospectus in two daily widely circulated newspapers in the kingdom.

If it turns out that the information in the prospectus is incorrect, misleading, incomplete, or if the prospectus failed to include some information that needed to be included, the company issuing the securities, represented by its executives, board members and the financial advisor who prepared the prospectus, would be held liable for any damages to investors incurred as a result of their (the investors) basing their decisions on this incorrect or incomplete information.

### *SECOND: Continuous Disclosure for Companies*

CMA imposed on listing companies, in addition to the prospectus, a continuous disclosure for its securities as long as it is traded. If there was any violation, there will be some penalties that range from temporary suspension of trading or paying a fine to cancellation of full listing.



*The companies' continuous disclosure is based on three pillars:*

### *Disclosure of Important Developments*

The important developments according to CMA's implementing regulations are any developments that might have an effect on the company's assets or liabilities, its financial position or its general line of work which may lead to a drastic change in the listed security's price. If these developments occur, then the issuer should disclose it to CMA and the public without any delay. Examples of the important developments are: increase or decrease in the net assets of the company in question, changes in the members of the board, lawsuits (against the company), increase or decrease in the total sales...etc.



### *Disclosure of Financial Information*

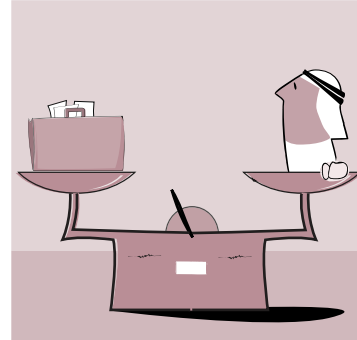
CMA's implementing regulations require the issuer to publish, through the "Tadawul" website, its quarterly and annually financial statements and the board of directors' report as soon as it is accepted by the board and before distributing it on any of the shareholders.

### *The Board of Directors Report*

The Listing Rules require the issuer to attach a report from the board of directors to the financial statements that includes the company's operations throughout the past financial year, the factors that affect the company and help the investor in evaluating the company's assets and liabilities as well as its financial position. Article 27 of the Listing Rules specifies the important major points to be included in the report.

### *3. Achieve the Justice Principle in the Capital Market*

Justice is achieved if all parties involved in the market think that they have the same chances and when they believe that they are all subjected to the rules and regulations without discrimination.



For example, justice is achieved when the companies that want to list their securities in the market find out that all the financial requirements and listing rules are applied on them as well as other listed companies and that the fees they pay are evaluated fairly according to a public policy clear to everyone. As for the companies who want to enter the securities business, the justice principle demands that they are required to fulfill the minimum of the conditions set in the authorized persons list regarding the capital and financial guarantees. The justice principle also demands applying the licensing standards and conditions on it and deal with its violations fairly without discrimination.

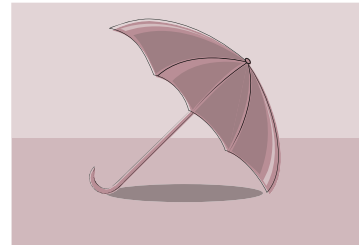
CMA and "Tadawul" employees are obligated to comply with the professional standards of

conduct. This includes them not dealing in the securities listed in “Tadawul” and to keep all their work related information confidential. Penalties on those who violate the standards will be applied fairly.

On the other hand, the justice principle demands that any trading operation from individual investors or companies should be carried out immediately. It should be settled and set off accurately and appropriately. The most important justice requirement for investors is to provide the companies’ information and disclose it as well as the information related to trading and transactions clearly, accurately, transparently and without discrimination. Fair pricing for securities in the market is one of the most important requirements of fairness and justice for investors. It is actually achieved if the appropriate supervisory and regulatory environment by the authority is available to ensure that there is a competitive supply and demand on the securities traded and that it is free from those operations which involve fraud, deceit and manipulation.

#### *4. Provide Protection for the Capital Market Investors*

Article 5 of the Capital Market Law, stipulates that one of the CMA objectives is to protect citizens and investors in securities. The Law gave CMA the authority to issue whatever it finds necessary of the implementing regulations to achieve this protection.



Officials in listed companies, authorised persons or even individual investors and investing companies may resort to various kinds of unfair practices or those that involve fraud, scam or manipulation in order to achieve special benefits that lead to a negative effect on the market and its investors whether it was direct or indirect.

Trading that is based on insider information is an example of the illegal practices that some officials might do. This has its effect on the

market by preferring some investors over others.

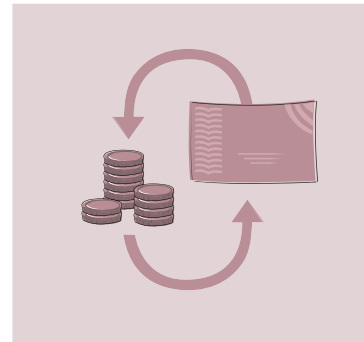
One of the illegal practices is that some authorized brokers ignore the Capital Market Law violations that are committed by some investors. It is also a violation if the authorized person does not act in the interest of his clients. There are a lot of other illegal acts related to individual investors and companies. The most important one is manipulation by giving a wrongful or misleading impression that there is an artificial act on the security.

CMA works hard to protect investors in the capital market by issuing the appropriate implementing regulations, developing it, monitoring the compliance of all parties involved, and applying the penalties on those who violate them.

### *5. Develop the Procedures to Reduce Risks Related to Securities*

Transactions in the financial markets are classified as high risk investments. The sources for the risks in financial markets' transactions can be divided into three kinds: First, Risks arising

from outside the financial markets such as the risks of inflation, recession, or volatility in exchange rates and so on. Second, Risks arising from inside the financial markets such as the low levels of disclosure and transparency, lack of justice, or imbalance in the investment behavior by the parties and so on. Third, Risks related to the investor's awareness and culture.



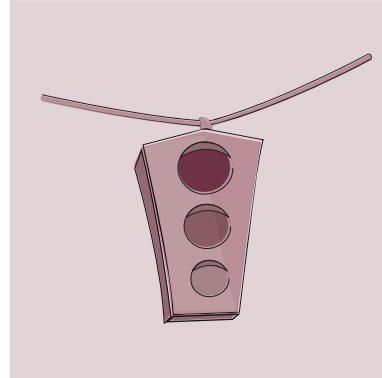
The role of capital market authorities is primarily in dealing with the second kind of risks as well as doing what they can to reduce the risks arising from the third kind.

CMA works on reducing those risks by enhancing the levels of disclosure and transparency when companies disclose their financial statements, any core incidents that would af-

fect its operations and work to deliver the information to everyone without any discrimination. CMA also works to reduce dealing practices based on insider information and control spreading rumors and wrongful information as well as controlling the practices involving fraud or manipulation in dealing with securities.

The rules and regulations imposed by CMA as well as its implementing regulations for authorized persons is another example of the attempts to protect investors from risks. CMA has a set of professional standards for their work and imposed others to guarantee their prudential status. It also guarantees that the amount of risk they apply in their work alongside their decisions are all fit for their clients and gives them the best results.

The CMA has to monitor the compliance of the security issuer with the listing rules and refer to suspend the security or cancel its trading in order to protect the investors from the risks resulting from trading it in the market.

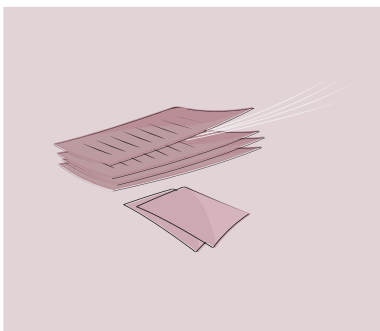


To reduce the risks, CMA has some specific rules, regulatory, administrative and operational frameworks that regulate the relationship between the liquidity levels and risk limits which are acceptable to manage the investment funds. It also monitors the changing levels of risk in these funds to keep the investors' money safe.

As for the risks related to the investors awareness and culture, CMA tries to decrease these risks by its investor awareness programs that includes: advertising campaigns, booklets, workshops, and specialized seminars and symposiums.

## Implementing Regulations of the Capital Market Authority

CMA has a number of implementing regulations to implement the rules of the capital market law. The Market Conduct Regulations is considered the one set of rules that pays attention to organizing the investor's activities and conduct.



The Authorized Persons Regulations regulate and organizes the relationship between the investor and the authorised person.

### *FIRST: Market Conduct Regulations*

It aims to protect those who trade in the capital market from illegal practices. The most important types of illegal practices, according to it, are:

1. Market manipulation.

2. Insider trading based on insider information.
3. Untrue Statements (Rumors).

The Capital Market Law gives CMA the right to investigate the illegal practices and take actions against those who participate in them and prosecute them. The procedures and sanctions include issuing a warrant to the person in question, stop any related operations by him, prohibit him from working in the market, impose a fine and send him to prison.

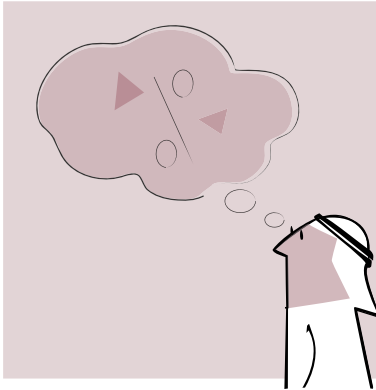
### *1. Market Manipulation*

Market manipulation is any act or practice that involves manipulation, deceit, fraud and misleading information when trading a security.

There are a lot of types of market manipulation but they all have one goal in common which is changing the price of the security in favor for some person by manipulating others.

Buying by prices that are artificially high or selling by prices that are artificially low leads investors, with time, to lose faith in the capital

market. Therefore, CMA's regulations prohibit any person involved in such practices that lead to wrong impressions in relation to the prices of the securities traded.



One example of market manipulation is when a person raises the price of a security by placing repeated buying orders on it. Raising the trading activity on this security by the manipulating method will give the impression that there is a huge demand on it by investors. That is not true of course! The manipulator would then sell the security at a high fictional price leaving other buyers hanging there with low prices paid for the security. There is another type of manipulation, that is when an investor places some buying or selling orders on a security and he knows that there

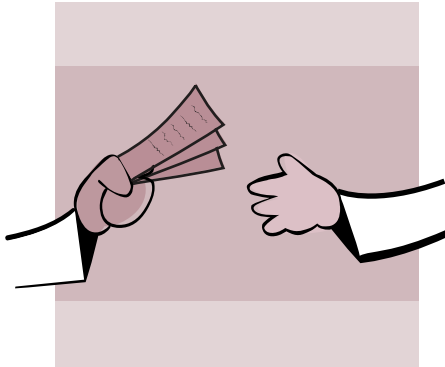
are some similar orders placed by others. This type of manipulation might increase or decrease the security's price which would lead to fictional prices in the market. This act would have a negative effect on other investors who are unaware of these previously arranged deals. In a similar way, market manipulation can be done by placing a lot of selling and buying orders on a security without having the intention to fulfill them or by creating a misleading impression that there is active or weak demand on the security. That is done by achieving a high or low closing price.

CMA seeks, by monitoring the traders behavior and conduct and disallowing such practices, to trust the transparency and fairness of the trading process. It also insures that the supply and demand are the factors that determine securities' prices.

## 2. *Insider Trading*

Insider trading takes place if a member of the board, an executive or a majority shareholder in some company sells or buys shares or other securities of the company based on information that is concealed from the public. Examples of

this : to know if there is a change in the executive management, to have prior knowledge of good or bad earnings reports or encounter information on imminent acquisition or takeover. All these actions are violations of the market conduct regulations.



The rule stipulates that the person who gets this disclosed information through his family members, family connections or business relations is not allowed by law to trade based on this kind of insider information. This means that : first, it is illegal to get such information from inside sources and second, it is illegal to benefit from such information in stock trading.

In a similar manner, non-executive personnel in a company whose relations with the com-

pany gives them access to insider information, are not allowed to trade based on such information. They are also not allowed to give this information to others to act on because this would be insider trading which is also prohibited by the rules.



### 3. *Untrue Statements (Rumors)*

When people say “Rumor”, they mean untrue statements that are spreading among people in order to hurt someone or entity. Rumors’ effects can reach the business operations and securities. A rumor can hurt thousands of investors in commercial properties compared to the limited effect of the traditional definition of rumors.

The Market Conduct Regulation prohibits any person to give an untrue statement about some company that might have an effect on the price of its security. For example, when someone gives an incorrect statement relating to some company, which he already knew was not true, then this would be an illegal act because of its expected effect in changing the price of the security without a sound reason for that.

The price of a security depends on the impression formed about the company. So, spreading false information would affect the company's market value and therefore investors decisions and their portfolios' content. This possible huge effect of false information on individuals, companies and the market as a whole, results in a punishment on those who spread it according to the Capital Market Law and its implementing regulations. The person who spreads this kind of information is held responsible for all the damages caused by it.

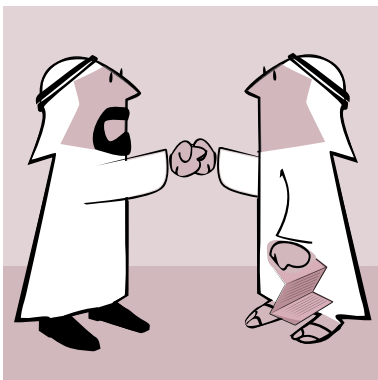
### *Second: Authorised Persons Regulations*

Those who work in the business of securities such as, financial advisors, brokers and portfolio managers are usually held responsible for most of the financial activity done in the capital market. For this reason, a set of rules has been set up to determine the necessary procedures and conditions to get the license and its validity. The regulations also include the rules and conduct guidelines, applied systems and precautions as well as the conditions relating to the clients' assets and money. In addition to the general principles mentioned in Article five that includes licensing and licensed conduct standards such as integrity, professionalism, internal audit, financial sufficiency and disclosure; there are some other principles related to the relationship between the authorized person and the client. The most important one is that the authorized person must comply to:

- Protecting Clients' assets, by arranging for adequate protection.
- Communicating with clients, by communicating information to them in a way which is clear, fair and not misleading.



- No conflicts of interest, by managing conflicts of interest fairly, both between itself and its customers and between a customer and another client.
- Adopting adequate risk management policies and systems.
- Customers' suitability, by taking reasonable care to ensure the suitability of its advice and discretionary managing decisions for any customer to whom it provides those services.



## *Penalties for Violations*

The Capital Market Law have set some penalties for those who violate one of its articles or the implementing regulations set by CMA.

The penalties can be classified into: general penalties for any violation to the rules of the Capital Market Law or the implementing regulations, and special penalties on specific violations in the Capital Market Law.

### *FIRST: General Penalties*

If it appears to the Authority that any person has engaged, is engaging, or is about to engage in acts or practices constituting a violation of any provisions of the Capital Market Law or its implementing regulations, then The Committee for the Resolution of Securities Disputes would sentence him in one or more of the following penalties:

- Warn the person concerned.
- Oblige the person concerned to cease or refrain from carrying out the act which is the subject of the suit.
- Oblige the person concerned to take the necessary steps to avert the violation, or to take such necessary corrective steps to address the results of the violation
- Compensate the persons who have suffered damages as a consequence of a violation that has occurred, or oblige the violator to pay to the Authority's account the

gains realized as a consequence of such violation.

- Suspend the trading in the security.
- Barring the violating person from acting as a broker, portfolio manager or investment adviser for such period of time as is necessary for the safety of the market and the protection of investors.
- Seize and execution on property.
- Travel ban.
- Barring from working with companies whose Securities are traded on the Exchange.
- Fine.

The resolution of securities disputes in the Kingdom is done, according to the Capital Market Law, through The Committee of Resolution of Securities Disputes. This committee includes legal professionals and expert personnel in securities. They are assigned, according to the law, by the CMA Board for three years applicable to renewal.

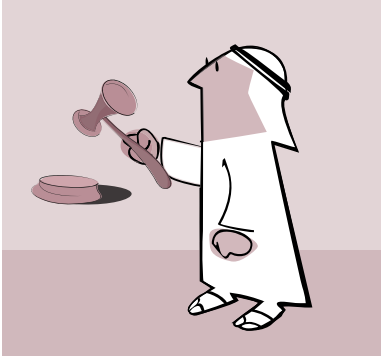
### *SECOND: Specific Penalties*

In addition to the general penalties mentioned above, CMA has more severe penalties for those who fall in one of the two Capital Market Law violations which are: market manipulation and insider trading. Based on Article 57, in addition to the general penalties, whoever commits one of the previous two violations may be sentenced to jail for a period not exceeding five years.

In Article 60, imprisonment is applied for a term not to exceed nine months in addition to a fine for whoever worked as a broker or claimed to be one without a license.

### *Settling Disputes*

The Committee for Resolution of Securities Disputes looks into the complaints and cases filed against the authorized persons or statements of claim regarding some CMA or “Tadawul” decisions or those cases where losses are caused as a result of violations to the Capital Market Law and Implementing Regulations like market manipulation or insider trading.

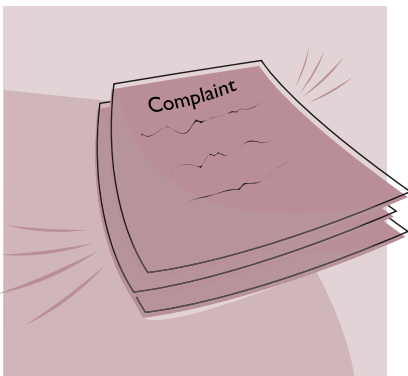


Each case stands alone due to its related evidence and merits. The Committee of Resolution for Securities Disputes works according to a set of rules and regulations by the Capital Market Law. The committee has full power to investigate complaints or law suits. It also has the right to summon witnesses, issue some rules and sanctions, impose penalties and order the parties involved to present evidence and documents.

## *Filing Complaints*

People who have a complaint, a suit or want a settlement in any dispute under the Capital Market Law jurisdiction or its implementing regulations that are approved by CMA and “Tadawul”, can file a complaint and try to reach a satisfactory settlement or resolution.

This first step is to fill the form and then present it to CMA. If the reached settlement does not please the complainant, CMA would raise the issue to “The Committee for Resolution of Securities Disputes”. A complaint or a statement of claim cannot be filed in front of the committee without being filed first with the authority and a 90 days period has passed from the filing date. Unless CMA gives permission to submit it before the period expires. The Capital Market Law requires the committee to look into the case in a period not exceeding 14 days after its submission.



If the prosecutor or the defendant didn't accept the decision by the committee, they can file for an appeal in front of an assigned appeal panel. An Appeal Panel is to be formed by a Council of Ministers' decision, and it shall have three members representing the Ministry of Finance, the Ministry of Commerce and Industry and the Bureau of Experts at the Council of Ministers. The Appeal Panel members shall be appointed for a three-year term renewable. It shall have the discretion to refuse to review the decisions of the Committee for the Resolution of Securities Disputes, to affirm such decisions, to undertake a de novo review of the complaint or suit based on the record developed at the hearing before the Committee and to issue such decision as it deems appropriate in relation to the com-

plaint or the suit. The decisions of the Appeal Panel shall be final.

Evidence and documents have a major role in The Committee of Resolution for Securities Disputes decisions as well as the appeal committee. Therefore, whoever wants to file a complaint should support it with all the evidence and documents available that could be helpful including computer data, phone records, electronic mail or facsimile messages (faxes).







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