

Insight: Capital Markets

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Qatar Financial Markets Authority adopts four new financial regulations

In June 2012, the Qatar Financial Markets Authority (the “**QFMA**”) adopted four new regulations aimed at strengthening the legal infrastructure of the Qatari financial markets, encouraging investment and providing more attractive financial opportunities. These new regulations cover (I) liquidity providers’ activities, (II) guaranteed entry to the market, (III) the lending and borrowing of securities, and (IV) the listing of units of investment funds¹.

I Liquidity Providers’ Activities

By introducing a new regulation governing liquidity providers’ activities (the “**LP Regulation**”), the QFMA aims to enhance the liquidity of securities listed on the Qatari financial markets. A liquidity provider (the “**LP**”) is usually committed to maintaining two way bid/ask quotes in the stocks for which it acts as market maker. LPs typically guarantee transactions at the best price and boost the volume of transactions in the order book, by setting the selling and buying prices for a particular security. Consequently, they help to maintain liquidity and efficiency for these securities. Under the LP Regulation, each LP that obtains a license from the QFMA sets the selling and buying prices of a particular security pursuant to an agreement entered into between the LP and the applicable exchange by virtue of which the exchange determines the conditions to be followed by that LP (the “**LP Agreement**”).

In this context, the LP Regulation provides that the QFMA will adopt an implementing regulation (the “**LP Implementing Regulation**”) that will determine the specific conditions and requirements to be met by the LP. The LP Regulation lists the topics to be covered by the LP Implementing Regulation, including legal capacity, capital adequacy ratio, risk management procedures and conflict of interest rules to be adopted by the LP. In addition, the LP Implementing Regulation will include samples of the LP Agreement and the liquidity provision agreement to be entered into between the LP and a given issuer. The LP Regulation is, however, silent on one important point that will ultimately need to be addressed: whether the QE Venture Market (the newly created Qatari Second Market)² will have designated LPs.

¹ This Client Alert is based on the official Arabic text of each of the four regulations.

² For more information on the QE Venture Market, please see our Client Alert covering this topic: <http://www.whitecase.com/alerts-02132012/>.



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II Guaranteed Entry to Market

Under the Guaranteed Entry to Market Regulation (the “**GEM Regulation**”), an existing QFMA licensed financial services company (the “**Guaranteeing Member**”) is allowed to perform brokerage services for a foreign company (the “**Guaranteed Participant**”), allowing the latter to enter the trading system on the Qatar Exchange by using the Guaranteeing Member’s direct connection line for the purpose of trading stocks under the umbrella of the Guaranteeing Member’s transactions. Such an arrangement is very similar to the “direct market access” (“**DMA**”) in Europe whereby the trading member of the exchange can permit third party clients to trade on the exchange markets using the account of the member. It is one of the services usually provided by a prime brokerage agreement by which, for example, a fund manager can use the trading systems of the prime broker. The broker stands behind and guarantees the trades of the DMA client firm and the level of guarantees demanded by the exchange will accommodate a given level of DMA access by the trading member firm’s clients.

The GEM Regulation mainly enumerates a list of requirements to be met by the Guaranteed Participant in order for the Guaranteed Participant to obtain the approval of the QFMA to start its activities in the Qatari market. These requirements include both the need for the Guaranteed Participant to be licensed in its home jurisdiction by the authority that is equivalent to the QFMA and to have obtained an approval from such equivalent authority regarding the guaranteed entry.

The GEM Regulation also requires that the relevant guarantees (to be determined by the QFMA and the Qatar Exchange) be submitted and that the amount of all the non-guaranteed transactions undertaken by the Guaranteed Participant be less than the aggregate guarantee submitted by the Guaranteeing Member. In this regard, the

GEM Regulation provides that the Guaranteeing Member shall be responsible for all the transactions undertaken by the Guaranteed Participant and any faults or damages arising therefrom.

III Lending and Borrowing of Securities

The QFMA has adopted the Lending and Borrowing of Securities Regulation (the “**LBS Regulation**”) for one primary purpose: to cover settlement failure when sold stock cannot be delivered at the time of the transaction, a situation that would typically arise when a first party failed to deliver to a second party stock that has already been sold by the second party to a third party. In order to avoid the costs and penalties that can result from settlement failure, stock can be borrowed at a fee and delivered to the third party. The LBS Regulation prohibits lending or borrowing of securities except for such purpose “or in any other case determined by the QFMA,” which means that the LBS Regulation targets mainly, at least initially, settlement failure.

Securities lending and borrowing require a license that is granted by the QFMA. According to the LBS Regulation, such license can only be granted to a financial services firm that is already licensed by the QFMA or that has a financial services license recognized by the QFMA but issued by another authority that regulates financial services in Qatar.³

Such license allows the licensed firm to undertake “securities lending and borrowing activities,” noting that such activities are broadly defined. Indeed, the definition includes a non-exhaustive list of activities that are considered as lending and borrowing of securities. In addition to lending securities and borrowing securities, this list includes providing advisory services to the lender or the borrower regarding the related transaction, providing market pricing, record keeping, delivering, receiving or ordering the receipt of the borrowed securities or the guarantees.

In addition, any firm that is licensed to undertake securities lending and borrowing activities must enter into a securities lending agreement (the “**Securities Lending Agreement**”) with the client, setting forth the terms and conditions governing the firm’s transactions, and taking into account whether the client is a sophisticated investor or not. In this regard, the LBS Regulation enumerates a set of requirements that should be addressed in the Securities Lending Agreement including: (i) an undertaking by the borrower to return the equivalent of the loaned securities to the lender at a specified time, (ii) the provision by the borrower of a guarantee equivalent to the loaned securities, in cash or in any other form determined by the QFMA, (iii) a requirement that the cash value of the collateral should be marked-to-market at least on a daily basis and should not be less than the then-current value of the loaned securities (or any higher amount determined by the QFMA or the Qatar Exchange), and (iv) a provision allowing the lender to request from the borrower, in the event the value of the guarantee(s) becomes less than the value described in sub-paragraph (iii) above, to increase the value of the guarantee(s) by providing additional guarantees. Once the Securities Lending Agreement is finalized between the parties, the QFMA must approve the document. Also, the LBS Regulation clearly allows the use of securities lending agreement samples adopted by the securities lending industry such as the GMSLA (the Global Master Securities Lending Agreement) when the licensed firm is dealing with sophisticated investors.

From a legal perspective, it should be noted that title to a given security transfers to the borrower when such security is borrowed. Indeed, the LBS Regulation provides that the borrower of the loaned securities becomes the full legal and beneficial owner of such securities⁴, having the right to transfer or assign the loaned securities, and is entitled to any other right including voting

³ The reference to another regulator presumably intends to cover the Qatar Central Bank.

⁴ The LBS Regulation seems to have adopted the approach of English law stock lending agreements that provide for the loaned securities to pass to the borrower under an absolute title transfer arrangement with the borrower being placed under an obligation to re-deliver equivalent stock but not the actual securities that are loaned.

rights and the right to dividends.⁵ Moreover, the LBS Regulation allows the lender to enforce the guarantee provided by the borrower if (i) the value of the guarantee(s) becomes less than the value of the loaned securities for one day following notification to the borrower or (ii) no additional guarantee is provided by the borrower by the end of the second business day following notification to the borrower.

Finally, the LBS Regulation provides that implementing regulations will be adopted to specify the mechanics of the securities lending and borrowing transactions, addressing notably the legal capacity of the licensed firms, risk management procedures, compliance, training, and granting the Qatar Exchange the power to sanction any person that violates the LBS Regulation or the future implementing regulations.

IV Listing Units of Investment Funds

The QFMA regulation covering the listing of units of investment funds (the “**LUIF Regulation**”), which follows the principles found in European exchange rules that list investment funds, is applicable to units of (i) open-end investment funds and closed-end investment funds that are established in Qatar, that invest in securities⁶, and that seek to go public, or (ii) non-Qatari funds where the QFMA approves the listing of units of such non-Qatari funds.

These units cannot be traded on the market before obtaining the approval for listing of the QFMA. In order to list such units, a fund must be validly constituted in accordance with applicable law, have a minimum capital of ten million Qatari Riyals and have obtained all necessary approvals. The LUIF Regulation provides a sample application for listing and a checklist of all the documents that need to be submitted to the QFMA. Once the application is submitted, the QFMA has 30 business days from receipt of all the required documents to render its decision, noting that it has a complete discretionary power in that regard, under the LUIF Regulation.

Once the units of a fund are listed, such fund will have to comply with the entire legislative infrastructure governing the QFMA and the financial markets, including the listing and trading rules and regulations of the QFMA.

The LUIF Regulation also provides for additional restrictions regarding open-end funds. Indeed, an open-end fund will have to determine, for example, the days and time of valuation and the date on which the fund buys back the units, in accordance with the fund’s bylaws and its prospectus. The LUIF Regulations further provide that the net asset value of the fund should be computed at the end of every business day.

Concerning the fund’s manager (the “**Fund Manager**”), the LUIF Regulations put on the Fund Manager certain disclosure duties including a duty to send to the unit holders

a report every three months regarding the net asset value of the fund, the number of units and their respective net value, and any distributions made as of the date of the last report sent to the unit holders. In addition, the Fund Manager must submit semi-annual reports regarding its performance and the fund’s results, the risk management procedures put in place, etc.

Other restrictions are also provided for in the LUIF Regulation such as the prohibition for any fund to acquire more than 10% of the securities of a given issuer, except the securities issued or guaranteed by the State of Qatar or by the Qatar Central Bank. Also, a fund cannot invest more than the equivalent of 15% of its net asset value to acquire securities issued by one single issuer, nor can it invest in another investment fund more than the equivalent of 10% of its net asset value or 10% of the net asset value of that other fund.

Conclusion

The four new regulations are expected to enhance the Qatari financial market. However, it will not be possible to judge the success of these regulations before a comprehensive set of regulations detailing the mechanics of the various activities covered by each of the regulations is put into place, which can only happen once the respective implementing regulations are adopted by the QFMA.

⁵ The LBS Regulation provides for the possibility to pass back the dividends to the lender by having an arrangement regarding dividends “and other rights”. The QFMA will have to specify if an arrangement can be made as to voting rights.

⁶ The QFMA will approve on a case-by-case basis the applications to list units of open-end or closed-end investment funds that do not invest in securities, noting that the term “securities” is broadly defined in Law No. 33 of 2005 governing the QFMA.