Guide Book

EXCHANGE TRADED FUNDS

FALCOM فالكم

INTELLIGENT
INVESTMENT
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WORLD FINANCE
Best New
Investment Bank
Saudi Arabia
2009

A NEW CHAPTER BEGINS

The kingdom of Saudi Arabia is about to witness a major development in the capital market with the launch of a new asset class (Exchange Traded Funds) ETFs.

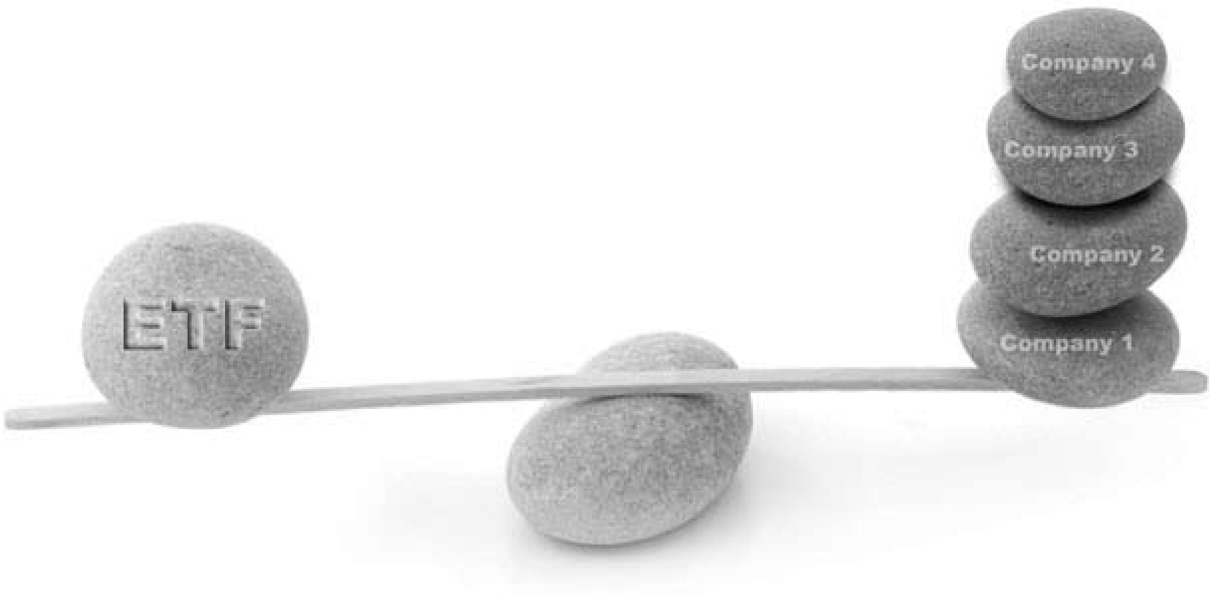
At the end of February 2010 the global ETF industry had 2,090 ETFs with 3,997 listings, assets of US$1,001.5 bln, from 115 providers on 40 exchanges around the world.Today, Saudi Arabia joins the global ETF market, with its first listing.

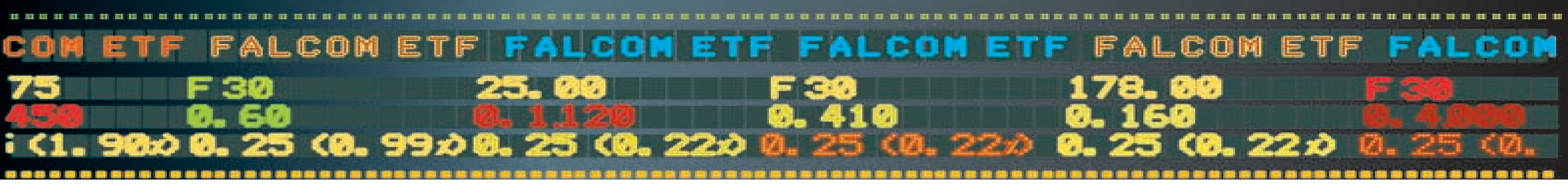
FALCOM is the first ETF provider in Saudi Arabia to bring a new level of transparency, liquidity and trading capabilities for the investors seeking diversification and cost effective investment opportunities.

INTRODUCTION

The objective of this document is to provide the reader with a brief and adequate explanation of Exchange Traded Funds (ETFs). At the same time this document will also serve as the ETF reference for those involved in the ETF awareness campaign, by providing adequate information in order to increase the awareness of the investment community by highlighting ETF attributes in comparison to other investments i.e. equities and the mutual funds.

This document is not for the marketing of any product rather, as mentioned earlier, it aims at educating target investors and stock market traders on ETF.



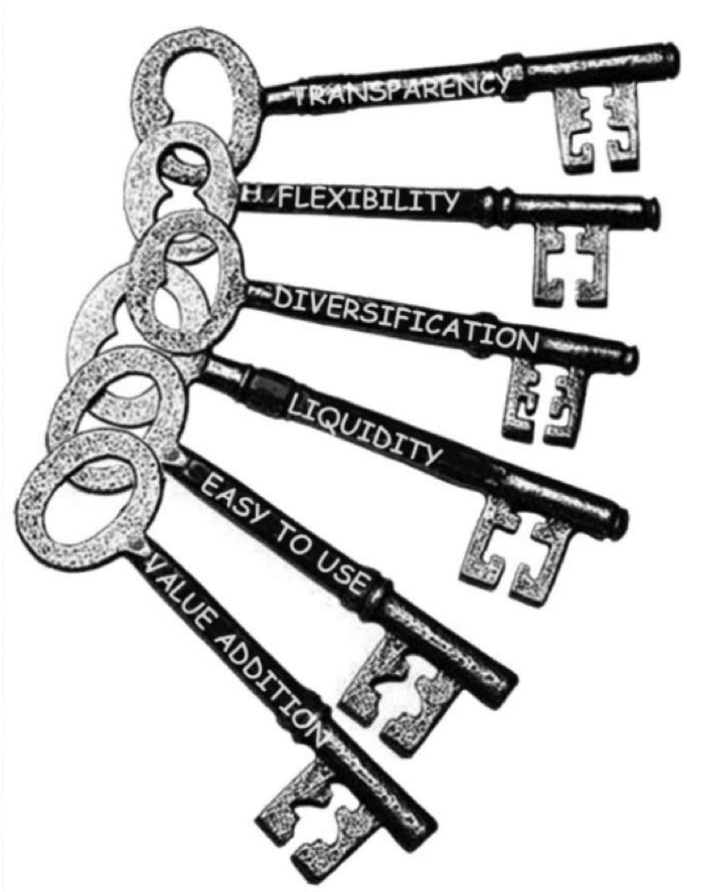


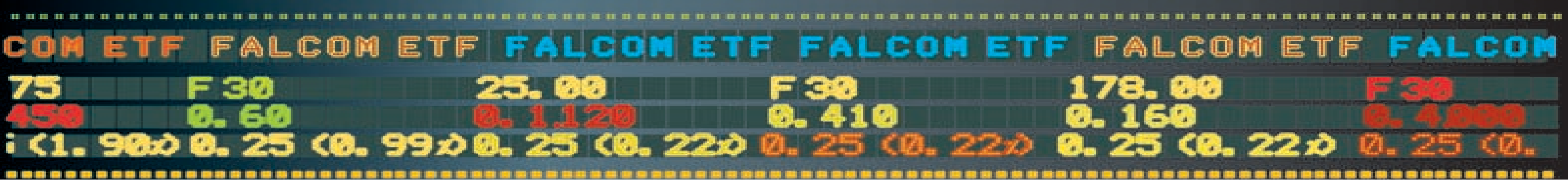
Introduction to the Exchange Traded Funds

In short, ETFs are investment funds divided into equal units that are traded on the stock market during trading hours, similar to stock companies. ETFs enjoy advantages of both mutual funds and stocks at the same time without any major disadvantages. (Explained later in the document).

Like other investment funds ETFs are composed of a basket of listed company shares however unlike mutual funds ETFs are traded on the exchange. ETFs are more transparent since they track the movement of the underlying index by way of investing in the index in the same proportions. That makes it easier for investor to gauge the performance of the ETF by looking at the market movement of components of the underlying index. ETF units can be traded by bid-ask during trading hours, as well as also through the creation and redemption* of these units through a market maker or any other Authorized Participant.

ETFs entered global markets for the first time in 1989 through the Canadian market followed by the U.S. in 1993. Since then ETF have enjoyed rapid growth, the ETF asset under management (AUM) have increased from $72 billion in 2001 to $530 billion by the end of 2008 in the U.S. market alone.





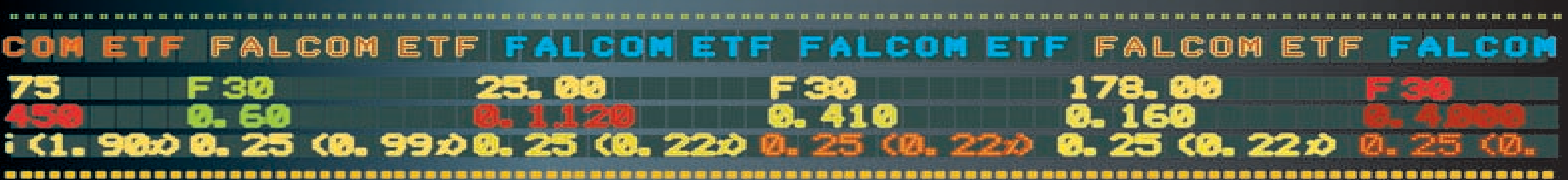
What are the salient characteristics of ETFs

Transparency

Since ETFs track the underlying indices, the individual invested components and their weights in ETF are known and it is easy to track these individual components. The ETF managers are committed to provide full disclosure of ETF components and the index.

In addition, Fund managers are obliged to disclose fund value during the trading hours called Indicative NAV (iNAV) and ETF value at the end of the day known as Net Asset Value (NAV) Thus investors will be able to continuously access the ETF unit value (iNAV) throughout the trading hours.

* Units creation is done in accordance with ETF's Terms and Conditions as per the ETF Prospectus approved by CMA.

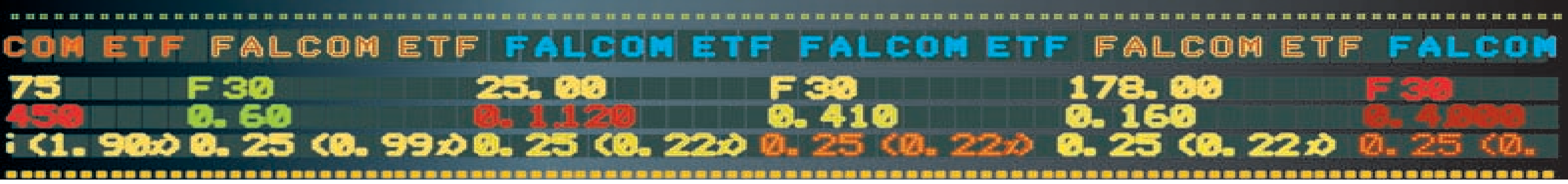


Flexibility

The minimum investment required for the ETF is the market value of the single ETF unit, which makes the investment affordable for all investors along with the ability of buying and selling in the secondary market

Cost

The cost of investing in ETF is generally lower than investing in mutual funds. The direct costs borne by investors in ETF are only the buying and selling exchange commissions. Moreover, the ETFs management fees are very low compared to the mutual funds and are disclosed in the ETF Prospectus.



Diversification in Investments

Generally, underlying ETF investments are diversified as per the underlying index reducing the company specific investment risk and price volatility unlike the risks involved in direct investment in company shares.

Following table compares the ETFs and other investment vehicles i.e. mutual funds and stocks:

Stocks	Mutual Funds	ETFs	
More	Less	More	Transparency
More	Less	More	Flexibility
Less	More	Less	Cost
Less	More	More	Diversification

FALCOM ETF

The Market Maker

Market Maker

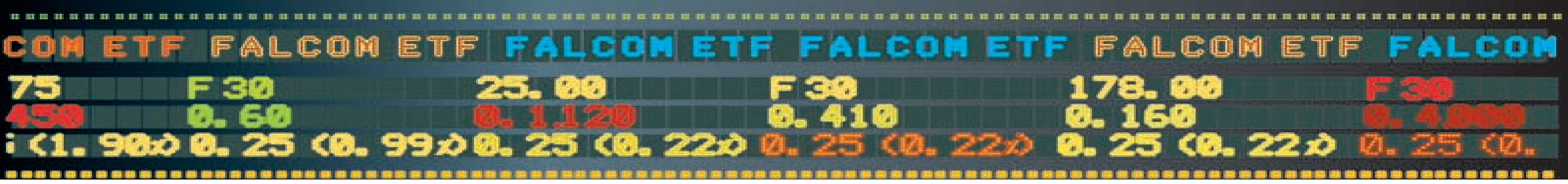
Market Maker is an entity licensed by the Capital Market Authority (CMA) whose function is to provide liquidity in the market, or more precisely to provide continuous bids and offers so that the investor can, at any time, buy or sell ETF units.

However, market makers are subject to the following CMA conditions:

A market maker is committed to continuously providing ETF buy and sell orders at specified bid-ask spread

ETFs bid-ask spread must not be less than a specific amount or equivalent units

Market makers are obliged to keep order from 5 minutes after opening of trading until 5 minutes before closing. The market maker activities will be monitored by the fund managers and the exchange to ensure market maker's performance of its obligations.



Terms and Definitions

Terms and Definitions

Exchange Traded Funds (ETFs): are the investment funds divided into units of equal value that are traded on the exchange during the market hours. ETFs generally track the performance of the underlying index.

Fund Manager: is the party that issues and manages ETFs and is licensed by the Capital Market Authority for Asset Management.

Net Asset Value (NAV): Total assets of the Fund minus the total ETF liabilities and the expenses of managing ETF. Fund manager is obliged disclose the value per unit (NAV) of ETF at the end of each trading day and also continuously provide iNAV (indicative Net Asset Value) during the trading session on its website and in the exchange website.

* Market Maker: is a party authorized by the Capital Market Authority to provide liquidity on a particular ETF through providing continuous buy and sell orders.

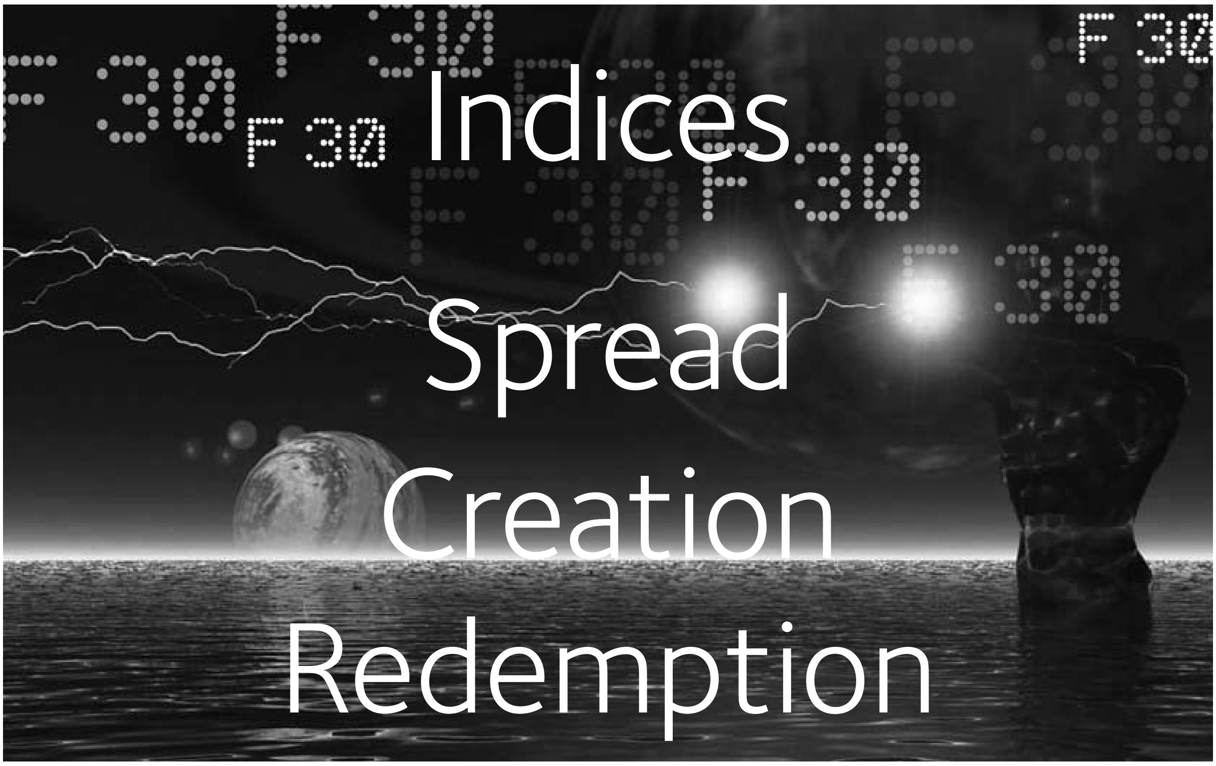
Indices (Indexes): Numerical criteria for measuring the performance of a group of companies listed on the exchange.

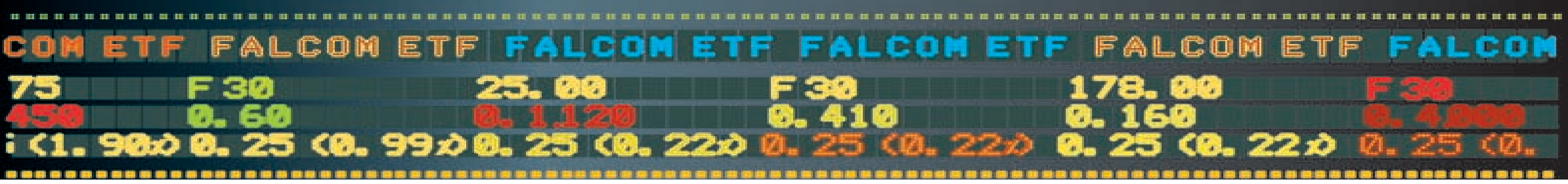
Spread: is the difference between the highest ask and lowest bid.

Creation: is the process of purchasing units directly from the fund manager or authorized party licensed according to the instructions by the Fund manager.

* Market Maker and the Exchange should agree to establish a spread, order size, volume etc, to be monitored by the Exchange.

Redemption: is the process of selling the units directly to the Fund Manager or the authorized party according to the instructions by the Fund Manager.





Trading periods and the types of orders

Trading sessions

A trading day is divided into 3 distinct sessions as described below.

1st Session: 10:00 – 11:00 Pre-Open session (or Open-Order Maintenance):

During this session, orders can be entered, amended or cancelled
Market Transparency:

> The five best price levels are displayed for each symbol along with the total number of orders in each level and the total volumes.

2nd session: 11:00 – 15:30 Open-Trading (Continuous Trading)

At the beginning of this session, opening prices are determined, and continuous trading commences.
Market Transparency:

> The five best price levels are displayed for each symbol along with the total number of orders in each level and the total volumes.
> Also, the best 10 orders by price are displayed.

Orders can be entered, amend or cancelled.
Orders can be maintained.

3rd session: 15:30 – 16:30 Pre-Close

Market Transparency:

> The five best price levels are displayed for each symbol along with the total number of orders in each level and the total volumes.
> Also, the best 10 orders by price are displayed.

Orders can be cancelled and order validity amended.
Order prices can not be changed, quantities can be decreased but not increased.
New orders can not be accepted.

Order Types and Conditions

1. Limit Orders

During the 1st session:
Limit orders can be entered without any conditions, if not executed at opening, they will be carried over to continuous trading.
If entered with the condition to execute at the opening, it will be cancelled if not executed or partially executed at opening.

During the 2nd session:

Certain conditions can be applied to Limit Orders.

Fill-and-kill (FAK): if not executed fully or partially the whole or the remaining quantity is cancelled automatically.

Fill-or-kill (FOK): the full quantity has to be executed or cancelled. Partial execution is not permitted.

2. Market Orders (un-priced orders)
The order will execute at available market prices. Price protection within five price ticks will apply in both sides, during the continuous trading.

Price Protection does not apply to market orders entered during Pre-open.
Additional Conditions can be applied to market orders:

During the 1st session
"At Call- Only" condition can be added: if the order is not executed or partially executed at opening, the remaining quantity will be cancelled directly.
During continuous trading: market orders are cancelled if there is not an opposite market.

During 2nd session :

Fill-and-kill (FAK)
Fill-or-kill (FOK)

3. Undisclosed Order: is a limit order that is typically with a very large quantity. Only the disclosed quantity is displayed to the market. The total quantity should not exceed 4000 times disclosed quantity and vice versa

During the 1st session: the whole quantity is included in the market-by-price level.
During 2nd session: when the disclosed quantity is executed, a new quantity is displayed with new priority.

Orders

Order Type	Pre-Opening	During Trading
Limit Order	X	X
Undisclosed Order	X	X
Market Order	X	X
Execution		
Fill and Kill (FAK)		X
Fill or Kill (FOK)		X
Condition Validity		
Daily	X	X
At Call Only	X	
Good to Date (GTD)	X	X

Order Type	Limit Order		Undisclosed Order	Market Order	
	Trading	Pre Opening	Trading and Pre Opening	Trading	Pre Opening
Price Condition	(!)	(!)	(!)	(!)	(!)
Execution					
FAK	X			X (!)	
FOK	X			X (!)	
Condition Validity					
Daily	X	X	X		
At Call Only		X			X (!)
Good to Date (GTD)	X	X	X		

In the above table (X) specifies that merging is allowed and (!) states that order will not be accepted without conditions.

Important Notes:
Change in price or increase in volume results in change to the order priority.

All suspended orders are cancelled at market close.

Good-till-date orders are cancelled at end of day if they fall beyond the daily price fluctuation limits (±10%).

Market Orders always have execution priority.

Frequently Asked Questions (FAQs)

1. What are Exchange Traded Funds, how and when they started?

ETFs are investment funds divided into equal units that are traded on the stock market during trading hours. ETFs enjoy advantages of both mutual funds and stocks at the same time without any major disadvantages. (Explained later in the document).

ETFs entered global markets for the first time in 1989 through the Canadian market followed by the U.S. in 1993. Since then ETF have enjoyed rapid growth, the ETF asset under management (AUM) have increased from $72 billion in 2001 to $530 billion by the end of 2008 in the U.S. market alone.

2. How can investors buy ETFs?

Investors can buy and sell units throughout the exchange trading hours. The units can also be created / redeemed through the market maker or any other authorized party.

3. Is there any upper or lower limit on the number of ETF units that an investor can buy or sell?

Minimum ETF than an investor can purchase over the exchange is one unit, whereas creation of ETF units would be as per ETF terms and conditions.

4. What are the differences and advantages of ETF and mutual funds?

Mutual Funds	ETFs	
Less	More	Transparency
Less	More	Flexibility
More	Less	Cost
More	More	Diversification

5. What are the benefits to the investor for investing in ETFs?

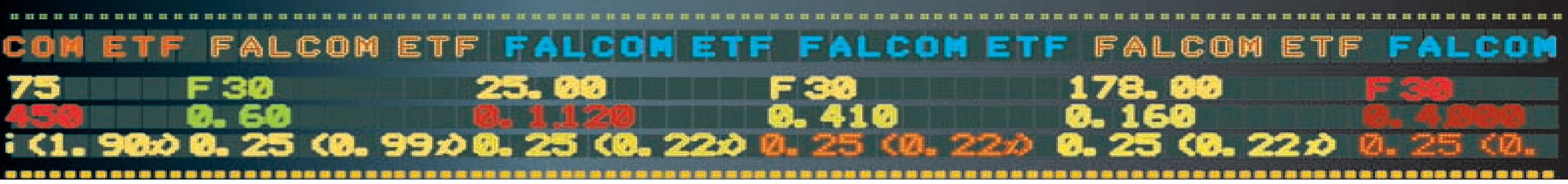
In general, the investors could gain from the increase in value of the underlying assets of ETF in addition to any related dividends.

6. Is there a relationship between the ETF performance and the performance of the underlying stocks of the ETF?

Yes, there is a direct relationship between the performances of the ETF NAV and the value of underlying assets.

7. Are there any commissions or other administrative expenses borne by the buyer of these units?

The cost of buying and selling units and any other management fee or expenses would be disclosed in the ETF prospectus.



8. Do the ETF investors get dividends in-kind or in cash?

The cash dividends received from the underlying ETF companies can be reinvested or distributed as per the policy of ETF as disclosed in the prospectus.

9. Is the unit price for the ETF equal to the stock price of the underlying constituent of the ETF?

One must clearly distinguish between the trading price of the ETF units which is subject to supply and demand and the value of net assets (NAV) of the unit which represents the market value of assets consisting of the ETF unit. Often buying and selling of ETF units happen at a price very close to the value of net assets.

10. Would the ETF prospectus be available before the ETF starts trading on the on the primary and secondary markets?

The Fund Manager, as per Capital Market Authority regulations particularly ETF regulations, is obliged to provide the ETF prospectus and the terms and conditions an adequate period ahead of the ETF trading.

11. What are the risks investors faces by investing in ETF?

The risks that investors face by investing in ETF are the equivalent to risks of investing in securities. However, due to benefits of diversification, risks of investing in ETF may be to a lesser extent.

12. Are ETFs limited to stocks only?

No. ETFs are not limited to the stocks only they also may include other instruments or commodities such as gold and silver. However, in the initial phase of this project, ETFs will be limited to Saudi equities only.

13. Who will be the provider of ETFs?

Authorized participants having Asset Management license by the Capital Market Authority.

14. Are there limits to the ownership of ETFs?

No, it is subject to ETF volume available in the stock market.

15. Would all people and nationalities be allowed to invest in ETFs?

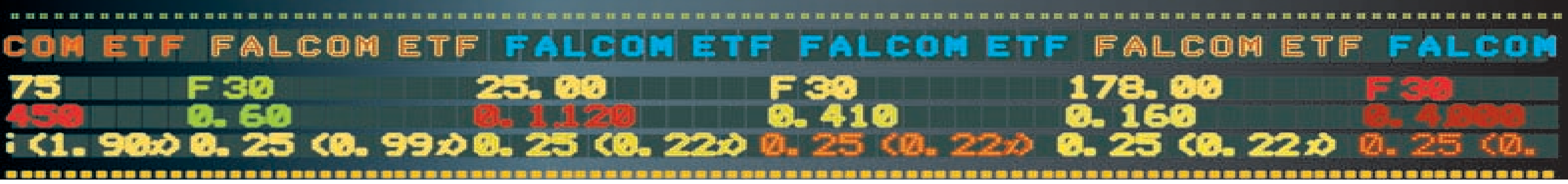
Yes, ETFs will be available to all categories of investors who are registered to trade in exchange.

16. Would the ETF owners have the right to attend the assemblies and vote?

ETFs are managed completely and directly by the fund manager subject to the Investment Fund Regulations issued by the Capital Market Authority (CMA) and therefore no general assemblies are arranged for these funds.

17. Would the conversion process and transfers be available between the customers' portfolios?

Yes, following the same terms and conditions of the transfer of shares.



18. Are ETFs closed or open funds?

ETFs are open funds.

19. How would the ETF units be priced in the secondary market?

The ETF will be priced at NAV upon listing on the secondary market, then going forward ETF unit price will be determined by the supply and demand.

20. When does the ETF expire and be delisted from the market?

Upon redemption of all ETF units by the Fund Manager.

21. Can an authorized participant issue more than one ETF at a time or at different times?

Yes, an authorized participant can issue more than one ETF, at the same time, based on different styles or strategies.

22. Can an authorized participant issue ETFs consisting of local and international shares?

Yes, after the approval of Capital Market Authority (CMA).

23. What are the most popular international markets for ETFs?

ETFs are generally traded in the international markets; however ETFs are traded more actively in the United States, Canada and Germany.

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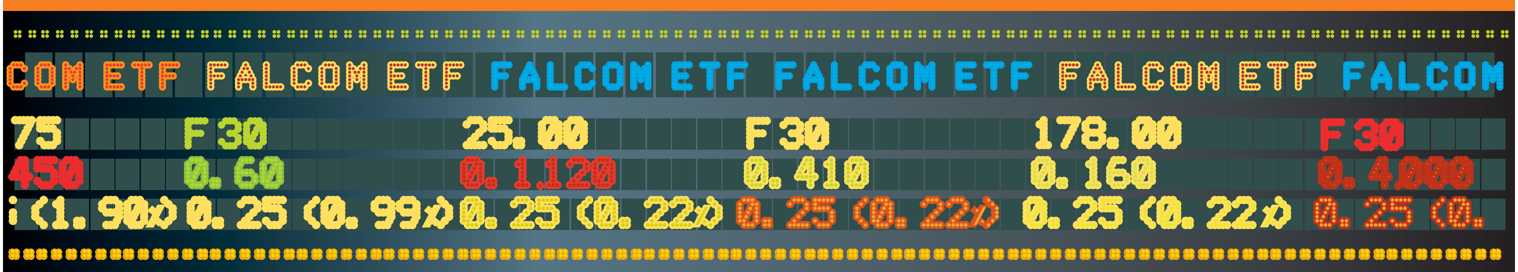

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