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UAE Investment Funds Regulations

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On 22 July 2012 the UAE Securities and Commodities Authority (“**ESCA**”) issued the much anticipated new UAE investment fund regulation (the “**Regulation**”) pursuant to resolution no. 37 of 2012. The Regulation shall come into force from the day after it is published in the UAE Official Gazette, which is expected to be in early September 2012.

Key changes to UAE funds regime

Transfer of regulatory supervision - In practice, ESCA has for quite some time had responsibility for the day-to-day regulation of investment funds, including licensing and marketing. However, the Regulation formalizes the transfer of responsibility to ESCA from the UAE Central Bank.

No exemptions for private placements of foreign funds - Previously, a “tolerated practice” was accepted in the UAE which informally permitted discreet marketing of foreign funds to sophisticated investors without any requirement to obtain the approval of the UAE Central Bank. The new Regulation does not contain any exemption for such “private placements” and marketing of a foreign fund in the UAE will now require ESCA approval.

Framework for domestic funds - The Regulation sets out detailed requirements for the establishment and distribution of UAE domestic funds.

Marketing by local promoter - All foreign funds marketed in the UAE will now need to be offered through a licensed agent (or a locally established representative office in certain circumstances).

Marketing of foreign funds in the UAE

ESCA approval

The Regulation provides that any foreign fund promoted in the UAE will need to be approved by ESCA. The fact that a foreign fund may only be offered to institutional investors does not provide an exemption from the requirement to obtain ESCA approval.

This is likely to affect the business of DIFC firms offering non-retail funds in the UAE as they will no longer be able to use their physical proximity to the onshore market to discreetly promote such funds without the prior approval of ESCA.

Public offerings of foreign funds

The Regulation states that a foreign fund may not be marketed to the public in the UAE unless the foreign fund is:

- subject to the supervision of an authority equivalent to ESCA in its jurisdiction of incorporation; and
- authorized to make offers to the public in its jurisdiction of incorporation.

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The Regulation also provides ESCA with the power to impose further conditions.

Private placements of foreign funds

If a foreign fund cannot satisfy the criteria set out above to make a public offering, then it will only be authorized to promote the fund by way of a private placement, the promotion of which is limited to direct contact with investors identified in advance. The black letter wording of the Regulation provides that particular investors must be identified in advance. It is not clear whether ESCA would simply approve a class of investors generally.

The minimum subscription amount by an investor in respect of the private placement of a foreign fund shall be not less than AED500,000 or AED1,000,000 for a fund incorporated in a free zone outside the UAE. No guidance has been provided but it is assumed that the reference to foreign free zones is intended to catch jurisdictions such as the Qatar Financial Centre.

Local promoter

The Regulation provides that a foreign fund, whether public or private, may only be promoted by:

- banks licensed by the UAE Central Bank;
- investment companies licensed by the UAE Central Bank; or
- companies licensed for such purpose by ESCA.

The representative office of a foreign company may also act as local promoter where it is marketing only to institutional investors with a minimum subscription amount of AED10,000,000 per investor.

The local promoter of a fund shall be required to, among other things, take all necessary care when selecting a foreign fund to be promoted in the UAE and perform its duties in a manner that “guarantees the protection of the money paid by investors”. This places a significant obligation on the promoter but is less onerous than the earlier draft of the Regulation which required a promoter to indemnify UAE investors against all non-commercial risk.

Establishing and marketing domestic funds in the UAE

Fund sponsor

The Regulation provides that an entity establishing a local fund must be a UAE joint stock company or a UAE branch of a foreign company.

Capital requirements

The capital of the company or branch must not be less than AED10,000,000. However, entities licensed by the UAE Central Bank can instead provide an unconditional bank guarantee to ESCA for the amount of AED10,000,000.

The company or branch shall invest not less than 3% of its own capital into the fund so that it has financial exposure to the fund which it is sponsoring.

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Fund offer document

The Regulation sets out a detailed list of information which an offer document shall contain and also provides that the offer document shall be prepared in accordance with a form provided by ESCA. The offer document must be in Arabic and while an English version may also be provided the Arabic version shall prevail in the event of any discrepancy.

Investment policy

The investment policy of the fund must specify, among other things, proposed investment instruments, investment risks relevant to the proposed investment instruments, restrictions on types of investments and borrowing controls.

The Regulation also prescribes ratio restrictions on investing in traded securities, including the following:

- no more than 15% of a fund's capital may be invested in the securities of any one issuer and no more than 20% may be invested in the securities of an "interconnected group";
- no more than 10% of the fund's capital any be invested in any category of security (e.g. shares or bonds) of any one issuer;
- no more than 20% of a fund's capital may be invested in other similar funds and no more than 10% may be invested in any single fund. In addition, an investment in another fund should not constitute more than 15% of that other fund's capital; and
- no more than 20% of a fund's capital may be invested in foreign markets.

The final restriction makes it clear that domestic funds in the UAE will need to be primarily focused on investing in local markets such as the DFM and ADX. As a result, the regime is likely to be a disincentive to foreign funds with an international focus looking to establish in the UAE.

Other notable areas

Fund application and timing

ESCA is required to approve or refuse an application on the prescribed forms within 30 days of the date on which the required documents and information are submitted.

Grace period for compliance

The Regulation provides that entities currently engaged in investment fund activities in the UAE shall have one year to comply with the terms of the Regulation.

Standard form documents

The Regulation provides that application forms and other standard documents are to be produced by ESCA and it is expected that ESCA will make such standard forms available in due course.

Penalties for violations

Following a violation of the Regulation ESCA, may issue warnings, impose fines and suspend or cancel a license.

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Fees

The Regulation provides that ESCA shall issue a resolution on the fee structures relating to licensing of a fund, annual renewal of a license, approval for the promotion of a foreign fund and any other fees payable in connection with the administration of the Regulation.

Restrictions on using fund assets as security

The Regulation provides that the monies of a local fund may not be pledged or seized for the satisfaction of any obligations of the fund entity.

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