

New UAE Investment Funds Regulations and Impact on International Businesses

2 October 2012

Authors: VincentR.Gordon , AmritaMaini

The Emirates Security and Commodities Authority (“**ESCA**”) have implemented their new UAE Investment Funds Regulation (the “**Regulations**”).

In the past, the offer of units in a foreign fund to a limited number of known sophisticated investors in the UAE was tolerated without triggering any licensing and registration requirements with the UAE Central Bank, as there were no formal regulations governing this practice. The new Regulations transfer regulatory responsibility for the licensing and marketing of investment funds from the UAE Central Bank to ESCA and are aimed at protecting investors. However, the Regulations do provide the Central Bank with authority in the area of control and inspection of the financial status of investment funds.

These Regulations deal with two different issues:

- Establishment and licensing of domestic investment funds
- The promotion and offering of foreign funds in the UAE

ESTABLISHMENT AND LICENSING OF DOMESTIC FUNDS

No investment fund may be incorporated in the UAE without the prior approval of and licensing by ESCA.

Incorporation Requirements

Any company wishing to incorporate a fund in the UAE (i.e. the fund sponsor) must fulfill the following conditions:

- It must be a UAE joint stock company (which by its terms requires 51 percent UAE ownership) or a branch of a foreign company licensed by the authorities
- Have a minimum capital of AED 10 million; however, banks, financial investment companies and others that are licensed by the Central Bank are exempted so long as such entities provide ESCA with a bank guarantee of AED 10 million
- The sponsor's articles of association must provide that establishing investment funds is a permitted activity, but financial investment companies and branches of foreign banks are exempted from this requirement
- The sponsor of a domestic fund must contribute at least 3 percent (but not more than 49 percent) of the capital of the fund
- The sponsor must be financially solvent to carry out fund activities

Please note that there is no prescription for the actual form of the fund itself, and rather, the Regulations envisage a contractual arrangement between the sponsor, investment manager and investors. However, the fund is required to appoint a board of directors to manage the fund. At least three directors must be independent of the sponsor or any service provider. ESCA will be required to approve each director, and no director may be removed without ESCA approval.

Offering Document / Disclosure

The Regulations provide that although an offering document may be prepared in English, an Arabic version must be submitted for approval to ESCA, and in case of any discrepancy between the English and Arabic versions, the Arabic shall prevail. The Regulations detail the basic information that must be provided for the fund. In addition, unless there is a purely a technical change, any amendment to the offering document must be approved by the investors. ESCA must, in any case, approve any amendment in order for it to be effective.

Investment Policy

The Regulations provide that each fund must adopt an investment policy, which adheres to the specifications contained in the Regulations. For example, a fund's investment policy must detail how its policy will be amended and also what restrictions will be placed on investment into other

funds. As with amendments to the offering document, no amendment to a fund's investment policy is considered effective until approved by ESCA.

The Regulations also set forth specific restrictions and ratios on investing in traded securities:

- No more than 15 percent of the fund's capital may be invested in securities issued by one company
- No more than 20 percent of the fund's capital may be invested in the securities issued by one interconnected group
- No more than 10 percent of the fund's capital can be invested in any single category
- No more than 20 percent of the fund's capital can be invested in other similar funds
- No more than 20 percent of the fund's capital can be invested in foreign markets; if ESCA agrees to an exemption then the fund must submit monthly reports to ESCA detailing the volume and details of the foreign investments and the financial status of the fund

Funds can apply to ESCA in order to be exempted from one or more of these ratios.

We note that these restrictions may not make it attractive for funds to set up in the UAE with a view to investing outside of the UAE.

Third-Party Service Providers

Under the Regulations, each domestic fund will be required to appoint an investment manager (may be the same as the sponsor), an administrative services company, a custodian and an external auditor. This will increase the costs of running a domestic fund.

PROMOTION AND OFFERING OF FOREIGN FUNDS

All foreign funds made available to investors in the UAE would need to be approved by ESCA and offered through a local promoter or, in limited circumstances, a locally established representative office.

Public Offering of Foreign Funds

In order to obtain ESCA's approval, the foreign fund must:

- Be incorporated in its home country and subject to supervision of the applicable controlling authority that is the equivalent of ESCA in the UAE (for example, the FSA in the UK or the SEC in the United States)
- Be licensed for the promotion of public offering in its home country

Even if the foreign fund meets the above requirements, ESCA reserves the right to impose (or exempt from) certain conditions on any public offerings of foreign funds and/or request additional documentation at its discretion.

After obtaining ESCA's approval, the foreign fund may then use any and all promotion means and market the fund to all investors.

Private Offering of Foreign Funds

A non-retail foreign fund that is not licensed in its home jurisdiction may be offered by way of private placement, but will be subject to approval by ESCA and to minimum subscription amounts. In a private placement, promotion is limited to direct contact with predetermined investors.

The minimum subscription amount for a subscriber investing by way of private placement is AED 500,000 or, in a foreign fund incorporated in a free zone outside the UAE, AED 1 million. Unlike many other jurisdictions, private placement availability is based entirely on the amount subscribed and does not take into account the investor's level of sophistication, income or net worth.

Some very limited exceptions do apply, such as subscriptions made pursuant to a savings and investment plan, and subscriptions by an ESCA-authorized investment manager on behalf of a client for whom he undertakes discretionary portfolio management.

Again, even if the foreign fund meets the above requirements, ESCA reserves its right to impose (or exempt from) certain conditions on any private offerings of foreign funds, and/or request additional documentation at its discretion.

Local Promoter

A foreign fund wishing to promote its units in the UAE, either by way of public or private placement, must appoint a local promoter. The local promoter must be either a bank or investment company licensed by the UAE Central Bank, or a company licensed for such purpose by ESCA.

In case of a private offering, the promotion can also be undertaken through a representative office in the UAE of an entity connected to the fund (or potentially its founder or operator), provided that the promotion is directed only at institutional investors who are required to invest at least AED 10 million each in the fund.

Role of the Local Promoter

The local promoter will act as an intermediary between the foreign fund and those to whom the units are promoted in the UAE. The promotion of the units in the UAE may only be undertaken by the local promoter.

Pursuant to the Regulations, the local promoter must provide all mechanisms that enable the foreign fund to satisfy its obligations to investors.

In addition, Article 39 specifies that the local promoter must:

- Exercise due care and diligence in selecting the foreign fund to be promoted in the UAE and must continue to monitor with diligence the performance of such fund to protect the investors
- Maintain a register of units distributed
- Provide all investors with a copy of the fund-offering document prior to any subscription
- Ensure that the investors are provided with access to the daily price for the fund units or the unit share of net assets of the fund
- Provide suitable means for the investors to have access to any disclosure and financial reports issued by the fund, such that the investors located in the UAE will have access to

such information at the same time as investors of the fund located in the fund's home country

- Provide investors with proof of subscription of the fund units
- Ensure that, prior to any subscription, the investors are aware of certain disclaimers, including that any approval by ESCA of the promotion of the foreign fund is not a recommendation by ESCA to purchase or invest in that foreign fund

Application

The local promoter will be required to file with ESCA the pro forma application form for the promotion of the foreign fund's units in the UAE, with all required attachments. ESCA in turn will be required to issue its decision to approve or reject the marketing of the foreign fund in the UAE within 30 days of receipt of a complete application form.

The supporting documents duly translated into Arabic that ESCA currently requires (which are subject to change) are:

- The key data regarding the fund (i.e. domicile, fund name, investment objectives, nature of fund, assets under management, type of capital, key investors in the fund, etc.)
- An undertaking by the fund to abide by all laws and regulations
- The fund prospectus or private placement memorandum
- An executed promotion agreement with the local promoter
- Memorandum of association, commercial license and the audited financial statements for the past two years

Existing Funds

Funds already in existence have one year from the date of publication in the UAE Official Gazette to adjust their activities to conform to the requirements of the Regulations.

Potential Impact on International Businesses

The Regulations will limit the ability of foreign funds to market themselves in the UAE on the informal basis that they have been doing. They will now have to go through a rigorous and what might potentially be a lengthy application process with ESCA. In addition, they will have to incur additional costs, which may be quite high, in order to retain a local promoter. Also, additional legal costs will be incurred as the relationship between the fund and the local promoter will have to be documented. One benefit, though, could be that the local promoter may be able to expedite the ESCA approval process. It is worth noting, however, that restrictions apply to the marketing of foreign funds within Western countries, including the UK and the USA. These are early days and there may be merit in revisiting the issue in light of practiced experience in a few months' time.

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