LATHAM & WATKINS

Number 1358 5 July 2012

Client Alert

Latham & Watkins
Corporate Department

Key Changes to the DIFC's Markets Law Regime Take Effect Today

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Following a public consultation process that began in April 2011, a number of key changes to the securities and capital markets legislation and regulations of the Dubai International Financial Centre (the DIFC) take effect from today, 5 July 2012.

The changes represent the stated aim of the DIFC's regulator, the Dubai Financial Services Authority (the DFSA), to more closely align the DIFC with leading benchmark jurisdictions and, in particular, the requirements of the EU Prospectus Directive (2003/71/EC) (the PD) and the EU Market Abuse Directive (2003/6/EC) (MAD). At the same time, the proposals seek to retain features and flexibility deemed necessary to accommodate the needs and circumstances of the capital markets in the United Arab Emirates (UAE) and the wider Gulf Co-operation Council (GCC) region. The changes affect a number of DIFC laws and regulations, including the DIFC Markets Law of 2004 and the Offered Securities Rules module of the DFSA Rulebook (the OSRs) — together referred to here as the "Markets Law Regime".

Changes taking effect today include:

- The new Markets Law (DIFC Law No. 1 of 2012) replaces the previous Markets Law of 2004 in its entirety.
- An all-new Markets Rules (MKT) module of the DFSA Rulebook replaces the OSRs and includes the new DFSA Listing Rules following the recent transfer of listing authority functions from NASDAQ Dubai to the DFSA.
- A number of consequential amendments to certain other modules of the DFSA Rulebook.

This *Client Alert* provides an overview of the changes. Note that capitalised terms used in this *Client Alert* and not defined herein have the meanings given to them in the updated Glossary (GLO) module of the DFSA Rulebook.

Changes broadly reflect public consultation. The changes discussed here broadly reflect the proposals outlined by the DFSA in its Consultation Paper No. 75 dated 20 April 2011 regarding the Markets Law Regime (CP 75) (see our *Client Alert* No. 1208 dated 21 June 2011), Consultation Paper No. 77 dated 15 June 2011 and Consultation Paper No. 78 dated 6 October 2011 regarding the proposed new DFSA Listing Rules.

Building on recent developments. These reforms build on other recent revisions aimed at harmonising the DIFC's regulations with those of leading international jurisdictions. These have included the introduction of the DFSA's new regime for Collective Investment Funds, which came into effect on 11 July 2010 (see our *Client Alert* No. 1078 dated 31 August 2010). The latest changes also reflect the recent split in regulatory functions between the DFSA, as the DIFC's regulator, and NASDAQ Dubai, as the DIFC's authorised securities exchange, which became effective on 1 October 2011.

Overview of Key Changes

New DFSA Listing Rules. On 1 October 2011, responsibility for administering the Official List and listing authority functions in the DIFC was transferred from the NASDAQ Dubai securities exchange to the DFSA. NASDAQ Dubai has retained responsibility for regulating the admission of securities to trading on its exchange, and on 6 February 2012 issued NASDAQ Dubai Consultation Paper No. 1 of 2012 in relation to its proposed new Admission and Disclosure Standards (see our *Client Alert* No. 1288 of 14 February 2012). In the transitional period from 1 October 2011 until the entry into force of the new DFSA Listing Rules (which are contained in Chapter 9 of MKT), the applicable listing rules in the DIFC were, strictly, those of NASDAQ Dubai but administered by the DFSA, although in practice market participants had regard to the provisions of the then-draft new DFSA Listing Rules. With the entry into force today of the definitive DFSA Listing Rules, this situation has been regularised. In terms of terminology, it is important to note that, generally, the term "admission" as used by the DFSA refers to the admission of Securities to the Official List, whereas when used by NASDAQ Dubai it generally refers to the admission of those Securities to trading on the exchange. It is also worth noting that, in both cases, it is the particular class of Securities — rather than the issuing entity itself — that is admitted.

Split mirrors UK position. This split in function between the regulator and the securities exchange mirrors the position in the United Kingdom, where responsibility for maintaining the UK's Official List and listing authority functions rests with the Financial Services Authority (in its capacity as the UK Listing Authority under the Financial Services and Markets Act 2000), while admission of securities to trading is regulated by the relevant securities exchange.

Listing Principles. The DFSA Listing Rules contain six overarching listing principles aimed at ensuring that Listed Entities "*pay due regard to the fundamental role played by them in maintaining market confidence and ensuring a fair and orderly market*". The principles include issuers (i) taking reasonable steps to ensure that its senior management and other relevant employees understand and comply with their responsibilities under the Listing Rules; (ii) maintaining adequate policies, procedures, systems and controls in order to enable compliance; (iii) acting with integrity towards holders and potential holders of a Listed Entity's Securities; (iv) communicating information to holders and potential holders of Securities in a way that avoids the creation of a false market in those Securities; (v) dealing with the DFSA in an open and co-operative manner and (vi) ensuring equal treatment of the holders of its Securities (in accordance with the rights attached to those Securities).

General eligibility requirements. The DFSA's Listing Rules contain a number of eligibility requirements which an issuer must satisfy in order to be eligible for admission to the Official List. These include obvious requirements such as being duly incorporated or established in its home jurisdiction, as well as more nuanced requirements such as demonstrating to the DFSA's satisfaction that the issuer's Directors have appropriate experience and expertise in the business operations of the applicant. More technical eligibility requirements include an applicant's ability to demonstrate independence from any controlling shareholder, free transferability of its Securities and demonstrating to the DFSA's satisfaction that it has sufficient working capital for its present requirements. An entity seeking admission of Securities to the Official List must have a market capitalisation of at least US$10 million in the case of Shares and US$2 million in the case of Debentures. There is also a requirement that at least 25 percent of a class of Shares admitted to the Official List must be in "public hands", and the Listing Rules set out the circumstances in which Shares will not be regarded as being in public hands, which are closely modeled on the equivalent provisions in the UK Listing Rules. The DFSA will generally require an entity seeking admission of Securities to the Official List to have published audited financial statements covering the period of three years prior to admission, but may accept a shorter period at its discretion.

Procedure for admission. The Listing Rules set out (in Rule 9.4 of MKT) the procedure to be followed and documentation required to be submitted to the DFSA in connection with an application for admission. The principal document to be submitted to the DFSA is the draft Prospectus, iterative versions of which are submitted on a confidential basis to the DFSA for its review and comment, with a final version submitted for DFSA approval shortly before admission.

Continuing obligations. Rule 9.7 of MKT sets out the post-admission obligations that a Listed Entity must observe in respect of listed Securities on an ongoing basis. In particular, these include continued observance of the Listing Principles, ensuring the Securities are admitted to trading on an AMI (as defined below) and compliance with market disclosure obligations described below.

Offers of Securities to the Public – *Circumstances triggering the requirement for a Prospectus.* The previous Markets Law Regime employed a three-way classification of all offers of securities in or from the DIFC as being either "Public Offers", "Exempt Offers" or "Unregulated Offers". This has been replaced with a structure that is more closely aligned with the PD regime and focuses on two types of activities, each of which triggers the requirement for a Prospectus pursuant to Article 14(1) of the new Markets Law. These are (i) an Offer of Securities to the Public in or from the DIFC; and (ii) an application to have securities admitted to trading on an "Authorised Market Institution" situated in the DIFC (an AMI), which is broadly equivalent to the concept of a "*regulated market*" as that term is used in the Listing Rules issued by the Financial Services Authority in the UK.

Definition of "Offer of Securities to the Public". The OSRs defined an "Offer of Securities" in terms of "offers" and "invitations" which directly or indirectly targeted investors. Where those investors were "Retail Clients" located in the DIFC, the offer or invitation would be a Public Offer triggering the requirement for a Prospectus. The definition of "Offer of Securities to the Public" contained in the new MKT module has broadened this to include a "communication to any person in any form or by any means, presenting information on the terms of the offer and the Securities offered, so as to enable an investor to decide to buy or subscribe for those Securities…". This definition is closely based on the EU model. Recognising that this is broader than the definition previously contained in the OSRs, MKT provides that, in line with the PD, those communications made in connection with the trading of Securities on an AMI or Regulated Exchange be excluded from the definition of "Offer of Securities to the Public".

Exemptions from the requirement to publish a Prospectus. The new Markets Law Regime provides for two specific exemptions from the requirement to publish a Prospectus, namely (i) in the case of an Offer of Securities to the Public which is an "Exempt Offer" under Rule 2.3.1 of MKT; and (ii) in the case of "Exempt Securities". Rule 2.3.1 refers to Exempt Offers as being offers which, among other things (a) are made to or directed at only Professional Clients other than natural Persons; (b) are directed at fewer than 50 Persons (in addition to Professional Clients who are not natural Persons) in any 12 month period or (c) are denominated in amounts of at least US$100,000 or equivalent. The new regime also follows the PD approach with regard to exempting offers made to "qualified investors" (which is broadly analogous to the DFSA concept of a "Professional Client"), but with one exception. The one divergence is that the DFSA does not apply the exemption in respect of an Offer of Securities made to a Professional Client who is a natural Person.

It should be noted that the question of whether an offer is an "Exempt Offer" for the purposes of MKT is only relevant in respect of the first of the two "triggers" for the requirement to publish a Prospectus (*i.e.* the making of an Offer of Securities to the Public in or from the DIFC). Where the second limb (having Securities admitted to trading on an AMI situated in the DIFC) is triggered, the fact that the offer is an Exempt Offer will not exempt the issuer from publishing a Prospectus. In practice, this means that the range of offerings that can be made without a Prospectus in the DIFC is considerably narrower than would be the case in the UK. This is because there is only one securities exchange in the DIFC (NASDAQ Dubai) and it is an AMI for the purposes of the Markets Law Regime (the Dubai Mercantile Exchange is also an AMI in the DIFC but it is an energy futures and commodities exchange). By contrast, in the UK, there are alternative exchanges available (such as AIM and PLUS Markets) which are not "regulated markets" and therefore the admission of securities to trading on those markets by means of an exempt offer under the UK regime would not trigger the requirement to publish a prospectus.

Secondary sales. The OSRs provided that, where Securities were offered by way of a Prospectus, a secondary offer of those Securities would not be treated as a new offer requiring a new Prospectus. This rule has been further developed in line with the PD. Where the original offer was made without a Prospectus in reliance upon an exemption, the subsequent offer will now be treated as a new Offer of Securities to the Public requiring a Prospectus unless that secondary offer itself qualifies as an "Exempt Offer" in its own right. It remains to be seen how significant this somewhat subtle tweak to the existing rule will be in practice. Clearly, this addresses the issue whereby the original offer is made to professional investors who require less regulatory protection but then potentially on-sell on the same basis to retail investors who require greater protection.

Approval and validity of a Prospectus. A notable feature of the previous regime was that, although the DFSA reviewed the contents of a Prospectus, it did not formally approve its publication. This differed from the position in many comparable jurisdictions. In line with the PD, the new Markets Law Regime provides that, going forward, the DFSA's formal approval of a Prospectus will be required before it can be published in the DIFC. In addition, whereas the OSRs were silent on the validity period for a Prospectus, MKT, again in line with the PD, provides that a Prospectus will have a validity period of 12 months from the date of approval.

Authorised Market Institutions. Under the OSRs, there was no requirement that Securities admitted to an Official List of Securities be also admitted to trading on an AMI. This contrasted with the position in the UK, where securities admitted to the Official List of the UK Financial Services Authority must also be admitted to trading on a regulated market (and vice versa). MKT now includes a requirement that Securities admitted to an Official List of Securities must also be admitted to trading on an AMI. Interestingly, an effect of this is that a Prospectus will now be required for any listing or offer of securities on an AMI, even if it is an Exempt Offer, since the admission of Securities to listing on an AMI is itself a trigger event requiring the publication of a Prospectus.

Obligations of Reporting Entities. A "Reporting Entity" for the purposes of the Markets Law Regime is generally the person who makes an Offer of Securities to the Public or has Securities admitted to trading on an AMI. An exception to this is in the case of a listed Fund, where it is typically the Fund Manager who constitutes the Reporting Entity. CP 75 contained a number of significant proposals in relation to Reporting Entities, their governance and disclosure obligations. The general theme running through the changes is one of fostering a culture of enhanced corporate governance, market disclosure and reporting, and is in line with similar developments in more established markets.

Definition of Reporting Entity. The revised rules contain an enhanced definition of "Reporting Entity". The enhancement of the definition is aimed at identifying with greater clarity the specific entity within an offer structure that is the Reporting Entity for the purposes of the regime, and ensuring that, as a result, the governance, disclosure and reporting obligations incumbent on a Reporting Entity are applied to the most appropriate entity within the structure. In the majority of situations, the issuer itself will be the Reporting Entity and there will be little need to focus on the definition. However, there are scenarios – such as in the case of a special purpose vehicle (SPV) issuer or a listed Fund, where another entity (*e.g.* the Fund Manager) will be the more appropriate person to serve as the Reporting Entity for regulatory purposes. The enhanced definition seeks to address such cases.

Governance of Reporting Entities. The changes taking effect today contain a number of changes to the DFSA's corporate governance requirements for listed companies to reflect recent amendments, effective in June 2010, to the UK Corporate Governance Code published by the Financial Reporting Council in the UK (the UK Code). In particular, in line with the approach taken in the revised UK Code, the DIFC's regime now includes an "overarching governance requirement", requiring a Reporting Entity to have "*a corporate governance framework which is adequate to promote prudent and sound management of the Reporting Entity in the long-term interests of the Reporting Entity and its shareholders*". This overarching requirement is supported by corporate governance "principles" which, despite their name, are effective as rules.

Directors' duties. MKT sets out in one place (section 3.3) the range of duties of directors' of Reporting Entities, including the duty to act in good faith and on an informed basis and to exercise due diligence in discharging their functions. These provisions were previously scattered throughout the 2004 Markets Law but have now been aggregated in a single section of MKT for ease of reference. Interestingly, as the DFSA itself pointed out in CP 75, these requirements or their equivalents are, in most developed jurisdictions, contained in the relevant companies legislation rather than in a listing regime. For example, the UK recently codified express directors' duties into the Companies Act 2006. This means that the directors of Reporting Entities in the DIFC are subject to express duties under MKT regardless of where the Reporting Entity is incorporated or established. In many cases these duties will be additional to existing directors' duties contained in the company law of the Reporting Entity's jurisdiction of incorporation or establishment.

Conflicts of interest, related parties and dealings by restricted persons. The new regime contains a number of provisions relating to conflicts of interest, largely benchmarked against the UK. It employs three separate definitions — "Related Parties", "Restricted Persons" and "Connected Persons", with corresponding provisions relating to transactions between such parties and a Reporting Entity or member of a Reporting Entity's Group. By the DFSA's own admission, there is a degree of overlap between these three classes of person, but this is by design as the specific restrictions applicable to each are designed to address different risks, and are modeled on the UK regime. The changes mark a widening of the scope of regulation for Reporting Entities in the DIFC, with the triggers and reach of disclosure and reporting obligations generally being expanded. The increased regulation of related party transactions, a more common feature of the corporate landscape in the Middle East, should be welcomed by all market participants.

In terms of dealings by Restricted Persons, the current "close period" during which dealings are prohibited has been expanded so as to ensure that dealings do not occur when information relating to a Reporting Entity is likely to be accessible to

Restricted Persons. In addition, the definition of "Restricted Persons" has been expanded beyond the Directors to include senior management.

In terms of transactions with Related Parties, the definition of "Related Party" has been clarified in line with the UK regime, so as to capture those persons who are likely to be able to obtain more advantageous terms than those available to independent third parties. The rules also now require disclosure to the market of transactions with parties who hold 5 percent or more of the voting rights of the Reporting Entity or its holding companies. This contrasts to 10 percent in the UK, Australian and Hong Kong regimes, and is a deliberate deviation by the DFSA in view of the more nascent nature of the DIFC as a capital markets jurisdiction and the need to protect investors.

Disclosure by Connected Persons is also addressed in the new regime, including through an enhanced definition of Connected Persons and specified circumstances in which disclosure is required.

Market Disclosure. The new Markets Law Regime includes a number of "refinements" to the DIFC's market disclosure regime (known as "continuous disclosure"). The changes are largely inspired by MAD and, in particular, the UK regime. Among the changes are a replacement of the dual concepts of "Material Information" and "Price Sensitive Information" with a single concept of "Inside Information" and the replacement of the previous requirement for market disclosure of Inside Information to be made "without delay" with the requirement for such disclosure to be made "as soon as possible", to accommodate short delays which may be justified in certain unexpected situations.

Listed Funds. Provisions applying to Reporting Entities of listed Funds (which will usually be the Fund Manager) have been brought together in a discrete chapter of MKT (chapter 6), with the exception of provisions relating to sponsors and systems and controls, which will be dealt with in chapters 7 and 8 of MKT, respectively.

Recent Additions and Other Changes. Additions to the Markets Law subsequent to CP 75 include a new Article 37, which introduces the concept of a list of "recognised persons" to be maintained by the DFSA. A person or body located in a jurisdiction other than the DIFC whose name does not appear on the list of recognised persons may not (i) be admitted as a recognised member of an Authorised Market Institution situated in the DIFC; or (ii) provide direct access to exchange, clearing house or alternative trading system facilities to persons in the DIFC. The criteria which a person must satisfy in order to be admitted to the list of recognised persons is set out in the new Recognition module of the DFSA Rulebook (REC), which also takes effect on 5 July 2012. The "recognition criteria" include a requirement that the recognised person be licensed or otherwise authorised in a jurisdiction acceptable to the DFSA, regulated by a financial services regulator to a standard satisfactory to the DFSA and subject to a legal framework broadely equivalent to that of the DIFC. A new Article 48 of the Markets Law provides that a Reporting Entity which is a Public Listed Company must appoint as its auditor a Registered Auditor **-** *i.e.*, an auditor registered by the DFSA in accordance with Part 8 of the Regulatory Law of 2008 of the DIFC.

The introduction of the new Markets Law and MKT module have necessitated consequential amendments to certain other modules of the DFSA Rulebook, and accordingly a number of amendments to the Fees (FER), General (GEN), Takeover Rules (TKO), Representative Office (REP), Price Stabilisation (PRS), Recognition (REC), Glossary (GLO), Authorised Market Institutions (AMI), Collective Investment Rules (CIR) and Islamic Finance Rules (IFR) modules also take effect on 5 July 2012.

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