Client Alert

Latham & Watkins
Corporate Department

DIFC Funds Update: The DFSA's New Regime for Collective Investment Funds

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This summer has seen the most significant reforms yet to the regulatory framework for collective investment funds in the Dubai International Financial Centre (the DIFC) since the introduction of the DIFC's funds regime in 2006. The changes are the result of recommendations from an industry panel appointed by the DIFC's regulator, the Dubai Financial Services Authority (the DFSA). The revisions confirm the DFSA's determination to enhance the attractiveness of the DIFC as a domicile of choice for investment funds, fund managers and other service providers. The aim of the new regime is to bring the DIFC in line with established funds jurisdictions.

The reforms, which came into effect on 11 July 2010, are contained in the Collective Investment Law 2010 (DIFC Law No. 2 of 2010), the Collective Investment Rules (CIR) module of the DFSA Rulebook and amendments to the Regulatory Law of the DIFC (DIFC Law No. 4 of 2004) and other rulebook modules issued by the DFSA.

This *Client Alert* provides an overview of the key changes of the new regime relevant for sponsors considering the DIFC as a potential fund domicile and for sponsors marketing Foreign Funds[1] in or from the DIFC. In summary, the key highlights are:

- A new Exempt Funds regime with a lighter touch regulatory burden for funds aimed at high net worth and sophisticated investors
- A DIFC-based Fund Manager is now able to manage an External Fund (*i.e.*, a fund established in a jurisdiction other than the DIFC) in certain circumstances
- An External Fund Manager (*i.e.*, a Fund Manager based in a jurisdiction other than the DIFC) may now manage a DIFC-based Domestic Fund
- The restrictions on marketing Foreign Funds in or from the DIFC have been significantly relaxed

New terminology. Those familiar with the previous DIFC funds regime will notice some changes in terminology. In particular, the concept of "operating" a fund has become that of "managing" a fund, and the term "Operator" has been replaced with "Fund Manager".

Exempt Funds regime. The DFSA has introduced a new category of fund — the "Exempt Fund". The Private Fund, which the Exempt Fund replaces, will be phased out over the next two years. The key benefit of an Exempt Fund is the lighter regulatory burden to which it is subject. A prospectus for an Exempt Fund (known as an information memorandum) is not subject to any specific content requirements, although it must, at a minimum, contain all the information which an investor would reasonably require and expect to find in such an information memorandum. By contrast, a prospectus for a Private Fund was required to comply with an itemised list of content requirements.

In order to qualify as an Exempt Fund, a fund must have no more than 100 investors, all of whom must be Professional Clients,[2] and the minimum subscription amount per investor must be at least US$50,000. An Exempt Fund may not be distributed by way of a public offer.

Managing an External Fund from the DIFC. For the first time, the DFSA now permits a DFSA-licensed Fund Manager to sponsor and manage a fund established in a jurisdiction other than the DIFC (an External Fund). An External Fund is generally not bound by the DFSA's ongoing compliance requirements that apply to DIFC-based Domestic Funds. However, the DFSA may assess the "desirability" of the jurisdiction in which the External Fund is established. The rules contain a non-exhaustive list of factors which the DFSA may take into consideration. These include the Fund Manager's need to establish the Fund in the particular jurisdiction, any regulatory risks and whether the relevant jurisdiction complies with FATF or other relevant international standards or requirements.

Managing a DIFC Domestic Fund from Overseas. The DFSA also now permits a Fund Manager based overseas (an External Fund Manager) to establish and manage a DIFC-based Domestic Fund without the External Fund Manager having to obtain a DFSA licence. The External Fund Manager must manage the fund from one of an approved list of recognised jurisdictions maintained by the DFSA (Recognised Jurisdictions).[3]

The External Fund Manager must also subject itself to DIFC law and the jurisdiction of the DIFC courts, and appoint a DFSA-authorised Fund Administrator or Trustee. The Fund Administrator or Trustee will undertake certain functions within the DIFC as agent for the External Fund Manager, such as liaising with the DFSA, acting as agent for service of process, maintaining the register of unitholders and making the fund prospectus or information memorandum available to investors in the DIFC.

Marketing of Foreign Funds. One of the key limitations of the DIFC as a funds jurisdiction to date has been its restrictions on the marketing of Foreign Funds in or from the DIFC. Under the previous regime, a Foreign Fund could only be marketed in or from the DIFC if it met the criteria of a Designated Fund[4] that was appropriately regulated in a Recognised Jurisdiction or met certain other criteria imposed by the DFSA — including that the Fund Manager and Custodian were authorised and supervised by a financial services regulator in a Recognised Jurisdiction.[5]

In addition to these exceptions, which are retained under the new regime, the DFSA now also permits the marketing of a Foreign Fund, provided at least one of the following criteria is met:

- The authorised firm makes a recommendation to a particular investor as to the suitability of investing in units in the Foreign Fund in light of that investor's investment objectives and circumstances
- The foreign fund is open to 100 or fewer investors, each of whom is a Professional Client and makes a minimum subscription of US$50,000 and is not offered to investors by way of public offer

It should also be noted that in no circumstances may a Foreign Fund be marketed to retail investors in or from the DIFC if it cannot be marketed to retail investors in its home jurisdiction.

Fees. The DFSA has also introduced a revised and more competitive schedule of fees. In particular, the fee for an application to become an authorised Fund Manager has been reduced from US$40,000 to US$10,000 and there is no fee for becoming an External Fund Manager. The registration fee for a Public Fund has been reduced from US$5,000 to US$1,000 and there is no fee for establishing an Exempt Fund, although there is an ongoing annual fee of US$4,000 for both Public Funds and Exempt Funds.

Our capabilities. Latham & Watkins LLP is a full-service international law firm with more than 2,000 lawyers in 30 offices around the world. We have been advising some of the most active strategic and financial dealmakers in the Middle East for more than 15 years. The firm's offices in Dubai, Abu Dhabi, Doha and Riyadh are staffed with more than 50 internationally qualified lawyers. Our regional investment funds practice has extensive experience advising clients on the formation of and investment in a wide variety of Shari'ah-compliant and conventional private investment funds, including private equity funds, real estate funds, venture capital funds, mezzanine funds, hedge funds and funds of funds. We regularly advise sponsors on accessing the US and European markets as well as on other regional securities issues, including DIFC and other local registration and licensing requirements and selling restrictions.

Endnotes

1 Unless otherwise defined in this *Client Alert*, capitalised terms used herein have the meanings given to them in the Glossary (GLO) module of the DFSA Rulebook (the Glossary Module).

2 The definition of "Professional Client" is contained in the Glossary Module, and includes a person who has net assets of at least US$500,000 calculated in accordance with Rule 2.4.1 of the Conduct of Business (COB) module of the DFSA Rulebook.

3 The current list of Recognised Jurisdictions is available on the DFSA's website at www.dfsa.ae. As of the date of this *Client Alert*, the list includes, among others, the United States, Australia, Hong Kong, Singapore, most European countries and certain established offshore centres, such as the Isle of Man, Jersey and Guernsey. It currently does not include Bermuda, the Cayman Islands or the British Virgin Islands.

4 The list of Recognised Jurisdictions maintained by the DFSA specifies which types of funds within the Recognised Jurisdictions are "Designated Funds" for the purposes of the rules. These include European UCITS compliant funds or schemes.

5 Alternatively, the Foreign Fund must have been rated or graded as at least "investment grade" by Moody's, Fitch or Standard & Poor's or such other international rating agency acceptable to the DFSA.

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