

Client Alert

Latham & Watkins
Corporate Department

UAE Funds Update: Proposed New Investment Funds Regulations in the UAE

The Emirates Securities and Commodities Authority (ESCA) published drafts of two new proposed investment funds regulations in January 2011 — a decision on the regulation of investment funds (the Investment Funds Regulation) and a decision on regulating investment management activity (the Investment Management Regulation). If adopted, these regulations would significantly alter the regulatory regime governing both the establishment and management of local investment funds (*i.e.*, funds domiciled in the UAE outside of the Dubai International Financial Centre (the DIFC), and the marketing of foreign investment funds in the UAE (outside of the DIFC).

The proposed changes to the UAE investment funds regime follow the adoption of revisions to the regulatory regimes governing investment funds in the DIFC, effective as at 11 July 2010 (see our *Client Alert* 1078 dated 31 August 2010), and the Qatar Financial Centre, effective as at 1 January 2011 (see our *Client Alert* 1131 dated 27 January 2011).

This *Client Alert* provides an overview of key aspects of the proposed regulations relevant for sponsors considering the UAE as a potential fund domicile or seeking to market funds in the UAE.

In summary, the key highlights are:

- The proposed regulations would create a new regulatory regime governing local investment funds (funds established in the UAE outside of the DIFC)
- A licence from ESCA would be required to conduct investment management activities in the UAE
- The marketing of a foreign fund in the UAE (outside of the DIFC) would require approvals from ESCA and the UAE Central Bank (the Central Bank), as well as the appointment of an ESCA-licensed local distributor
- The proposed regulations do not provide for a private placement exemption

New regulatory regime for local funds. The proposed regulations would establish a new regulatory regime governing the establishment and operation of investment funds in the UAE. The new regime would apply to all “local funds”, which does not include funds established in the UAE’s free zones, such as the DIFC. Under the Investment Funds Regulation, each new investment fund established in the UAE would need a licence from ESCA.

Among other things, the Investment Funds Regulation:

- Regulates which entities may sponsor local investment funds (*e.g.*, the sponsor must meet a minimum capital requirement)

“Under the proposed regulations, the marketing of a foreign fund in the UAE (outside of the DIFC) would require approvals from ESCA and the UAE Central Bank, as well as the appointment of an ESCA-licensed local distributor”

- Sets out detailed requirements for the contents of the governing documents of the investment fund
- Sets out requirements for the investment fund's investment policy, including diversification and other investment limitations
- Provides procedures that would govern the offering and subscription process
- Requires the preparation of quarterly audited financial reports
- Regulates the governance of the investment fund, including the make-up of its board and the holding of an annual general assembly of investors
- Imposes certain requirements and obligations on the investment fund's investment manager and service providers
- Provides for the Central Bank to be responsible for the supervision and inspection of the investment fund's financial situation and for ESCA to be responsible for the supervision and inspection of the investment fund's investment activities, redemptions and relationships with its related parties and service providers

The Investment Funds Regulation does not include a private fund or exempt fund scheme, which would subject certain funds to a lesser level of regulation based on the sophisticated nature of their investors or other criteria.

ESCA licence required for investment management activities. Under the Investment Management Regulation, an ESCA licence would be required in order to conduct investment management activities in respect of securities in the UAE. Investment management is defined to include the management of securities portfolios for others or the management of investment funds in accordance with defined investment objectives and policies. Such licences would be available to: (a) a company established in the UAE and 51 percent owned by UAE nationals and/or nationals of other Gulf Cooperation Council countries, (b) a local commercial bank, foreign investment bank or branch of a foreign

bank, with the approval of the Central Bank, and (c) an office or branch of a foreign company licensed by the UAE Ministry of Economy, subject to certain limitations determined by ESCA.

The draft version of the Investment Management Regulation published by ESCA does not expressly exempt investment managers in the DIFC from its provisions, but our understanding is that ESCA does not intend the regulation to reach the activities of investment managers within the DIFC.

ESCA and Central Bank approvals, and the appointment of a local distributor, required to market foreign funds.

Under the Investment Funds Regulation, ESCA approval would be required to market foreign funds (including DIFC funds) in the UAE (outside of the DIFC). The conditions for obtaining ESCA's approval include: (a) the investment fund must be licensed and subject to the supervision of an authority that is the equivalent of ESCA (or supervised by an authority in a UAE free zone), (b) the investment fund's related parties, which include its sponsor and service providers, must be licensed and subject to the supervision of an authority that is the equivalent of ESCA, (c) the fund must engage an ESCA-licensed local distributor to conduct its marketing in the UAE, and (d) the fund must be approved by the Central Bank for marketing in the UAE. Documents evidencing compliance with these conditions must be submitted to ESCA and accompanied by a certification from a legal advisor accredited by ESCA.

No private placement exemption. The proposed regulations do not provide for a private placement exemption. The Central Bank has generally tolerated discrete offerings of securities by unlicensed foreign companies to private investors provided that such conduct is limited to certain informally identified "tolerated practice" (e.g., the offering must be made to a discrete and defined group of sophisticated investors and all marketing must originate from outside of the UAE). As the proposed regulations address the marketing of foreign funds

in the UAE in greater detail than existing regulations and do not include a private placement exemption, the continued viability of this "tolerated practice" regime appears to be in question.

Transitional period. The Investment Funds Regulation provides that entities currently conducting investment funds activities must come into compliance with the new regulations within one year. The Investment Management Regulation provides for a similar transitional period, although its duration is not specified.

Comment period. ESCA has indicated that it will accept comments on the proposed regulations until the end of February 2011. We would encourage all interested parties to provide comments to ESCA.

Our capabilities. Latham & Watkins LLP is a full-service international law firm with more than 2,000 lawyers in 30 offices around the world. The firm's offices in Dubai, Abu Dhabi, Doha and Riyadh are staffed with more than 50 internationally qualified lawyers. Latham's investment funds practice

includes more than 80 investment funds attorneys worldwide with resources in key financial centres across the globe. We have 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, 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 UAE and other local registration and licensing requirements.

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