JUNE 2014

COMMENTARY

Investment Funds in the Dubai International Financial Centre: A Lighter Touch Coming?

There are currently a number of different options for establishing and offering investment funds from the United Arab Emirates (the "UAE"), and all of these options are highly regulated. One option is to establish a fund in the Dubai International Financial Centre (the "DIFC"), an economic free zone located in Dubai, established as an international financial hub with its own laws and regulations. Financial services in the DIFC are regulated by the Dubai Financial Services Authority (the "DFSA"). Anyone wishing to establish or manage a fund in the DIFC (or offer fund units into the DIFC) must comply with the DFSA's regime relating to the regulation of collective investment funds (the "DIFC Funds Regime"). This regime was relaxed in 2010 with the intention of promoting the DIFC as an attractive international forum from which to manage or establish funds. Since this relaxation, the DFSA has recognized that there is capacity to provide an even greater degree of flexibility for the establishment and offering of funds aimed at professional investors. As a result, proposals are currently well advanced to introduce a further category of fund in the DIFC with less onerous regulation to allow the DIFC to compete further with the world's other leading fund centers.

Establishing and Managing Domestic Funds in the DIFC: The Current Regime

The DIFC Funds Regime makes a distinction between funds established in or managed from the DIFC ("Domestic Funds") and foreign funds ("Foreign Funds"), which may only be offered into the DIFC under certain conditions.

In order to establish or manage a Domestic Fund in the DIFC, the fund manager must either:

- Be licensed directly by the DFSA and based in the DIFC; or
- Operate from a jurisdiction either recognized by the DFSA (for the purposes of which the DFSA publishes a "Recognized Jurisdictions List") or assessed by the DFSA as providing an adequate level of regulation (an "External Fund Manager").

An External Fund Manager must appoint a DFSA-licensed fund administrator or trustee, who will be required to undertake certain functions including acting as the local agent of the External Fund Manager to deal with the DFSA and its regulatory processes.

Types of DIFC Domestic Funds. The following types of Domestic Funds are currently available in the DIFC:

- **Public Funds.** Public funds may have more than 100 investors, can be offered to investors by way of a public offer, and their investors may include retail investors. As public funds are open to retail investors, extensive prospectus, disclosure, and regulatory requirements apply.
- **Exempt Funds.** Exempt funds may have up to 100 investors only, must be offered only by way of private placement, and all investors must be "professional clients" based on criteria set out in the relevant DFSA regulations. Exempt funds have the same qualification criteria as private funds but with a minimum subscription of US$50,000 from each investor. Exempt funds are subject to less regulation than public funds but remain regulated to a significant degree by the DFSA.

Types of Fund Vehicle and Application to Specialist Funds. There are currently three types of fund vehicles that can be used to establish a Domestic Fund in the DIFC:

- **Investment Company.** An investment company needs to be incorporated in the DIFC, and the fund manager must be a corporate director of the Investment Company. This vehicle is suited to general purpose funds.
- **Investment Trust.** An investment trust needs to be established by trust deed between a fund manager and a trustee. The trustee can either be licensed directly by the DFSA (and based in the DIFC) or may be a person regulated and supervised in a "reputable jurisdiction" for custody or depository services. Property funds are often structured as investment trusts. Property funds in the DFIC must be closed-ended funds and are subject to substantial further regulation if they are public funds. Real Estate Investment Trusts ("REITs") are available as a specific fund structure in the DIFC with specific further regulation and must be public funds and listed on an authorized exchange or clearing house.
- **Investment Partnership.** An investment partnership is a limited partnership registered in the DIFC. The General Partner must be authorized directly by the DFSA to act as the fund manager. Private equity funds are often structured as investment partnerships.

A Proposed New Category of DIFC Fund

In December 2013, the DFSA issued a consultation paper proposing a new and significantly less onerously regulated category of Domestic Fund. This category is the "qualified investor exempt fund" ("QIEF").

The DFSA has stated that its proposal to introduce the QIEF was made following reviewing other jurisdictions that have exempt fund or similar regimes, including Bahrain, the British Virgin Islands, Luxembourg, the Cayman Islands, Ireland, Singapore, and the UK. In making this proposal, the DFSA has recognized the need for more flexibility than was provided with the introduction of the exempt funds regime in 2010.

In order for a fund to qualify as a QIEF and benefit from the less stringent regulatory regime, the following criteria have been proposed:

- A minimum subscription of at least US$1 million; and
- A maximum of 50 investors, all of whom must be "professional clients."

QIEFs will be able to be offered only by way of private placement.

The proposed introduction of QIEFs has come in part as a response to the number of applications that have been received by the DIFC for waivers from or modifications of certain aspects of the DFSA's regulatory regime when establishing exempt funds. As such, the proposed relaxations are a targeted response from the DFSA to the perception that regulation of exempt funds in the DIFC is still considered too onerous by some for the purposes of establishing a fund targeting professional investors.

Some of the proposed relaxations for the regulation of QIEFs include the following:

- Removal of the majority of specialist fund regulatory requirements;
- Removal of the need to appoint a custodian;
- Significantly reduced requirements for disclosures in the fund constitution and information memorandum; and

- Only annual reports being required (unless there is a "material change," in which case an interim report will still be required).

While the proposed regulatory regime for QIEFs is significantly relaxed in terms of regulation of the fund itself, fund managers will continue to need to be licensed by the DFSA and be subject to its existing general duties, systems, and controls. In part, this focus on regulation of the fund manager itself reflects trends in other prominent funds jurisdictions, including the recently introduced AMIFD regime in the European Union.

Final Thoughts

The DFSA's proposal to introduce a new category of funds with significantly less onerous regulatory requirements is to be welcomed. The introduction of the QIEF, which could occur as early as in Q4 of 2014, should further boost the DIFC's credentials as a center for fund establishment, and we look forward to the implementation of these proposals.

Lawyer Contacts

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

Eric J. Milne
Dubai
+971.4.709.8412
emilne@jonesday.com

Daniel Partovi
Dubai
+971.4.709.8403
dpartovi@jonesday.com