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The UAE Securities and Commodities Authority (“SCA”) has published new Investment Funds Regulations (SCA Board Resolution No. 37 of 2012) (the “Regulations”). The Regulations are likely to significantly impact the way in which foreign funds are marketed in the UAE.

Promoters of foreign funds and other securities investments that are marketed in the UAE should comply with the new Regulations. However, the Regulations are inflexible on their face and strict compliance may prove time consuming, costly and/or unduly burdensome.

Therefore, a key question is the extent to which the current “tolerated practices” regime will continue to apply. Until now, promoters of foreign funds and other securities investments relied on “tolerated practices” when making occasional trips to the UAE to market investment opportunities to a small number of sophisticated high net worth and institutional investors.

SCA certainly has the authority to sanction any non-compliant activity that previously fell within “tolerated practices”. We expect that, as time passes, SCA will gain experience in the implementation and administration of the new Regulations, and more robust conclusions regarding the extent of tolerated practices will become possible. In the meantime, no conclusive legal conclusions can be drawn. We believe that neither we nor any other lawyer can advise that any particular “tolerated practice” is legal.

That said, solely as a matter of commercial risk assessment, we would expect that the following is true:

- If an existing fund sponsor meets with an existing investor in the UAE (on a fly-in, fly-out basis) as part of its customary client care procedures to discuss portfolio performance and related matters and, in the course of that conversation, invites the investor to contact the sponsor to discuss identified new investment opportunities, where the principal purpose of the meeting is not to market new opportunities, we expect that the risk is remote that SCA would not tolerate the practice.
- If a fund sponsor contacts a sophisticated or institutional investor with which it has a pre-existing relationship following a “reverse solicitation”, we expect that the risk is remote that SCA would not tolerate the practice. This view is supported by comments reportedly made by SCA officials at a public meeting in November 2012.
- If a fund sponsor meets with several prospective new and existing investors in the UAE (even on a fly-in, fly-out basis) to market a new fund investment opportunity and to distribute promotional literature about the fund, we expect that doing so without complying with the new Regulations carries a more significant risk.

Ultimately, the degree of such “tolerated practices” will depend upon the circumstances in which SCA chooses to strictly enforce the Regulations and this may take some years to become apparent.

The Regulations came into effect on 27 August 2012. There is a grace period of one year to bring existing funds into line with the new Regulations. As a practical matter, however, this grace period applies only to existing UAE established funds and does not apply to the marketing of foreign funds in the UAE following the effective date of the Regulations.

This note highlights some significant provisions in the Regulations concentrating, in particular, on those aspects that relate to the marketing of foreign funds in the UAE on a private placement basis.

## 1. Overview

**1.1** The Regulations are the UAE’s first attempt to comprehensively regulate the promotion of funds (whether domestic or foreign) and the establishment of domestic funds in the UAE. While the Regulations are relatively detailed, at around 30 pages of text (compared to other regulations issued by SCA), many parts of them are vague and will require regulatory clarification.

**1.2** The Regulations distinguish between domestic funds (i.e. those established in the UAE) and foreign funds (i.e. those established outside of the UAE and those established in the UAE’s free zones (e.g. DIFC)).

## 2. Pre-Approval Requirement

**2.1** All marketing of foreign funds (whether to the public or on a private placement basis) must be approved by SCA. SCA has 30 days in which to approve or reject the application to market the fund.

**2.2** SCA has a wide discretion to impose “any conditions and to require any documents” it considers appropriate. This wide discretion could mean that SCA imposes conditions with regard to the type of foreign fund that can be marketed, the fund jurisdictions it considers appropriate and so on. No further guidance is available from SCA at this stage.

## 3. Private Placements and Marketing

**3.1** Private placements of foreign funds will require:

**3.1.1** offers to be made only to pre-identified investors – it is unclear whether SCA will require the list of pre-identified investors as part of the approval process; and

**3.1.2** a minimum investor subscription of AED 500,000 (for most foreign funds including those established in UAE free zones) or AED 1,000,000 (for those foreign funds established in a “free zone outside of the State [i.e. UAE]” – while it is clear what a UAE free zone is (e.g. DIFC), it is unclear what SCA might consider a

“free zone outside of the State” to include and there is a concern that offshore jurisdictions like the Cayman Islands might be considered by SCA to fall into this category).

**3.2** All marketing of units in a foreign fund (whether on a public or private placement basis) must be carried out by a locally licensed bank or financial institution. In other words, the marketing of foreign funds must be “chaperoned” by locally licensed institutions.

**3.3** The exception to the “chaperone” requirement is that a foreign fund may be marketed by the UAE (not DIFC) based “representative office of the foreign company” provided that (i) the marketing is directed at institutions only and (ii) the minimum investor subscription is AED10,000,000.

**3.4** A few thoughts spring to mind with regard to the usefulness of this “representative office” exception:

**3.4.1** It is unclear what is meant by “representative office of the foreign company”. Is the exemption limited to foreign banks and fund sponsors with Central Bank licensed representative offices (to allow them to continue marketing their own fund products) or is it intended to include non-Central Bank regulated UAE representative offices? We consider the former view to be correct. If SCA’s intention is the latter then clarification (and perhaps further regulation) from SCA and the Central Bank would be required.<sup>1</sup>

**3.4.2** Marketing is limited to institutions and the minimum investor subscription level is set at AED10,000,000. The institution only restriction, in particular, inhibits the usefulness of the exemption as a significant body of wealthy investors in the Middle East tend to be high net worth individuals (not just institutions).

## 4. Violations

**4.1** Anyone violating the provisions of the Regulations can be warned, fined or have any licences/approvals granted, suspended or cancelled.

**4.2** The Regulations do not, however, give SCA the power to declare the investment/subscription agreement between the fund and the investor void.

## 5. Impact on Tolerated Practice

**5.1** Historically, the UAE has been one of the most loosely regulated jurisdictions in the region as regards the offshore marketing of securities, including funds. The UAE authorities have generally not sought to enforce the law in respect of foreign entities (i.e., those entities not licensed to do business in the UAE) engaging in the marketing of securities (including units in a fund) to targeted investors in the UAE provided that such marketing is carried out within the confines of certain “market practice” (also referred to as “tolerated practice”).

**5.2** This “market practice” has developed over many years due to the lack of a formal private placement regime and appropriate exemptions from the requirements to seek approval and be licensed. Such practice has been widely used by foreign entities in marketing securities in the UAE and involves adhering to a combination of the following: (i) pre-identifying investors that are sophisticated and of sufficient net worth to be capable of absorbing the risks in making the investment; (ii) ensuring that marketing is carried out by a person/entity with no legal/physical presence in the UAE; (iii) ensuring that marketing in the UAE is limited, solicited by the investor, done on a one-on-one basis and discreet; and (iv) ensuring that contracts to invest and payments are made outside of the UAE. Prior to the Regulations, this practice was generally accepted by the legal community as reducing, albeit not eliminating, the risk of action by the UAE authorities in relation to the marketing of foreign funds.

**5.3** Now that there is a separate private placement regime in respect of funds (albeit, one requiring SCA approval and the use of licensed intermediaries), there is considerable uncertainty on the extent to which, the UAE authorities will continue to tolerate such market practice in relation to the marketing of foreign funds in the UAE.

**5.4** Given the inflexibility of the private placement provisions in the Regulations, it is probable (though not certain) that a new version of “tolerated practices” will develop. Based on comments reportedly made by SCA officials at a public meeting in November 2012, it appears that SCA could be open to tolerating marketing on a “reverse solicitation” basis (N.B. there is no such exemption in the Regulations). Ultimately, the degree of “tolerated practice” will depend upon the circumstances in which SCA chooses to strictly enforce the Regulations and this may take some years to become apparent.

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<sup>1</sup> Currently under UAE law, only Central Bank licensed representative offices of foreign financial institutions may promote their financial products/investments in the UAE. SCA would need to clarify whether the representative office that a fund sponsor establishes is to be: (i) a Central Bank licensed representative office (which is practically only available to banks and therefore a “non-starter” for many fund sponsors); or (ii) a representative office under a new SCA regime – there is nothing in the Regulations to indicate SCA is intending to put such a regime in place.