

# A Guide to Hedge Funds in the UAE

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# A GUIDE TO HEDGE FUNDS IN THE UAE

## FREQUENTLY ASKED QUESTIONS

### 1. What is the regulatory framework which regulates Hedge funds?

There is no distinction between the types of hedge funds available in UAE however, the law makes a difference between funds domiciled in the different jurisdiction, which means either in the Dubai International Financial Center (**DIFC**) or within the UAE, commonly known as the "**UAE Mainland**", and in Abu Dhabi Global Market (**ADGM**).

The laws and regulations governing hedge funds in UAE differ with the jurisdiction. DIFC and ADGM have their own legislative framework for regulating hedge funds and other financial activities. The Laws are as follows:

#### UAE Mainland

The Federal Law Number 10 of 1980 regarding the



Central Bank, the Monetary System and Organization of Banking (the **Banking Law**) is the legislation giving the UAE Central Bank the authority to regulate financial services in the country. Subsequent and important pieces of legislation are as follows:

- Central Bank Resolution 164/A/94 regarding the regulation of the financial companies and banking, and financial and investment consultation establishment of companies;
- Central Bank Resolution 89/3/2000 concerning the amendment to the regulation of investment companies and the banking and financial investment consultation companies;

- Central Bank Resolution Number 58/3/96 with regards to the regulation of the financial companies;
- Central Bank Resolution Number 21/2/88 with regards to the system of investment banks in the country;
- Securities Commodities Authority (**SCA**) Resolution Number 3 of 2000 concerning regulations on disclosure and transparency;
- SCA Resolution Number 4 of 2000 concerning the Emirates SCA and market; and analysis; and
- SCA Resolution Number 48 of 2008 concerning financial advice
- SCA Resolution Number 37 of 2012 concerning the regulations as to mutual funds.

#### DIFC

Specific DIFC laws administered by the DFSA regulate hedge funds within the DIFC market: DIFC Law 12 of 2004 in respect of judicial authority at DIFC (the **Judicial Authority Law**); DIFC Law 1 of 2004 regarding regulatory law (the **Regulatory Law**); and DIFC Law 1 of 2006 concerning the collective investment (the **Collective Investment Law**). In addition to the foregoing laws administered by the DFSA, several modules of the DFS A Rulebook are relevant, including but not limited to the Collective Investment Rules and the Offered Securities Rules.

#### ADGM

In ADGM, the regulating laws governing hedge funds market are as follows:

- i. The Financial Services and Markets Regulations of 2015 and its amendment of 2017; and**
- ii. The Common Reporting Standard Regulations of 2017.** Additionally, there is very less number of funds which are domiciled in the UAE Mainland. ADGM and DIFC are preferred areas for foreign investors to domicile their funds instead of UAE mainland, as there is no requirement of majority ownership by UAE national.

DIFC and ADGM offers a wide variety of corporate structures familiar to the international investment community such as Limited Liability Company (LLC), Company limited by shares, partnerships and investment companies.

## *How to qualify as an investor for a hedge fund?*



It is also possible to register branches of foreign corporations or partnerships in the DIFC. Nonetheless, it remains the case that the DIFC has had limited success in attracting fund managers.

### **2. What are the authorities responsible for governing hedge funds in UAE?**

#### **UAE Mainland**

The Central Bank of UAE established under Federal Law Number 10 of 1980 concerning the Central Bank, the Monetary System and Organization of Banking (the Banking Law) and the SCA established under Federal Decree Number 4 of 2000 regulates all the financial activities in UAE including hedge funds. SCA has an oversight of functions with regards to listed securities and the promotion of foreign funds.

#### **DIFC**

Dubai Financial and Services Authority (**DFSA**) established under DIFC Law Number 1 of 2004 governs the activities conducted by the financial center. As aforementioned, DIFC has its own legal and regulatory system regulating hedge funds and other activities. Moreover, DIFC's separate courts and arbitration centers adjudicate the matters thereof.

#### **ADGM**

ADGM has established Financial Services Regulatory Authority (**FSRA**) which governs and regulate all the financial activities within the free zone.

### **3. What are the essential requirements for the investors to qualify for the hedge funds regime?**

The UAE Central Bank and SCA do not make a difference between retail and expert or professional investors. It is mandatory for the authorized firms to classify their clients as the following:

- i. A** retail client;
- ii. A** personal client;

**iii. A** professional client about specific services and products and a retail client about other services and products.

The DIFC's collective investment funds regime (applicable to hedge funds) is stipulated under the Collective Investment Law and the Collective Investment Rules. Wherein, the law defines Collective investment funds where:

- I. The** primary purpose is enabling the participants who are taking part in the arrangement to profits and/or benefits arising out of the acquisition, holding, management or disposal of the property or other assets of the arrangement;
- II. The** rules do not require participants to regular control with regards to the management of assets or property of the arrangement, and
- III. The** assets or property of the arrangement are pooled or managed as a whole. Some provisions that would normally be included within this definition are here excluded, for example franchises and time-share rights.

Collective investment funds could be as either public funds or exempt funds. The difference between the two latter is that an exempt fund can have no more than hundred (100) investors qualified as the professional client while units of a public fund can be offered to retail clients. Exempt funds can only use private placement and not by way of a public offering to seek investment. There is a minimum subscription level of USD 50,000 (United States Dollar fifty thousand) for exempt funds. DIFC's collective investment funds regime includes that they must:

- I. Have** a DFSA-licensed fund manager;
- II. Comply** with the anti-money laundering rules
- III. Have** constituent documents with respect to the standards of the DFSA;
- IV. Respect** the pricing of the DFSA;
- V. Be** subject to accounting and audit requirements,

**VI. provide** certain periodic reports, including annual and interim reports; and

**VII. property** funds, private equity funds, Islamic funds or hedge funds shall be subject to fund-type specific additional requirements.

**4. Are there any conditional requirements which is applicable to hedge funds in this jurisdiction?**

Some conditions may be applied at the time of registration or authorization by the Central Bank. For example, the DFSA's Hedge Fund Code of Practice (*the Code*) recommends that hedge fund managers set in measures enabling it to monitor, assess and quickly modify the level of leverage.



**5. What are the other requirements which the investor must keep in mind prior to registering funds in UAE?**

*Offering Prospectus for funds*

**UAE Mainland**

The UAE Central Bank imposes a mandatory requirement for the applicants to have a prospectus. This must include complete details regarding the objective of the fund, its investment policies, through which its assets will be valued and the management of fund will be ascertained. The UAE Central Bank does not impose any further specific requirements in respect of hedge funds. The SCA does not impose additional requirements for any offering documents, although certain information from such documents must be submitted as part and parcel of its application procedure.

**DIFC**

An outline for a DIFC public fund must include but not limited to general information's, general statements investment objectives, complete details of the units in the fund limitations on the fund's units, information with respect to income and distribution, a statement specifying the base currency of the fund, details concerning the procedures for the convening the meetings and the procedures relating to board resolutions, voting and the voting rights of shareholders; details of the oversight arrangements, and if the fund is an Islamic fund the details of its Shari'a supervisory board; information regarding termination and suspension details regarding the manner in which alterations were made to the constitution; also a responsibility statement to the effect mentioning that a change in the constitution will not have an effect of exempting the fund manager and, if the fund is framed as an investment trust, the trustee, from any liability to shareholders imposed under DIFC law; and any other relevant matters.

*Directors and Board Meetings*

The use of any of the regular corporate vehicles in the UAE Mainland or the DIFC requires director's appointment for that entity, the number of which will vary, which depends upon the type and size of the entity. In the DIFC it is possible to establish a 'special purpose company', but even these require the appointment of at least two directors.

*Filing and Consent*

**UAE Mainland**

Investment companies established in UAE mainland are required to file their audited annual accounts with the UAE Central Bank. Also, a prior approval of UAE Central Bank is required if there is any change in the corporate form or ownership.

The licensed management services company handling the investments of a foreign fund in the territory must file the fund's audited quarterly and annual financial statements with the SCA and are required to publish the company's financial reports in two widely circulated local daily newspapers (*where at least one newspaper should be in Arabic*).



## DIFC

DFSA-authorized firms are required to make quarterly filings regarding, among other things, their capital adequacy. The disclosure regime within the DIFC is significantly more substantial than that in the UAE Mainland.

### **6. Are there any pre-requisites for local and non-local service providers?**

The primary requirement is that the foreign funds should be marketed by local establishment should be licensed by relevant ministries, if there is any onshore element to the offering. However, the investment companies licensed by the UAE Central Bank and licensed enterprises as local promoters by the SCA are allowed to directly market their funds to investors in the UAE. Similarly, the conduct of any financial service in or from the DIFC will require a DFSA authorization of some sort.

There are no requirements for non-local service providers.

### **7. Under what circumstances a person will be considered as a professional client?**

In order to consider a person as a professional client, the person should either:

- (i) has** net assets of at least USD 500,000 (United States Dollar five hundred thousand); or
- (ii) is** or has been in the previous two (2) years an employee of the authorized firm or a professional employee holding a professional position in another authorized firm.

Additionally, professional clients must appear on reasonable grounds to have sufficient experience and have knowledge of the relevant financial markets, transactions, products and any other associated risks and, finally, must not have treated as a retail client.

### **8. Are there any steps to be followed by the investor in order to establish hedge fund in UAE?**

#### **UAE Mainland**

In the UAE Mainland, a UAE Central Bank license is required in order to establish an investment fund (including a hedge fund).

The UAE Central Bank has the right to supervise over investment funds. However, several licensing responsibilities have been given to the SCA.

Also, the SCA has to oversee the marketing and promotion of any foreign fund, particularly where the fund is marketed and promoted by a foreign entity located offshore or from a representative office located in the UAE. The approval of the promotion from SCA is required for a foreign fund in order to be promoted in the UAE, and only a local promoter shall promote a foreign fund.

## DIFC

DFSA authorizations are required before any type of fund can be established, operated or marketed in or from the DFSA. The specific DFSA authorizations for a fund manager and distributor would generally include: arrange credit or deals in investments; advice on financial products or credit; managing a collective investment fund; and managing assets.



## ADGM

Within ADGM as well, one or more FSRA authorizations are required before any type of fund establishment.

### **9. Does the law mention any documentary requirements to be submitted prior to the registration of hedge funds in UAE?**

#### **UAE Mainland**

The applicant is required to submit an application for the license in UAE Central Bank for establishing a form or to the SCA for establishing a local promoter company. Apart from the application, the applicant is required to submit constitutional documents and a business plan for the activity. The relevant authority does not mention a complete list of documents required along with the application. The Central Bank or the SCA notify



*The Time-line and Cost involved in registering Hedge Funds is one of the Major Consideration.*

the applicant regarding the list of documents required for seeking approval. The SCA also requires an applicant seeking approval for the promotion of a foreign fund to submit the following documents:

- i. Information** regarding the key fund;
- ii. A NOC** from the local promoter;
- iii. A signed agreement** for promotion or the fund offering document.
- iv. The last two (2) years audited financial statements** of the applicant.

#### **DIFC**

Applicants submitting applications for DFSA authorizations are required to submit a regulatory business plan and multiple application forms. Applications must be made for the specific category of financial services which is to be conducted and also in respect of the individuals who will fill in the mandatory appointment positions in the company. Authorized individuals are required to adhere to mandatory standards relating to experience, knowledge, and qualifications. Applicants will be given authorization if DFSA is satisfied that they are fit and will justify their role in a sound and prudent manner.

#### **ADGM**

Applications for ADGM requires the filling of an application form as well as supporting documents such as Model Articles and Board Resolution templates.

### **10. Is there any timeline which needs to be followed while registering hedge funds in UAE?**

#### **UAE Mainland**

There is no prescribed timeline for seeking the reply from Central Bank or SCA for any type of license. It completely depends upon the documents submitted to the authority.

The requirement that all foreign documents are fully authenticated adds to the time required to make the

initial application. The SCA will respond to a request for approval of the promotion of a foreign fund within thirty (30) business days.

#### **DIFC**

In comparison with UAE Mainland, the applications filed with DFSA, generally proceed at a swifter pace. However, the whole procedure might take couple of months since the time the applicant submits and application and DFSA issues its preliminary approval letter.

The DFSA's current aim is to complete its review of a full application within fifty (50) business days of receipt of the application documents.

### **11. What are the cost and charges involved in permits and licenses in the UAE?**

#### **UAE Mainland**

No charge registration or license fees are applied for the initial and ongoing of registration in the UAE Mainland. However, if a UAE Central Bank license is being sought then the applicant wants a UAE Central Bank license, then a form of local corporate presence needs to be established. Thus, administrative fees have to be paid in respect of that corporate entity including registration fees and an annual licensing fee. The amount will vary with regards to the type of corporate entity as well as the size of the local operation.

#### **DIFC**

Regarding the DFSA, the fees for an authorization to manage a collective investment fund are up to USD 10,000 (United States Dollar ten thousand). There is also a fee of USD 10,000 (United States Dollar ten thousand) to register a domestic public fund. Then, an annual fee to the DFSA of USD 10,000 (ten thousand Dollars) plus USD 1,000 (One thousand Dollars) for each USD 1 million (One million Dollars) of expenditure has to be paid by the manager of the investment fund. In addition to the fees

levied by the DFSA, initial and ongoing fees to the DIFC Registrar of Companies have to be paid by the DIFC entities. Finally, it is mandatory requirement for DIFC entities to have a physical office DIFC entities within the free zone. However, DIFC rents are significantly higher than in the UAE Mainland.

#### **ADGM**

The initial registration fee in ADGM is USD 15,000 (United States Dollar fifteen thousand).

### **12. What is the code that sets out the standards of good practice and manners?**

The Hedge Fund Code of Practice (the **Hedge Fund Code**) has been implemented by the DFSA as the standard for good practice and manners for the operators of hedge funds in DIFC to practice within the field. The principles mentioned below are formulated in such way that they address the risks inherent in the operation of hedge funds:

**Principle 1** – a fund manager of a hedge fund should have, or have access to, appropriate skills and resources to conduct the operations of the fund;

**Principle 2** – a fund manager of a hedge fund should develop and implement a robust and flexible investment process to suit the objectives and risk profile of its investment strategies;

**Principle 3** – a fund manager of a hedge fund should have systems and controls to mitigate trading related risks such as price overrides and failed trades;

**Principle 4** – a fund manager of a hedge fund should have adequate back-office systems and controls to avoid backlogs in trade confirmations;

**Principle 5** – a fund manager of a hedge fund should have appropriate measures to identify and manage portfolio risks;

**Principle 6** – a fund manager of a hedge fund should have adequate valuation policies and procedures to ensure integrity, accuracy and timeliness of the valuation process;

**Principle 7** – a fund manager of a hedge fund should not have arrangements under which any material benefits or concessions are provided to some investors where it would be unfair to any other investors in the fund;

**Principle 8** – a fund manager of a hedge fund should have adequate systems and controls to deal with market sensitive information; and

**Principle 9** – a fund manager of a hedge fund should not invest in an underlying hedge fund without appropriate due diligence.

### **13. Does the Law stipulate any restrictions on funds not based in UAE?**

There are several restrictions and/or consequences of some activities on funds which are not based in UAE such as:

**i. The** investors prior to undertaking any commercial activity with UAE or in DIFC or ADGM must seek an appropriate license from the relevant authorities in the different jurisdiction. Also, if the investor is just conducting board meetings within UAE, it will not constitute as 'commercial activity' within UAE.

**ii. For** all the local service providers, it is the primary requirement to hold a valid UAE license for any activity conducted within UAE.



**iii. SCA** has implemented new regulations, through which the fund managers are mandated to appoint a licensed local service promoter to promote their vehicle.

### **14. What (if any) are tax implications in your jurisdiction for local investors?**

The Abu Dhabi and Dubai government are promulgating income tax regimes being Abu Dhabi Tax Decree 1965 and Dubai Income Tax Decree 1969 which is yet to be enforced. It is still unclear whether or not the taxation regime applies to industries except hydrocarbon industry and branches of foreign banks established in UAE. Whereas, currently under the prevalent taxation regime, there is no mandate for withholding or deduction on payments of accrued return and/or principal on investments.

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