Dubai Financial Services Authority

A Guide to the DFSA Funds Regime

Dubai International Financial Centre (DIFC) and the Dubai Financial Services Authority (DFSA)

The DIFC is a purpose-built financial free-zone, located within the Emirate of Dubai, United Arab Emirates. The DFSA is the independent regulator of financial and ancillary services conducted in or from the DIFC, responsible for managing or distributing Collective Investment Funds (Funds).

Whom is this Guide for?

This guide will assist the following:

- Those wishing to establish a Fund management presence in the DIFC;
- Firms already either managing Funds or distributing Funds in the DIFC, who may wish to expand their business activities; and
- Key service providers to the Funds industry, such as Fund administrators, trustees and custody providers.

*(Capitalised terms are generally defined terms in the DFSA Rulebook. You may access the modules of the Rulebook at **www.dfsa.ae**)*

Regulatory regime for Funds in the DIFC

The DFSA first introduced its Collective Investment Funds regime (the Funds regime) in 2006, which was designed to provide adequate investor protection, meeting international standards for regulation.

In 2010, the DFSA made significant changes to the Funds regime, taking account of recommendations made by a panel of industry practitioners appointed by the DFSA (Panel) to make the regime more facilitative and business friendly, whilst remaining true to the International Organisation of Securities Commissions (IOSCO) principles for regulating collective investment schemes.

When the International Monetary Fund first assessed the DFSA in 2007 for its compliance with the IOSCO principles as part of its Financial Services Assessment Programme, it concluded that: "The DFSA has established a very impressive set of laws, regulations and rules and policies and procedures for regulation. Its staff are well qualified and work to international best practice standards."

The DFSA regime focuses on disclosure, corporate governance, valuations and service providers. The DFSA takes into account a range of matters when licensing and supervising Firms that manage and market Funds in or from the DIFC. The DFSA also regulates the key players in the Funds management service sector, such as Fund administrators, asset managers, custody providers and trustees, to ensure adequate investor protection by promoting high industry standards that meet international best practice.

Some of the key features of the DFSA's Funds regime are as follows:

- A Public Fund regime, which provides greater protection to retail investors through requirements such as the independent oversight and detailed disclosure in Prospectuses;
- An Exempt Fund regime, which is a type of Fund that is open only to professional investors (investors who meet the Professional Client test and make at least a USD $50,000 minimum subscription). Exempt Funds enjoy a fast-track registration process and attract lower regulatory requirements than a Public Fund, which is open to retail investors;
- DFSA licensed (i.e. DIFC-based) Fund Managers being able to establish and manage Funds in the DIFC, as well as in jurisdictions outside the DIFC;
- Fund Managers coming from reputable jurisdictions being able to establish and manage Funds in the DIFC under certain circumstances;
- DFSA licensed firms being allowed to distribute a wide range of Foreign Funds in or from the DIFC, particularly where a recommendation about the suitability of the investment is made to a client;
- A competitive fee structure being applied to Fund Managers and Funds;
- Fund Managers of Umbrella Funds having the flexibility to use the protected cell company (PCC) structure for open-ended Umbrella Funds, thereby giving investors in each Sub-Fund of the Umbrella legal segregation from liabilities arising in other Sub-Funds and the Umbrella;
- Bespoke Shari'a governance requirements applying to Islamic Funds, which promote high Shari'a governance standards with flexibility of application; and
- Bespoke regulatory requirements to accommodate specialist Funds, such as Private Equity, Property and Hedge Funds.

How Funds are regulated

Fund Manager*

To establish and manage a Fund in the DIFC (using any one of the three vehicles noted below), you need to be either:

- A DFSA licensed Fund Manager; or
- An External Fund Manager.

**The term Fund Manager replaces the term Operator used until 11 July 2010.*

DFSA licensed Fund Manager

To obtain a DFSA licence, you need to demonstrate to the DFSA that:

- You have adequate systems and controls to manage the type of Fund you propose to establish; and
- The individuals performing certain functions within the Firm such as its Board Members, senior management and key control functions (eg compliance and anti-money laundering) meet the relevant suitability and integrity criteria.

Once you have been granted a licence, the DFSA supervises your activities relating to the Funds you manage on an ongoing basis.

Certain types of Funds you manage attract specific requirements. For example, if you are proposing to establish a Fund in a jurisdiction outside the DIFC (i.e. an External Fund), the DFSA will assess the desirability of the relevant jurisdiction in terms of its Financial Action Task Force compliance and whether you have adequate systems and controls to address any risks arising from having the Fund established in that particular jurisdiction. If you are proposing to establish and manage only Exempt Funds, there is a fast-track process that involves self certification relating to adequacy of systems and controls. However, the DFSA's ongoing supervision will require you to demonstrate how you meet the relevant requirements.

External Fund Manager

This is a new concept introduced by the DFSA in July 2010, taking account of the globalised nature of the Funds management industry. Under the applicable requirements, a Fund Manager coming from a reputable jurisdiction may establish and manage a Domestic Fund without having to obtain a DFSA licence provided:

- It is a body corporate;
- It manages the Domestic Fund from a place of business that is in a jurisdiction either included in the DFSA's Recognised Jurisdictions List or assessed by the DFSA as providing an adequate level of regulation;
- It subjects itself to the DIFC laws and courts; and
- It appoints a DFSA licensed Fund Administrator or Trustee, who will be required to undertake certain functions, ie acting as the local agent of the External Fund Manager to receive process and deal with the DFSA for regulatory processes, and also to undertake certain investor relation functions relating to the Fund (such as maintaining the Unitholder register and making the Fund's Prospectus available to investors in the DIFC).

Fund Vehicle

Three types of Fund vehicles can be used to establish a Domestic Fund in the DIFC. These are Investment Companies, Investment Trusts and Investment Partnerships.

Each has its unique qualities, with the most popular today being the Investment Company model, with Trust structures predominantly utilised for Property Funds and Limited Partnerships being utilised for Hedge Funds and Private Equity Funds.

An Investment Company will need to be incorporated in the DIFC and the Fund Manager must be a corporate director of the Investment Company. An Investment Company can also use the PCC structure.

An Investment Trust will need to be established by trust deed between a Fund Manager and a Trustee. A Trustee can be DFSA licensed Trustee or a Custody Provider, or a person regulated and supervised in a reputable jurisdiction for custody or depository services. The Trustee is responsible for the safe-keeping of Fund property and the maintenance of the unit holder register, and must monitor whether the Fund is managed in accordance with the Trust Deed and the applicable laws.

An Investment Partnership is a Limited Partnership registered in the DIFC, comprised of a General Partner and Limited Partners. The General Partner must be authorised by the DFSA to act as the Fund Manager of the Fund.

Types of Funds

There are two types of Funds that can be established in the DIFC, and be managed by either a DFSA licensed Fund Manager or an External Fund Manager:

Public Funds

Public Funds are open to retail investors, and can be marketed by way of public offer. Because Public Funds are open to retail investors, more extensive regulatory requirements apply to such Funds to protect retail investors. These requirements meet international standards for retail protection, in particular, IOSCO principles for regulating collective investment schemes. These include detailed disclosure in the Fund's Prospectus to enable retail investors to make an informed investment decision relating to the Fund and independent oversight of the Fund management either by a three member oversight committee or by the Trustee or Eligible Custodian of the Fund.

Exempt Funds

Exempt Funds are a category introduced to the DFSA Funds Regime and replaces the existing Private Funds regime. Exempt Funds are open only to Professional Clients who make at least a minimum subscription of USD $50,000 each. Such Funds can only have 100 or fewer Unitholders and cannot be offered to the public - distribution being only by way of private placement.

Both Public Funds and Exempt Funds must have a Registered Auditor who is required to report on the financial accounts of the Fund on an annual basis, pursuant to international financial reporting standards. A Fund Manager must also provide interim and annual reports to unitholders and the DFSA. The annual reports must include a valuation of the Fund assets acceptable to the Fund's registered auditor.

Specialist Funds

The DFSA Funds regime also provides for the creation of certain specialist Funds.

Islamic Funds

The Fund Manager of an Islamic Fund needs to have a licence that authorises it to conduct Islamic Business or an Islamic Window before setting up an Islamic Fund.

The Fund Manager must, in respect of the Islamic Fund:

- Appoint a Shari'a Supervisory Board (SSB) to the Fund. It may use the Firm's SSB for Shari'a governance purposes of the Islamic Fund;

- Establish and maintain Shari'a compliant systems and controls and an Islamic financial business policy and procedures manual for the Fund; and
- Ensure that the Constitution and Prospectus of the Fund are approved by the Fund's or Firm's SSB.

Hedge Funds

The Fund Manager of a Hedge Fund is responsible for ensuring that risks associated with the Fund are adequately managed by:

- Ensuring that there is adequate segregation of duties between the investment function and the Fund valuation process;
- Observing best practice standards and guidance issued by the DFSA, in particular the DFSA Hedge Fund Code of Practice; and
- Observing the requirements that relate to the appointment of prime brokers with authority to combine the assets of the Fund with any other assets, which can only be done in respect of Exempt Funds, and not Public Funds.

Private Equity Funds

These are generally Exempt Funds and taking account of the practices and associated risks, the Fund Manager of an Exempt Fund, for example:

- Is not required to entrust the Fund Property to an Eligible Custodian; instead it must appoint an Investment Committee to the Fund; and
- Must make certain disclosure in its Prospectus relating to how the Fund's assets are held.

Property Funds

All Property Funds (i.e. Funds investing predominantly in real estate or real estate-related assets) must be closed-ended Funds.

A Property Fund which is a Public Fund, in addition to being a closed-ended Fund, must:

- Invest only in Real Property or Property Related Assets, but may retain up to 40% of its investments in cash or certain specified Securities;
- Be an Investment Company or Investment Trust;
- Be listed, within 6 months of its establishment, either on an Authorised Market Institution or an Exchange in a Recognised Jurisdiction;
- Have the Fund property valued annually, and before acquiring or disposing any asset, do so on the basis of an independent valuation of the relevant property; and
- Limit its borrowings to 80% of its total net asset value.

Property Funds – Real Estate Investment Trusts (REITs)

REITS are a sub-set of Property Funds, which are designed for income generation. A REIT must, in addition to being closed-ended:

- Use only Investment Company or Investment Trust as the Fund vehicle;
- Be a Public Fund that is listed and traded on an Authorised Market Institution;

- Distribute 80% of its audited annual net income to Unitholders;
- Not borrow beyond 70% of net asset value; and
- Invest in 'property under development' only up to 30% of its total assets.

In addition to the above specialist classes of Funds, the DFSA Funds regime also has specific provisions dealing with Feeder Funds and Fund of Funds.

Fund distribution (marketing of Funds)

The marketing of both Domestic and Foreign Funds are based on generally accepted principles of disclosure through prospectus requirements. However, the level of prospectus disclosure required for Public Funds, which are open to retail investors, is higher than the disclosure requirements for Exempt Funds, which are open only to professional investors.

Foreign Funds can only be marketed in or from the DIFC by DFSA licensed Firms holding advisory or arranging authorisations. Such Firms can now market units of Foreign Funds if one of the following criteria is met:

- The Foreign Fund is a regulated Fund in a jurisdiction included in the DFSA's Recognised Jurisdictions list (available on the DFSA website) or the alternative criteria of equivalent regulation prescribed by the DFSA; or
- The Firm makes a suitability recommendation of the investment in the Units of the Foreign Fund to the particular investor, in light of that investor's investment objectives and circumstances; or
- The Foreign Fund is open to 100 or fewer investors each of whom meets the Professional Client test and makes a minimum subscription of USD $50,000 and is not offered to investors by way of public offer.

The Foreign Funds which cannot be marketed to retail investors in the home jurisdiction of that fund are prohibited from being marketed to retail investors in or from the DIFC.

Fee structure

The table below highlights the fees applicable to Fund Managers and Funds.

	Fees in USD
Fund Manager licensing application fee	$10,000
Fund Manager annual licence fee	$10,000
Annual fee per Fund	$4,000
Annual ongoing fee per Fund	$4,000
Public Fund registration fee	$1,000
Umbrella Fund (Umbrella) (licensing and annual)	$8,000
Each Sub-Fund (annual)	$1,000

For details of the DFSA fees, please refer to the Fees Module (FER) on the DFSA website.

Getting Help

DFSA Rulebook: The DFSA website contains more information about the DFSA Rulebook. Applicable modules include: Collective Investment Rules (CIR) and Islamic Financial Rules (IFR).

Enquiries: Firms who hold a licence from the DFSA should direct any enquiries through their relationship manager.

Visit the DFSA website at **www.dfsa.ae** for:

- More information regarding the DFSA's Funds regime
- More information on how to apply to manage or market Funds in or from the DIFC
- Full text of the Laws, Regulations and Rules
- More news about the DFSA.

General Enquiries

- Via telephone +971 4 362 1500
- Via e-mail **info@dfsa.ae**

About the DFSA

The DFSA is the independent regulator of financial and ancillary services conducted in or from the DIFC, a purpose-built financial free-zone in Dubai. The DFSA's regulatory mandate covers asset management, banking and credit services, securities, collective investment funds, custody and trust services, commodities futures trading, Islamic finance, insurance, an international equities exchange and an international commodities derivatives exchange.