

New SCA Investment Management Regulations

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As flagged by the Securities and Commodities Authority (“SCA”) when the 2012 Fund Regulations came into force, the SCA has recently released Board of Directors’ Decision No. 1 of 2014, concerning the Regulations on Investment Management (“Investment Management Regulations”), which became effective on 28 February 2014.

The new Investment Management Regulations provide a more regulated regime and greater protection for investors in UAE investment funds. However, there remain some systemic issues with setting up funds in the UAE.

Former Central Bank regime

Prior to the introduction of the Investment Management Regulations, the Central Bank regulated investment and fund management activities in the UAE and granted investment company licences to entities other than banks, pursuant to which, such activities (including the establishment of funds) could be undertaken. There has been a limited local fund management industry in the UAE to date, which reflects that these activities have largely been carried out in house by the entities establishing local funds (i.e. banks and investment companies). Under the new Investment Management Regulations, the Central Bank will still licence investment companies, however, the regulation of investment and fund management activities will move across to the SCA.

New SCA regime and its impact

With the shift of regulation of investment and fund management activities to the SCA, all existing entities carrying on such activities in the UAE (including banks and investment companies) will be required to obtain a new licence from the SCA by 28 February 2015. Enquiries and applications to the Central Bank prior to 28 February have been directed to the SCA for approval and, now that the Investment Management Regulations are effective, it is possible to obtain the licence from the SCA.

In short, the effect of the new Investment Management Regulations will be to:

- open up the investment and fund management market in the UAE, including to DIFC asset and fund managers;
- provide greater security for clients and investors over assets by requiring full separation from, and of, client accounts and for all managed assets to be held by a licensed custodian; and
- generally create a more regulated regime for investment and fund management in the UAE.

Open up the market (including to DIFC entities)

The new Investment Management Regulations will open up investment and fund management in the UAE more widely than to just banks and investment companies, including to DIFC domiciled and DFSA regulated asset and fund managers. However, a DIFC entity applying for an SCA investment management licence will still need to establish an onshore office in order to operate under that licence.

Greater security for investors over assets

The new Investment Fund Regulations provide greater security for clients and investors in funds by

requiring investment managers to ensure full separation from and between client accounts and that all managed assets and fund assets are to be held by a custodian licensed by the SCA or a custodian outside the UAE in respect of foreign assets. However, as discussed below, we note that issues remain concerning the ability to establish a truly legally separate fund entity and the ability of SCA licensed custodians to hold certain assets.

Notwithstanding the requirements for a custodian, separation of client and fund assets and other client and investor protective measures in the new Investment Management Regulations, there remains risk associated with the current lack of separate legal personality for local funds and corollary risk to fund assets. The inability to establish a local UAE fund with separate legal personality has been an ongoing issue in respect of the separation and protection of fund assets. This is notwithstanding that both the Central Bank resolution concerning Investment Companies (“Investment Company Resolution”) and the SCA Fund Regulations purport to recognise that funds have a separate legal personality, and the expectation that the Central Bank and the SCA would support treatment of a fund’s assets as distinct from those of an investment company fund manager or bank fund manager in any Court proceedings. However, without recognition in the federal Commercial Companies Law of a separate legal entity for funds and, thus, a clear legal separation of the ownership of those fund assets, there remains a risk that those assets may not be treated as the separate property of a fund. We note that the latest draft new Commercial Companies Law provides for a recognition of the separate legal personality of funds in the UAE, but stops short, however, of explicitly providing that a fund may be established in a specific legal form or creating a new legal form for funds. The new Commercial Companies Law has been in draft form for several years without any indication when such proposed changes may come into effect.

In addition to the above, in respect of the custody requirement under the new Investment Management Regulations and under the Fund Regulations, we note that the SCA securities custody activities regulations (“Custody Regulations”) relate to custody over securities only. They do not extend to all assets of a fund, for example, property; there may also be issues with the ability of an SCA licensed custodian to hold property assets in respect of property funds even if the licence did enable it to do so. Thus, while the Investment Management Regulations require a custodian licensed by the SCA to hold the assets of a fund, the Custody Regulations themselves appear to prevent this. We also note that the Fund Regulations specifically contemplate a custody role in respect property funds, but again there appears to be a mismatch between this requirement for the assets to be held by a safe custodian licensed by the SCA and the actual ability of such custodians to hold these assets.

On a related note, in respect of the required custodian and investment manager SCA licensing requirements, there appears to be no requirement across any of the new Investment Management Regulations, the Custody Regulations or the Fund Regulations for separate independent persons or entities to perform these functions for a fund. That is, on the face of it, a bank can be licensed as a custodian and an investment manager and could thus establish a fund, manage it and provide the required custodial services – effectively the status quo for existing bank funds. We have not received any indication whether the SCA would require a separation of these roles or would allow the status quo to remain, just confirmation that it would expect all banks to gain an SCA investment management licence if conducting investment and fund management activities.

Generally a more regulated regime

In addition to opening up the market and greater prescribed separation for client and fund assets, and notwithstanding the lack of separate legal personality and custodial issues noted above, in general the new Investment Management Regulations will create a more regulated regime for investment and fund management in the UAE which may go somewhat to helping mitigate the abovementioned issues, these provisions include:

- an increased minimum capital requirement to AED 50 million from AED 25 million under the Investment Company Resolution;
- the new SCA Investment Management licence will be required to be renewed annually rather than every three years under the Investment Company Resolution; also quarterly accounts (plus audited annual accounts) will be required to be submitted to the SCA (as opposed to the Investment Company Resolution requirement for only annual audited accounts) thus giving the SCA more regular prudential and regulatory oversight of investment managers;
- investment managers must prepare an operational guide for risk management; and
- the requirement for a more formalised Investment Committee than the administrative committee required under the Investment Company Resolution, which is required to enable the new compliance role of the Internal Controller of the investment manager.

The Investment Management Regulations at a glance

We have set out below a brief summary of the main Investment Management Regulations provisions and application requirements along with certain limited commentary/clarifications we have received from the SCA. However, as the Investment Management Regulations are only newly effective, and we understand the SCA is yet to receive comments and queries on their implementation, there are still some ambiguities surrounding their reach and requirements which we expect will be clarified in due course.

The Investment Management Regulations shift regulation of investment management and fund management activities over to the SCA and outline licensing requirements and conditions along with the ongoing obligations of licensed entities to both clients and to the SCA.

Under the new regulations, 'investment management' is defined as management of securities portfolios of third parties or the management of mutual funds.

Any entity wishing to carry on or promote investment management activities in the UAE must obtain a licence from the SCA (except local or federal government entities). Entities with existing Central Bank approvals or licences (including local banks as we have specifically clarified with the SCA) must obtain an SCA licence by 28 February 2015.

Applicants for SCA Investment Management licences must be either:

1. a local joint stock company with the purpose to carry on investment management;
2. a local joint stock company with one of its activities being investment management (and an SCA licence relating to the prevention of conflicts of interest);
3. a local bank or branch of a foreign bank or investment company licensed by the Central Bank provided the Central Bank does not object; or
4. a branch of a foreign company established in a financial free zone in the UAE (i.e. the DIFC), or a branch of a foreign company, provided that such branch or company is licensed to carry on investment management and similarly regulated in the free zone or home jurisdiction as relevant. The SCA has clarified that any DIFC entities applying for a licence would need to establish an onshore office in order to operate under that licence.

Minimum capital requirements for each SCA licensed investment manager will be AED 5 million along with a bank guarantee for AED 1 million. There are also requirements as to technical and administrative staff, premises, internal control systems and operational and risk managements systems.

The application fee is AED 50,000 and the SCA will approve or reject an application with 30 days of receipt of a complete application. An application to renew the licence on an annual basis will cost AED 25,000.

Once licensed, there are requirements to (amongst other matters):

- form an internal Investment Committee to carry out certain prescribed tasks (including internal systems and policies reviews);
- appoint an Internal Controller (who may only be dismissed by a resolution of the board of directors of the investment manager upon 30 days' notice to both the Internal Controller and the SCA);
- provide copies of quarterly reports to the Investment Committee and also to the SCA;
- provide clients with (at least) monthly reports; and
- provide quarterly financial statements and annual audited financial statements to the SCA along with any periodic reports on activities and transactions or any other matter as requested the SCA.