Hedge Funds

Jurisdictional comparisons **Second edition 2014**

General Editors:
Stephen Ball & Robert Mirsky, KPMG

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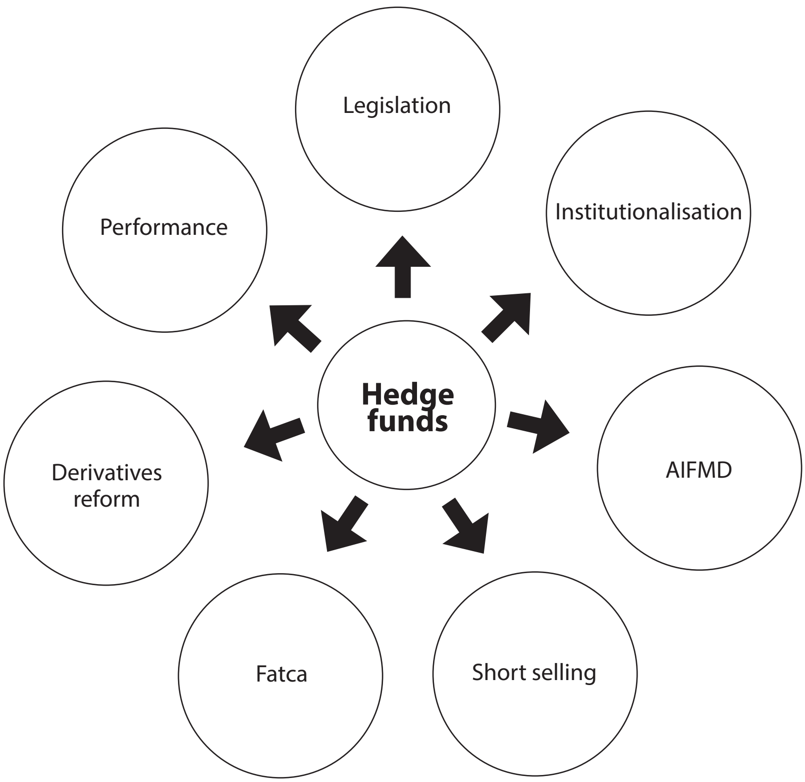
Foreword

Robert Mirsky Global Head of Hedge Funds, KPMG

The global financial crisis of 2008 continues to significantly impact the hedge fund industry through its ripple effect on global legislation, regulation and investor confidence. The current and impending reforms have come to the fore post financial crisis and will remain hot topics over the coming years.

Collectively, these reforms construct an extensive list of buzz words. In Europe, that list includes AIFMD (Alternative Investment Fund Managers Directive), MiFID (Markets in Financial Instruments Directive), and EMIR (European Markets Infrastructure Regulation) among others. In the Americas, the most notable reforms are SEC and CFTC regulation and the Dodd-Frank Act and FATCA (Foreign Account Tax Compliance Act). Globally, the hedge fund industry is impacted by countless reforms; including European short selling bans, global derivatives reform and shadow-banking.



Despite these reforms, the hedge fund industry continues to thrive; with $2.4 trillion in assets under management in the first quarter of 2013. The industry has also generated greater than average returns, after fees, over the past two decades than a traditional portfolio, including stocks, bonds and commodities. This has forced financial markets to take notice. Capital inflows are increasingly coming from institutional investors to provide diversification to conventional portfolios and generate alpha through actively managed strategies. The operational infrastructure of funds and their managers are also evolving as institutional sector investors – including endowments, pension funds and annuities – demand a higher degree of transparency.

Regulation and legislation

The hedge fund industry is suffering from regulatory overload. With draft legislation, numerous consultation papers and public responses introduced almost weekly, industry participants are struggling to wade through the information and determine their course of action. Hedge fund managers are turning to their service providers to help them sift through it all.

AIFMD

AIFMD was published by the European Commission in December 2012, giving member states until July 2013 to adopt it into national law. The Directive aims to increase investor protection, reduce systemic risk and provide a harmonised set of rules for investment firms to operate under in the European Union. This includes the highly debated remuneration code which may dramatically impact the way the industry pays itself. In effect, the Directive is changing the way the industry thinks and raises the cost benefit question among industry participants as they decide whether the future of their business is European. However, the impact of this Directive will be felt far beyond Europe.

Short selling

Globally, short selling regulation aims to provide increased transparency and clarity intended to benefit both investors and regulators. Importantly, regulators will be able to monitor the systemic risks created by short selling and the interdependent market abuse. In practice, this mandate requires investors to report significant short selling positions to the relevant regulatory authorities and places a ban on 'naked' trading. This differs from the past where market participants were able to sell positions prior to having any contractual borrowing agreement. In addition, the mandate grants the public access to some of the information provided by the mandatory reporting; including significant positions and existing penalties. The short selling regulation in Europe expands upon the existing Regulation SHO in the United States implemented in January 2005, which deems that failure-to-deliver positions must be closed within 13 consecutive settlement days before the broker or dealer can transact further short sales. The ban is forcing investment managers to question whether the increased reporting requirements and associated cost is greater than the returns earned from the market. As a consequence, investors may deem long/short funds too expensive and turn toward the more traditional long only fund manager who can promise absolute returns at a lower cost.

Institutionalisation of an industry

With the influx of capital from institutional investors into the hedge fund industry, it is becoming increasingly apparent that this influx comes at a cost. According to a recent survey, 'institutional investors now represent the majority of all assets under management by the global hedge fund industry, with 57% of the industry's AUM residing in this category.' The focus of these investors when looking at absolute return products has focused on risk management and compliance practices. Further, hedge funds need to be better resourced to deal with the increased volume of information and due diligence required by the more sophisticated investor. In the past, an investment manager was able to start up a hedge fund with less than $50 million in assets under management. The amount required to do so today is significantly higher due to additional compliance costs. In fact, the additional cost of compliance has raised the question as to whether this will act as a barrier to entry for new investment managers. For others it has raised the question whether the hedge fund industry can continue to be an efficient mechanism or whether the infrastructure burden will become too cumbersome to operate.

This book aims to demystify the evolving legal and regulatory landscape and act as a guide to successfully navigate the shifting global marketplace. Specifically, it seeks to provide insight into the challenges faced by the global hedge fund industry – broken down by jurisdiction – as participants struggle with the increased infrastructure burden and the resulting operational and compliance costs.

London, November 2013

Introduction

Kumar Panja Global Head of Prime Brokerage Consulting, J. P. Morgan
Michael Fox EMEA Head of Prime Custody Solutions Group, J. P. Morgan Investor Services

Since the last edition of this book, mitigating counterparty risk remains firmly on the agenda of alternative asset managers. While the immediacy of those catalysts may have subsided, the management of this risk is now a deeply entrenched practice within the risk management framework of an alternative asset manager, as well as being a key area of assessment for its investors. So from this perspective, the provision of asset segregation solutions by prime brokers to asset managers continues to remain important, however, the level of participation between the specific segregation solutions varies.

In the rush immediately after the financial crisis for prime brokers to provide segregated asset solutions, it has been the period since then that the depth, flexibility and general viability of those solutions has been tested. The provision of the Special Purpose Vehicle (SPV) model by a number of prime brokers has raised questions for some asset managers, not only surrounding the legal framework of such a provision, but also focusing on the operational robustness of the service, particularly when considered against the ongoing appetite of those prime brokers to invest in the service.

Equally, the model that has seen a number of the industry's prime brokers choosing to partner with a third party custodian, has also been said to have had limited take-up among asset managers.

This segregation solution offers the benefit of having unencumbered assets held by a separate institution, but feedback from asset managers has suggested that there are a number of drawbacks in practice. These include: the additional operational risk introduced by having assets flow between two separate organisations; as well as the appetite of the prime broker to introduce a third party to their client, particularly in a world where such third parties may be broadening their service capabilities to include those currently provided by a prime broker.

It is the third solution, the prime custody service, namely where the same institution brings together its established prime broker and custody business lines, where asset managers appear to have shown the keenest interest. While an asset manager will need to become comfortable with having the custodian and prime broker housed in the same institution, the combination of linking to an established custody practice as well as keeping the client relationship maintained within the same organisation, appears to answer some of the concerns raised by the other two asset segregation solutions.

However, it has been the ability to link the prime custody service into another market trend that has further provoked interest for a number of alternative asset managers. Specifically, over the past few years the industry has witnessed the migration of alternatives strategies into the registered mutual fund marketplace, whether that be 40 Act mutual funds, or its equivalent in Europe, UCITS. Recognising this trend, a number of the universal banks have positioned their integrated prime custody and prime brokerage offerings to meet an alternative asset manager's high-touch service and financing needs, while providing for the specific regulatory requirements demanded for the segregation of assets.

In summary, whichever way an asset manager decides to manage its counterparty risk, it remains on top of the agenda and prime brokers are prepared with solutions to help answer this need. No doubt asset managers have become more informed as to the benefits or otherwise of each of the segregation solutions being offered and while prime brokers will continue to offer a variety of solutions, it is likely that asset managers will migrate to those providers who can not only answer counterparty risk, but also deliver it in a way that complements asset managers' need for efficiency and the growth of their businesses.

London, November 2013

United Arab Emirates

Afridi & Angell Stuart Walker & Ronnie Dabbasi

1. REGULATION OF FUNDS

1.1 Funds domiciled in the jurisdiction

1.1.1 Brief overview of the fund regulatory regime

(i) Name of regulator

The principal financial services regulator in the United Arab Emirates (UAE) is the Central Bank of the United Arab Emirates. The Securities and Commodities Authority of the United Arab Emirates also has some oversight functions in certain specific areas, particularly in relation to listed securities and the promotion of foreign funds. Within the Emirate of Dubai there is a discreet geographical area known as the Dubai International Financial Centre (DIFC). Activities conducted in or from the DIFC are subject to regulation and supervision by the Dubai Financial Services Authority (DFSA). The DIFC can be thought of as a country within a country: it has a legal, regulatory and court system that is almost completely separate and very different from the UAE outside the DIFC. The DIFC is a common law environment, with the DFSA being modelled in part upon the United Kingdom's Financial Services Authority. The UAE is a civil law environment. References in this chapter to the 'wider UAE' refer to the UAE other than the DIFC.

(ii) Statutes/policies under which funds are regulated

Federal Law 10 of 1980 (the Banking Law) is the primary legislation giving the UAE Central Bank the authority to regulate financial services in the country. Subsequent and important pieces of legislation include 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 (regarding amendment to regulation of investment companies and banking and financial investment consultation establishment of companies); Central Bank Resolution 58/3/96 (regarding the regulation of the finance companies); Central Bank Resolution 21/2/88 (regarding the system of investment banks in the state); Securities and Commodities Authority Resolution 3 of 2000 (concerning regulations on disclosure and transparency); Securities and Commodities Authority Resolution 4 of 2000 (concerning the Emirates securities and commodities authority and market);

Securities and Commodities Authority Resolution 48 of 2008 (concerning financial advice and analysis); and Securities and Commodities Authority Resolution 37 of 2012 (concerning the regulations as to mutual funds).

Within the DIFC, there are specific DIFC laws administered by the DFSA relevant to the regulation of funds. These include DIFC Law 12 of 2004 (the Markets Law); DIFC Law 1 of 2004 (the Regulatory Law); and DIFC Law 1 of 2006 (the Collective Investment Law). In addition to the laws administered by the DFSA, various modules of the DFSA Rulebook are significant, including the Collective Investment Rules and the Offered Securities Rules.

(iii) Statistics on number of funds established and their regulatory classification as of July 2013

The vast majority of funds marketed in the UAE (whether to retail customers, high-net-worth individuals or institutional investors) were organised as offshore products. The number of onshore funds is extremely modest, although there has been growth in the asset management sector. Neither the UAE Central Bank nor the Securities and Commodities Authority publish statistics on the number of funds established within the wider UAE; however, there are informal reports that, as of the end of 2012, there were a total of 45 funds domiciled in the wider UAE, including 10 Shari'a-compliant funds. It is worth noting that hedge funds are not specifically regulated or classified in the UAE; rather, the Central Bank and Securities and Commodities authority approach them in the same manner as any other fund.

The number of funds established within the DIFC is extremely low. In total, 16 funds have been registered or domiciled in the DIFC. Five have subsequently withdrawn their registration. Of the 11 funds currently registered, all are domestic funds (ie, DIFC domiciled), with nine funds classified as exempt funds and two classified as public funds.

The DFSA defines a hedge fund as being an arrangement which has some or all of the following characteristics:

- it has a broad mandate giving its operator flexibility to shift strategy;
- it is aimed at achieving absolute returns rather than returns relative to the market;
- it employs some or all of the following techniques:
  - (i) the pursuit of absolute returns or 'alpha' rather than measuring their investment performance relative to the market;
  - (ii) the use of short selling;
  - (iii) the use of derivatives for investment purposes;
  - (iv) the use of economic or debt leverage as well as leverage embedded in financial instruments such as derivatives;
  - (v) the acquisition of distressed debt with a view to its realisation at a profit; or
  - (vi) the acquisition of 'high yield' debt securities; or
- it charges performance-based fees in addition to a management fee based on the volume of assets under management.

1.1.2 Expert/professional investor fund regimes

(i) Essential requirements to qualify for the regime

The UAE Central Bank and Securities and Commodities Authority do not make a distinction between retail and expert or professional investors.

The DFSA requires all authorised firms in the DIFC to classify clients either as:

(i) a retail client;
(ii) a professional client; or
(iii) a professional client in relation to certain services and products and a retail client in relation to other services and products.

An authorised firm may classify a person as a professional client only if such person either: (i) has net assets of at least US$500,000; or (ii) is or has been in the previous two years an employee of the authorised firm or an employee in a professional position in another authorised firm. In addition, professional clients must appear on reasonable grounds to have reasonable experience and understanding of relevant financial markets, products or transactions and any associated risks and, finally, must not have elected to be treated as a retail client.

The DIFC's collective investment funds regime (applicable to all funds, including hedge funds) is established under the Collective Investment Law and the Collective Investment Rules. Collective investment funds are defined as those arrangements where:

(i) the purpose or effect of which is to enable persons taking part in the arrangement (participants) to participate in profits or benefits arising out of the acquisition, holding, management or disposal of the property or other assets of the arrangement;
(ii) the participants do not have the day-to-day control of 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.

Certain arrangements that otherwise fall within this definition are expressly excluded, such as franchises and time-share rights.

Collective investment funds are categorised as either public funds or exempt funds.

The distinction between these two types is that units of a public fund can be offered to retail clients, while an exempt fund can have no more than 100 investors (and each investor must qualify as a professional client). Exempt funds can only seek investments by way of private placement and not by way of a public offering. There is a minimum subscription level of US$ 50,000 for exempt funds.

The key elements of the DIFC's collective investment funds regime include that they must:

- be managed by a DFSA-licensed fund manager or a qualifying external funds manager;
- comply with certain fund administration standards relating to compliance with anti-money laundering rules and holding of client money and assets, delegation and outsourcing and recordkeeping requirements;

- have constituent documents that meet certain prescribed standards;
- comply with valuation, pricing and other related requirements;
- be subject to accounting and audit requirements, including compliance with the relevant audit standards, and be subject to both internal and external audit requirements, the latter having to be conducted by a registered auditor;
- provide certain periodic reports, including annual and interim reports; and
- if a specialist type of DIFC fund – such as a property fund, private equity fund, Islamic fund or hedge fund – be subject to fund-type specific additional requirements.

Domestic funds which are public funds attract a more extensive regulatory regime when compared with exempt funds. For example, while a public fund requires a full prospectus, an exempt fund requires only a short-form prospectus containing much less prescribed information. A public fund is required to have an independent oversight committee, which is not required for an exempt fund. Similarly, while a public fund needs to be registered with the DFSA prior to any offer of its units to the public, only a notification to the DFSA is required prior to a private placement of units in an exempt fund. Public funds are subject to certain borrowing and investment restrictions, while private funds do not attract those restrictions.

Foreign funds, not being domestic funds by being domiciled outside the reach of the jurisdiction of the DIFC, trigger the DIFC requirements only if the units of such foreign funds are distributed or marketed in or from the DIFC. Accordingly, the distribution of units of foreign funds can only be undertaken by authorised firms provided such foreign funds qualify as eligible foreign funds. The eligibility criteria require foreign funds either to be regulated in a recognised jurisdiction or to be subject to alternative comparable regulation. The DFSA has established a list of jurisdictions recognised for this purpose and can also consider other jurisdictions on a case-by-case basis. Distribution of units of foreign funds attracts certain conduct rules set out in the Collective Investment Rules.

Finally, it is important to note that, in addition to the requirements noted above, there are other over-arching principles enshrined in the Collective Investment Law that are designed to provide investor protection. For example:

- managers of domestic funds must act honestly, exercise the degree of care and diligence that is expected of a manager, and act in the best interest of the unit holders of the domestic fund. If there is a conflict of interest between the interests of the unit holders and that of the manager, it must give priority to the unit holders' interests;
- managers must ensure that all unit holders of the same class are treated equally, and unit holders of different classes fairly; and
- managers must also ensure that the property of the domestic fund is subject to safe-custody provisions and is held separately from the property of the manager and any other fund that the manager manages.

(ii) Registrations/permits/licences required

In the wider UAE, a UAE Central Bank licence is required prior to establishing and/or marketing any investment fund (including a hedge fund). Investment funds can be publicised in the wider UAE by either a licensed investment company or a bank licensed to operate in the wider UAE. Establishing or managing investment funds requires 'special approval from the Central Bank on a case-by-case basis' (UAE Central Bank Board Resolution 89/3/2000).

Although the UAE Central Bank reserves the right to continue to exercise supervision over investment funds as noted above, it has shifted certain licensing responsibilities to the Securities and Commodities Authority. In particular, the Securities and Commodities Authority is now primarily responsible for overseeing the marketing and promotion of any foreign fund (including a hedge fund) to investors in the UAE, particularly where the fund is being marketed and promoted by foreign entities located offshore or from a representative office located in the UAE. No foreign fund may be promoted within the UAE prior to obtaining approval of the promotion from Securities and Commodities Authority, and all approved foreign funds must be promoted by a local promoter, which includes banks and investment companies licensed by the UAE Central Bank and companies licensed to be local promoters by the Securities and Commodities Authority (Securities and Commodities Authority Resolution 37 of 2012).

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

(iii) Documents required to be filed

Any application for a licence from the UAE Central Bank for the establishment of a fund or from the Securities and Commodities Authority for the establishment of a local promoter company requires the submission of a letter of application, various constitutional documents of the applicant and a business plan of some sort. The exact documents are not prescribed by the relevant authority; rather, the normal practice is for the Central Bank or Securities and Commodities Authority to notify the applicant of such additional documents as it might require on an *ad hoc* basis. The Securities and Commodities Authority requires an applicant seeking approval for promotion of a foreign fund to submit the fund's key information, an undertaking from the local promoter, a signed promotion agreement, the fund offering document, and the constitutional documents and the last two years' audited financial statements of the applicant (although additional documents may be requested).

Applications for DFSA authorisations require the submission of a regulatory business plan and the completion of multiple application forms. Applications must be made for the specific financial services to be conducted and also in respect of the individuals who will fill the mandatory appointment positions. Authorised individuals must meet particular standards relating to their experience, knowledge and qualifications. Applicants will only be authorised if the DFSA is satisfied that they are fit and proper, and that the functions of their role will be conducted and managed in a sound and prudent manner.

(iv) Regulatory timescales

Applications to the UAE Central Bank or Securities and Commodities Authority for any type of licence should be made with the understanding that it may be several months before any type of reply is forthcoming. The requirement that all foreign documents are fully authenticated adds to the time required to make the initial application. The Securities and Commodities Authority will respond to an application for approval of the promotion of a foreign fund within 30 business days.

DFSA applications generally proceed at a swifter pace than licensing applications in the wider UAE. However, it is still the case that several months will typically elapse between the time a potential applicant decides to begin work on an application and the date the DFSA issues its in-principle approval letter. The DFSA's current aim is to complete its review of a full application within 50 business days of receipt of the application documents.

(v) Registration/permit/licence fees – initial and ongoing

The UAE Central Bank does not charge registration or licence fees (neither initial nor ongoing). However, if a UAE Central Bank licence is being sought then the applicant will need to establish some form of local corporate presence. There will be governmental fees payable in respect of that corporate entity. These include registration fees plus an annual licensing fee. These fees will vary depending on the type of corporate entity being utilised plus the size of the local operation (number of employees plus physical size of the local office).

The Securities and Commodities Authority has yet to publish a schedule of initial and ongoing fees in respect of the promotion of foreign funds in the wider UAE. We anticipate that the procedural costs and requirements should be clearer going forward as, at the time of writing, the one-year grace period following the relevant regulation regarding promotion of foreign funds was due to expire in August 2013.

The application fee payable to the DFSA for authorisation to manage a collective investment fund is US$10,000. There is also a fee of US$10,000 to register a domestic public fund. Once authorised, the manager of a collective investment fund must pay an annual fee to the DFSA of US$10,000 plus US$1,000 for each US$1 million of expenditure. In addition to the fees levied by the DFSA, entities established within the DIFC must pay initial and ongoing fees to the DIFC Registrar of Companies (US$20,000 and US$12,000 respectively in the case of a company limited by shares). Finally, DIFC entities are required to maintain an office within the DIFC itself. DIFC rents are significantly higher than in the wider UAE.

(vi) Content requirements for offering memorandum

UAE funds regulated by the Central Bank

The UAE Central Bank requires that investment funds marketed in the wider UAE have a prospectus. This must include details of the objective of the fund, its investment policies, the means by which its assets will be valued and the manner in which the fund will be managed. The UAE Central Bank does not impose any further specific requirements in respect of hedge funds. The Securities and Commodities Authority does not impose additional requirements for any offering documents, although certain information from such documents must be submitted as part of its application process.

DIFC public funds

A prospectus for a DIFC public fund must contain the following information:

(a) general information including:
- the name of the fund;
- the fund manager's and, if the fund is structured as an investment trust, the trustee's name and the principal place of business in the DIFC as recorded by the Registrar of Companies;
- a statement that the fund is a domestic fund, the constitution of which is governed by the laws of the DIFC;
- a statement that the fund is a public fund or exempt fund, as the case may be;
- the legal form of the fund and whether it is open or closed ended;
- if the fund is a specialist class of a fund, the relevant specialist class, and if applicable, a statement that the fund is an Islamic fund and consequently the fund's entire business operations are conducted in accordance with Shari'a law;
- if the fund is managed by an external fund manager, a statement of that fact and the details of the appointed fund administrator or custody provider of the fund; and
- if the fund is an external fund, the name of the jurisdiction in which the fund is domiciled;

(b) general statements including the following:
- the fund manager is responsible for all operations concerning the fund and may from time to time delegate activities or outsource functions, but not the responsibility for conducting those activities and functions, to another person;
- the fund property is entrusted to the fund manager and the fund manager remains responsible for the property even when an eligible custodian holds the legal title to the fund property; or the fund property is held on trust by the fund's trustee;
- whether the duration of the fund is limited and, if so, for how long;
- that fees, charges and other expenses of the fund may be taken out of fund property and the basis for determination of the quantum of such fees, charges and other expenses;
- the maximum and minimum sizes of the fund's capital, if any;

- that the unitholders are not liable for the debts of the fund, unless the applicable legislation prescribes otherwise and, if so, those circumstances;
- that a unitholder is not liable to make any further payment after he has paid the price of his units and that no further liability can be imposed on him in respect of the units he holds; and
- that payments to the fund manager, trustee, any eligible custodian, or the person providing the oversight function (including a *Shari'a* Supervisory board) by way of remuneration are authorised to be paid (in whole or in part) out of the fund property; and
- where the fund is a trust:
  - the trust deed is made under and governed by the Investment Trust Law 2006 and: (i) is binding on each unitholder as if it had been a party to it and that it is bound by its provisions; and (ii) authorises and requires the fund manager and the trustee to do the things required or permitted of them by its terms and the Investment Trust Law; and
  - the fund property (other than sums held to the credit of the distribution account) is held by the trustee on trust for the unitholders according to the number of units held by each unitholder or, where relevant, according to the number of individual shares in the fund property represented by the units held by each unitholder; and the sums standing to the credit of any distribution account are held by the trustee on trust;

(c) investment objectives including:
- information covering the investment objectives of the fund and in particular: (i) whether the aim of the fund is to spread investment risks and, if a property fund, whether the fund invests in a single property; (ii) the types of investments or assets in which it and (where applicable) each sub-fund may invest; and (iii) if the fund is a specialist class of fund, the class of fund; and
- details of any investment, borrowing or stock lending restrictions or, in the event that there are no such restrictions, a statement to that effect;

(d) details of the units in the fund, which must include a statement specifying:
- the classes of units which the fund may issue; and
- the rights attaching to units of each class (including any provisions for the expression in two or more denominations of such rights);

(e) limitations on the fund's units, which much include details as to:
- the provisions relating to any restrictions on the right to redeem units in any class; and
- the circumstances in which the issue of the units of any particular class may be limited.

(f) information regarding income and distribution, which must include:
- details of who is carrying out the calculation, transfer, allocation and distribution of income for any class of unit issued and outstanding during the accounting period; and

- information regarding the provision for the payment of income, if any, and the date on which such distribution shall be made;

(g) a statement specifying the base currency of the fund;
(h) details of the procedures for the convening of meetings and the procedures relating to resolutions, voting and the voting rights of unitholders;
(i) details of the oversight arrangements, and if the fund is an Islamic fund, details of its Shari'a supervisory board;
(j) information regarding termination and suspension, which must include details as to:
- the grounds under which the fund manager may initiate a suspension of the fund and any associated procedures; and
- the methodology for determining the rights of unitholders to participate in the fund property on winding up;

(k) details of the manner in which alterations to the constitution may be made;
(l) a responsibility statement to the effect that nothing in the constitution has the effect of exempting the fund manager and, if the fund is structured as an investment trust, the trustee, from any liability to unitholders imposed under DIFC law; and
(m) other relevant matters including:
- details of those matters which enable the fund, fund manager or any person providing the oversight function of the fund to obtain any privilege or power conferred by the DFSA Rules which is not otherwise provided for in the constitution;
- if applicable, names and addresses of the banker, lawyer, registrar and any other person undertaking any significant activities in relation to the fund; and
- any mandatory disclosure that must be made by the fund operator to prospective unitholders in the prospectus and any other financial promotions relating to the fund, which in the case of a hedge fund is as follows: *'When considering investment in a Hedge Fund you should consider the fact that some Hedge Fund products use leverage and other speculative investment practices that may increase the risk of investment loss, can be illiquid, may involve complex tax structures often charge high fees, and in many cases the underlying investments are not transparent and are known only to the Hedge Fund Investment Manager. Returns from Hedge Funds can be volatile and you may lose all or part of your investment. With respect to single manager products the manager has total trading authority and this could mean a lack of diversification and higher risk. The Hedge Fund may be subject to substantial expenses that are generally offset by trading profits and other income. A portion of those fees is paid to the Hedge Fund Manager.'*

DIFC exempt funds

An 'information memorandum' of an exempt fund is a prospectus for the purposes of the relevant DIFC legislation.

There is no detailed prescribed disclosure content for the information memorandum of an exempt fund. However, as an information memorandum is a prospectus, it is subject to the disclosure obligation in Article 50(2) of the Collective Investments Law. As a result, a fund manager of an exempt fund must include all the information which professional clients to whom it intends to offer units of the exempt fund would reasonably require and expect to find in such a prospectus. This is to enable such clients to make an informed decision relating to investing in the fund.

(vii) Restrictions on investments/leverage

Funds marketed in the wider UAE have no general restrictions on investments or leverage. The UAE Central Bank may, however, impose conditions at the time of registration or authorisation. The DFSA's hedge fund code of practice recommends that hedge fund managers put in place measures enabling it to monitor, assess and quickly modify the level of leverage.

(viii) Requirements for local service providers

Foreign funds must be marketed by a locally licensed entity if there is any onshore element (ie, in the wider UAE) to the offering. As noted above, only banks and investment companies licensed by the UAE Central Bank and companies licensed as local promoters by the Securities and Commodities Authority may directly market funds to investors in the UAE. Similarly, the conduct of any financial service in or from the DIFC will require a DFSA authorisation of some sort.

(ix) Requirements for non-local service providers

None.

(x) Requirements as to directors and board meetings

Use of any of the normal corporate vehicles in the wider UAE or the DIFC will require the appointment of directors for that entity, the number of which will vary depending on the type and size of the entity. In the DIFC it is possible to incorporate a 'special purpose company', but even these require the appointment of at least two directors.

(xi) Ongoing filing/consent requirements (amendments to constitutional documents, offering memorandum, other documents)

Investment companies, being the principal type of corporate entity licensed by the UAE Central Bank to establish and market investment funds in the wider UAE, must file their audited annual accounts with the UAE Central Bank. Changes to their corporate form or ownership require prior approval of the UAE Central Bank.

The licensed management services company responsible for the investments of a foreign fund in the UAE must file the fund's audited quarterly and annual financial statements with the Securities and Commodities Authority (which may coordinate with the UAE Central Bank in this regard) and publish its financial reports in two widely circulated local daily newspapers (with at least one such paper issued in the Arabic language).

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

(xii) Requirements for AGMs; restrictions on side letters

The requirements for AGMs in the wider UAE and the DIFC depend on the vehicle that is conducting the financial service; however, each entity must conduct at least one AGM per year. Side letters are very common in the wider UAE and have successfully been used as a commercial measure to transfer beneficial ownership and management rights in onshore vehicles. It is worth noting, however, that these letters have yet to be tested in the UAE courts; accordingly, it is unclear whether such letters would be legally enforceable.

(xiii) Other

Within the DIFC, a 'private placement' is any offer made to a person who is likely to be interested in the offer having regard to:

- previous contact between the person making the offer and that person;
- a professional or other connection between the person making the offer and that person; or
- statements or actions by that person that indicate that they are interested in offers of that kind.

The DFSA has issued a Hedge Fund Code of Practice (the Code). This sets out the DFSA's view as to what constitutes best practice. Compliance with the Code does not in itself constitute compliance with the other aspects of the DFSA funds regime. Operators and sponsors of hedge funds need to be mindful of the full range of obligations applicable to them in addition to the Code itself.

The Code sets out the best practice standards for operators of hedge funds in the DIFC (ie, managers of both public and private domestic hedge funds). These are designed to address risks inherent in the operation of hedge funds and are set out under nine principles:

- *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.

1.1.3 Other regimes relevant to hedge funds
Not applicable in the wider UAE or the DIFC.

1.2 Regulatory treatment of funds not domiciled in the jurisdiction
1.2.1 Restrictions on/consequences of holding board meetings in the jurisdiction
An appropriate licence must be obtained before any commercial activity is undertaken within the UAE (including within the DIFC). Merely holding a board meeting within the UAE would not constitute 'commercial activity', and there are no restrictions upon, or adverse consequences of, simply holding a single board meeting in the UAE (including within the DIFC).

1.2.2 Licensing requirements if local service providers are appointed
Any local service provider must demonstrate that they hold valid UAE licences for any activity they are appointed to conduct.

1.2.3 Ability to market fund interests in the jurisdiction
As mentioned above, most funds marketed in the UAE are organised as offshore products. Until this past year, UAE banking officials have taken a liberal approach to the promotion of foreign funds in the UAE, although the onshore marketing of any investment product is a licensable activity and is highly regulated (by either the UAE Central Bank, the Securities and Commodities Authority and/or the DFSA). Accordingly, marketing activities for foreign funds are typically conducted in a low-profile manner. With the introduction of new regulations authorising greater oversight from the Securities and Commodities Authority, there is a greater onus on foreign fund managers to promote their vehicles through duly licensed local promoters.

2. TAXATION
2.1 Taxation of the fund
See Section 2.3.

2.2 Taxation of investors not resident in the jurisdiction
See Section 2.3.

2.3 Taxation of investors resident in the jurisdiction

There is currently in force in the Emirates of Abu Dhabi and Dubai, legislation establishing a general corporate regime (the Abu Dhabi Income Tax Decree 1965 (as amended) and the Dubai Income Tax Decree 1969 (as amended)). The regime is, however, not enforced save in respect of companies active in the hydrocarbon industry and branches of foreign banks operating in the wider UAE. It is not known whether the legislation will or will not be enforced more generally or within other industry sectors in the future. Under current legislation, there is no requirement for withholding or deduction for or on account of UAE taxation in respect of payments of accrued return or principal on investments.

The Constitution of the UAE specifically reserves to the Federal Government of the UAE the right to raise taxes on a federal basis for the purposes of funding its budget. It is not known whether this right will be exercised in the future.

The UAE has entered into double taxation arrangements with approximately 47 countries.

Dubai Law 9 of 2004 guarantees that there will be a zero rate of personal and corporate taxation within the DIFC for a period of 50 years from the date of the establishment of the DIFC. Law 9 of 2004 allows for the 50-year guaranteed tax holiday to be extended for an additional period of 50 years.

3. FUND STRUCTURES COMMONLY USED FOR HEDGE FUNDS DOMICILED IN THE JURISDICTION

As discussed above, very few funds are domiciled in the wider UAE. One of the reasons for this is the lack of suitable fund structures. All corporate entities (except branches of foreign companies) are required to be majority owned by one or more UAE nationals or entities owned by UAE nationals.

Within the DIFC there is no such requirement for majority ownership by UAE nationals. In addition, there are a variety of corporate structures familiar to the international investment community available in the DIFC. These include limited liability companies, companies limited by shares, limited liability partnerships, protected cell companies and investment companies. It is also possible to register branches of foreign companies or partnerships in the DIFC. Nonetheless, it remains the case that the DIFC has had limited success in attracting fund managers. It is hoped that the consultation process initiated by the DFSA in late 2009, and the changes to the DIFC's funds regime implemented in 2010, will improve the DIFC's competitiveness in this field.

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