CONSULTATION PAPER NO. 119

CHANGES TO THE PROTECTED CELL COMPANY (PCC) & INVESTMENT COMPANY (IC) REGULATIONS

24 MAY 2018

PREFACE

Why are we issuing this paper?

The Dubai Financial Services Authority (the DFSA) and the Dubai International Financial Centre Authority (DIFCA) propose changes to the current Companies Regulations relating to Protected Cell Companies (PCCs) and Investment Companies (ICs). These Regulations apply to persons conducting the business of an Insurer, using the PCC structure, or a Collective Investment Fund (Fund), using the PCC or IC structure.

The PCC and IC Regulations are part of the Companies Law regime, which is substantially contained in the Companies Law [2018][1] and the Regulations made under that law.[2] DIFCA and the Registrar of Companies (RoC) administer the Companies Law regime. It contains the general body of law applicable to all companies, with wide powers available to the RoC to register and deregister such companies, and to issue and revoke commercial licences, as appropriate. In addition, there is a wide range of provisions applicable to companies, dealing with shareholder rights, minority protection provisions, director's duties, financial reporting and mergers and acquisitions of companies.

PCCs and ICs are subject to the general body of law under the Companies Law regime. That regime adds to, and complements, the DFSA regime applicable to such companies as persons conducting Financial Services.

Hence the current joint consultation by DFSA and DIFCA on the proposed enhancements to the PCC and IC Regulations.

These proposals are designed to update the current versions of the PCC and IC Regulations in line with:

a) the changes resulting from the new Companies Law 2018 ("new Companies Law"); and

b) the DFSA Funds regime applicable to Investment Companies, including the recent changes to it.[3]

In addition, there are further refinements to the PCC and IC Regulations to provide greater clarity and to remove unintended gaps.

Who should read this paper?

The proposals in this paper will be of interest to:

a) Insurers and Fund Managers using the PCC structure;

b) Fund Managers and Funds using the IC structure;

c) persons proposing to establish PCCs or ICs to conduct their Insurance or Fund business;

d) sponsors and managers of cells of PCCs and those who propose to do so;

---

1 The DIFCA Board has approved the new Companies Law 2018 and it is now ready to be signed by HH the Ruler of Dubai. The new Law is intended to come into force in mid-2018 (with the AML related parts coming into force earlier).

2 In addition to the Companies Law and Regulations made under that law, the Insolvency Law 2009 and Regulations made under that law also apply to companies.

3 Following public consultation in CP115, we have made a number of changes to the Funds regime. These changes have not yet come into force. We anticipate these changes coming into force in July 2018, upon HH the Ruler of Dubai signing the amendments to the Collective Investment Law 2010.

e) persons investing in or proposing to invest in Umbrella Funds or Investment Companies;

f) persons acting as Fund Administrators or Captive Managers; and

g) other industry participants.

Terminology

Defined terms are identified by the capitalisation of the initial letter of a word or of each word in a phrase and are defined in the Companies Law [2018], Regulations made under that Law and the Glossary Module (GLO) of the DFSA Rulebook. Unless the context otherwise requires, where capitalisation of the initial letter is not used, the expression has its natural meaning.

What are the next steps?

Any comments should be emailed to **consultation@dfsa.ae** using the table provided in Annex C. Please refer to the CP number in the subject line. You may identify the organisation you represent when providing your comments. The DFSA and DIFCA reserve the right to publish, including on their websites, any comments you provide. However, if you wish your comments to be kept confidential, you must expressly request at the time of making comments that this should be the case and your reasons for requesting so.

The deadline for providing comments on this consultation is **24 June 2018**.

Following public consultation, and subject to any refinements to these Regulations as appropriate, the DFSA and DIFCA will take necessary steps to ensure the enactment of the PCC and IC Regulations, which are to be included in the DIFCA administered Companies Regulations. You should not act on these proposals until the relevant changes to PCC and IC Regulations are made. The DFSA and DIFCA shall issue a joint notice on their websites telling you when this happens.

Structure of this CP

The remainder of this CP contains:

Introduction

i a more comprehensive 'conflict of laws' provision to ensure that the DFSA regime applicable to PCCs and ICs prevails over any inconsistent provisions in the Companies Law regime (see paragraphs 7 to 12);

ii changes to bring greater visibility to the DFSA's due process procedures and the FMT's role relating to DFSA decisions applicable to PCCs and ICs (see paragraphs 13 to 16);

iii application of the accounting and audit requirements under the DFSA regime to both Insurers and Funds using the PCC or IC structure (see paragraphs 17 to 20);

iv removing some ambiguities relating to dividend distribution requirements in the Companies Law to Funds (see paragraphs 21 to 25);

v removing a number of other ambiguities and inconsistencies (see paragraphs 26 to 33);

vi a paragraph regarding transitional arrangements (see paragraph 34);

vii Annex A – Draft amendments to PCC Regulations;

viii Annex B – Draft amendments to IC Regulations; and

ix Annex C – Template for responding to this consultation.

INTRODUCTION

1. As noted in the Preface, these proposals are primarily to accommodate the changes to the current Companies Law regime and to align the requirements in the current PCC and IC Regulations better with the Funds regime.

2. Under the current Regulations, Protected Cell Companies can only be used to conduct Insurance Business or the business of a Fund. Insurers and Fund Managers use the PCC structure (a) to segregate assets and liabilities in one cell of a PCC from the assets and liabilities in a different cell and (b) to achieve cost savings by centralising administration and management functions common to all cells in the 'core' of the PCC.

3. Insurers who use the PCC structure do so to conduct captive insurance, which requires the segregation of assets and liabilities of one sponsor and its beneficiaries in one cell, from the assets and liabilities predicated to a different sponsor and beneficiaries, under a different cell.

4. Persons conducting the business of a Fund can only use the PCC structure to operate an Umbrella Fund.[4] Such a Fund offers to investors different asset classes representing different investment strategies and associated risks/benefits. An Umbrella Fund does not necessarily have to use the PCC structure, and can instead use the conventional contractual structure. However, the PCC structure offers tighter segregation of assets and liabilities of one Sub-Fund from the assets and liabilities of a different Sub-Fund of that Fund.

5. The current Companies Regulations have embedded in them the PCC and IC Regulations. However, to provide greater visibility, and for administrative convenience, we have created a stand-alone set of Regulations for each type of specialist class of companies established under the Companies Law regime.[5] Accordingly, we have restructured the PCC and IC Regulations as separate stand-alone Regulations.

6. The PCC and IC Regulations cover a range of matters specific to PCCs and ICs. For example, the PCC Regulations deal with matters relating to the segregation of assets and liabilities of one cell from the other cells of the company, which is a feature unique to a PCC. Similarly, where the Investment Company structure is used for conducting the business of a Fund, (i.e. collective investment), the structure-related requirements applicable to such a Fund are not applicable to other types of Companies (because they are not carrying on the business of collective investment).

I PROPOSED 'CONFLICT OF LAWS' PROVISION

Analysis

7. The current PCC Regulations contain a narrow 'conflict of laws' provision, which provides that where there is any conflict between the PCC Regulations and the Companies Law regime, the PCC Regulations prevail. However, the current IC Regulations do not contain a similar conflict of laws provision at all. We consider a more comprehensive conflict of laws provision than currently provided is needed for the reasons set out below.

---

[4] A protected cell company which conducts the business of an Umbrella Fund is a type of an Investment Company (see Article 26(2) of the Collective Investment Law 2010).

[5] Pursuant to Article 136 of the new Companies Law.

8. The DFSA regime contains the bespoke provisions for the DFSA regulated entities using the PCC or IC structure to conduct Insurance Business or Fund business (i.e. captive insurers and Umbrella Funds using the PCC structure and Funds using the Investment Company structure). As the use of these company structures is secondary to the primary purpose of conducting Financial Services activities, the DFSA regime needs to prevail over the more general provisions in the Companies Law regime common to all companies. There is the potential for such conflicting provisions, particularly where there is an overlap between the two regimes. The task of identifying potential conflicts is not always easy, given the broad width of the Companies Law regime.[6]

9. While the DFSA has the discretion to waive and modify the provisions in the DFSA Rulebook, the DFSA has no discretion to modify or waive the requirements contained in the Companies Law regime, even if they conflict with the DFSA regime and produce an unintended outcome.

10. The proposed conflict of laws provision provides a degree of flexibility by allowing the DFSA regime (which can be modified by the DFSA in appropriate circumstances) to prevail over any conflicting provisions in the Companies Law regime.

Proposal 1

See draft PCC Regulation 1.1.6 at Annex A and draft IC Regulation 1.2.2 at Annex B.

11. We propose to address the concerns noted in paragraphs 8 and 10 by including a more a comprehensive conflict of laws provision in both the PCC Regulations and IC Regulations. This would have the effect that the DFSA regime, which applies to a PCC or IC conducting Insurance Business or Fund business, prevails over the more general provisions in the Companies Law Regime that would otherwise apply to such companies, except where:

    (a) the PCC or IC Regulations contain express provisions; or

    (b) the context requires otherwise.

12. We also propose to delete the current narrow conflict of laws provision in the PCC Regulations in reliance on the more comprehensive provision proposed above.

Questions

1. Do you have any concerns relating to our proposals to introduce a comprehensive conflict of laws provision in both the PCC and IC Regulations? If so, what are they, and how should they be addressed?

[6] Some examples are the pre-emption rights and dividend distribution policy of a Fund and under the Companies Law regime.

II. PROVIDING GREATER VISIBILITY TO DUE PROCESS PROCEDURES AND THE ROLE OF THE FMT

Analysis and background

13. In 2014, we replaced the Regulatory Appeal Committee (RAC) with the Financial Markets Tribunal (FMT) as the body reviewing DFSA decisions. We also refined the DFSA's due process procedures when exercising its discretionary powers under the Regulatory Law and Rules under that law, which are set out in Schedule 3 of the Regulatory Law 2004.

14. At the time we made the above changes, we adopted, at the request of DIFCA, an alternative approach to updating the DIFCA administered legislation to reflect those changes. This entailed relying on an omnibus provision included in the DIFC Laws Amendment Law 2014. Instead of amending the discrete DIFCA legislation containing references to DFSA's administrative powers and referrals from such decisions to the FMT, that omnibus provision provided that any reference in the DIFCA administered laws to the 'Regulatory Appeals Committee' is to be taken as a reference to the 'Financial Markets Tribunal'.[7]

15. While this alternative approach is technically effective to confer jurisdiction on the FMT to review DFSA decisions made under DIFCA administered legislation, it did not provide a clear indication that the FMT has replaced RAC. Further, the due process procedures in Schedule 3 of the Regulatory Law (to which the DFSA is subject when exercising its discretionary powers) are not applicable to DFSA decisions when exercising its powers under DIFCA administered legislation.[8]

Proposal 2

See draft PCC Regulations 1.4.7, 1.6.4, 1.7.7 at Annex A, draft IC Regulations 1.4.6, 1.5.5, and 1.6.5 at Annex B, and draft Appendix 2 at Annex A and B.

16. To address the above concerns, we propose to update the PCC and IC Regulations by:

    (a) replacing references to RAC with FMT; and

    (b) introducing due process procedures mirroring Schedule 3 of the Regulatory Law 2004 in the PCC and IC Regulations.[9]

Question

2. Do you have any concerns relating to our proposals to make changes proposed in paragraph 16? If so, what are they, and how should they be addressed?

---

7 See Article 17 of the DIFC Laws Amendment Law 2014.

8 As far as we are aware, the main DIFCA administered legislation that includes DFSA administered powers and referrals to the FMT can be made, are in the PCC and IC Regulations. While the proposed Companies Regulations under the new Companies Law 2018 are to include due process procedures (similar to those in Schedule 3), in respect of certain DIFCA/RoC decisions (other than those carrying automatic fines), any appeal against such a DIFCA/RoC decision is to the Court, and not to the FMT.

9 The proposed Companies Regulations under the new Companies Law 2018 would also include the due process procedures similar to those in Schedule 3 of the Regulatory Law (with the exception that those decisions are reviewable only by the Court).

III. APPLICATION OF THE ACCOUNTING AND AUDIT REQUIREMENTS TO A PCC OR IC

Analysis

17. There are some ambiguities and inconsistencies relating to the way in which the DFSA's accounting and audit requirements apply to PCCs and ICs.

18. The new Companies Law expressly excludes the application of the accounting and audit requirements (in Part 9 of that law) to Authorised Persons. This is because such firms are subject to the accounting and audit requirements in GEN chapter 8. However, the current PCC Regulation 12.21.1(a) expressly overrides the exclusion in the Companies Law by applying to a person conducting Insurance Business using the PCC structure the accounting and audit requirements in the Companies Law. This is does not promote a consistent approach.

19. The current IC Regulations do not contain a provision, similar to that applicable to Umbrella Funds under the PCC Regulations, which expressly requires a Fund Manager to comply with the accounting and audit requirements in chapter 9 of the CIR in respect of Funds using the Investment Company structure. This could create some uncertainty.

Proposal 3

See draft PCC Regulation 1.21.1(a) at Annex A and draft IC Regulation 1.12.1(2) at Annex B.

20. We propose to:

(a) apply to a PCC conducting Insurance Business the accounting and audit requirements in chapter 8 of the GEN module of the DFSA Rulebook to promote a consistent approach relating to accounts and audit of all regulated firms;[10] and

(b) expressly apply the accounting and audit requirements applicable to Funds in chapter 9 of the CIR module of the DFSA Rulebook to Investment Companies to promote clarity.

Question

3. Do you have any concerns relating to our proposals in paragraph 20? If so, what are they, and how should they be addressed?

10 Both the Companies Law and GEN accounting and audit provisions require companies/firms to apply IFRS standards.

IV. AMBIGUITIES RELATING TO DIVIDEND DISTRIBUTION OF FUNDS

Analysis

21. We are aware that some Funds, particularly those where the Fund is to be an income generating or income distribution Fund (for example, a REIT, which is required to distribute 80% of its audited annual net income), may wish to make a distribution under circumstances that are more flexible than what is permitted under the Companies Law.

22. Under the new Companies Law, a Company can only make a distribution out of profits available for distribution (that is, accumulated realised profits, which are not previously distributed). In the case of a Public Company, there is a further restriction. A Public Company can only make a distribution if the amount of its net assets is not less than the aggregate of its share capital and the distribution does not reduce the amount of those net assets to less than that aggregate.[11]

23. The above requirements can pose difficulties for Funds in a number of ways. First, even if a Fund is generating income from its investments, in a falling market where its assets (i.e. the Fund Property) are experiencing a decline in value, a Public Fund will not be able to make a distribution if the amount of its net assets is less than the aggregate of its share capital. While Public Funds that are Investment Companies face this restriction, Public Funds using the trust or partnership structure would not be subject to a similar restriction. A distinction between Public Funds and Exempt Funds or QIFs is also unwarranted, if the Fund is structured as an income distribution Fund.

24. While we could rely on the expanded conflict of laws provision proposed at paragraph 11, to remove the application of the dividend distribution requirements in the new Companies Law to Funds that are Investment Companies, we think it is more appropriate to have express provisions in the PCC and IC Regulations that deal with this issue.

Proposal 4

See draft PCC Regulation 1.9.5(2) at Annex A and draft IC Regulation 1.11.1 at Annex B.

25. We propose to:

    (a) include a provision so that a Fund using the IC structure is subject to the distribution policy stated in its Articles of Association and the Prospectus; and

    (b) seek further comments on issues around Fund's distributions to be able to develop suitable provisions to deal with them.

Question

4. What practical difficulties would arise from our proposed approach? How should such difficulties be addressed?

[11] Article 68 of the new Companies Law.

V. REMOVING OTHER GAPS, AMBIGUITIES AND INCONSISTENCIES

Extending the obligations imposed on the PCC to its Fund Manager

Analysis

26. Under the current PCC Regulations, there are certain obligations imposed on the Protected Cell Company itself (in addition to some which are imposed on its Directors and Officers). Under the Funds regime, regardless of the structure used by a Fund (i.e. an Investment Company, Investment Trust or Investment Partnership), the Fund Manager must comply with the requirements applicable to a Fund, which are mainly under the Collective Investment Law and the CIR module.

27. Although the current PCC Regulations include a number of definitional provisions that extend the application of the requirements in them to Umbrella Funds using the PCC structure, these do not provide that the obligations imposed on the PCC are obligations that the Fund Manager must comply with.

Proposal 5

See draft PCC Regulation 1.1.5(3) at Annex A.

28. To ensure that the duties imposed on a PCC under the PCC Regulations apply to the Fund Manager of an Umbrella Fund using the PCC structure, we propose to:

    (a) include a further definitional provision to that effect; and

    (b) include specific references to Umbrella Funds in some Rules as appropriate.

Question

5. Do you have any concerns relating to our proposed approach to provide clarity relating to who should comply with the requirements imposed on the PCC? If so, what are they, and how should they be addressed?

Provisions to deal with the internal Fund Manager model

Analysis

29. Under the current Companies Law regime, only natural persons can be Directors of a Company.[12] However, the PCC and IC Regulations create an exception by permitting a PCC or IC, established solely for the purposes of conducting the business of a Fund 'to be managed by one director, which may be a body corporate'.

30. We recently introduced to the Funds regime[13] an internal Fund Manager model under section 8.1A of the CIR module of the DFSA Rulebook. The current provisions in the PCC and IC Regulations that permit a PCC or IC to be managed by a corporate director are not well aligned with the CIR model of an internal Fund Manager.

[12] See Article 51 of the Current Companies Law and Article 70 of the new Companies Law 2018.
[13] As per footnote 2, these changes have not yet come into effect.

Proposal 6

See draft PCC Regulation 1.1.8 at Annex A and draft IC Regulation 1.2.3 at Annex B.

31. We propose to align the PCC and IC Regulations with the internal Fund Manager model introduced under CIR.

Question

6. Do you have any concerns relating to our proposed clarifications relating to the internal Fund Manager model? If so, what are they, and how should they be addressed?

Removal of an absolute discretion

Analysis

32. Under the current PCC and IC Regulations, the DFSA may, at its absolute discretion, refuse to grant its consent for the establishment of a PCC or IC for the purpose of conducting Insurance Business or the business of a Fund.[14] Using an absolute discretion can be seen as inconsistent with the administrative law principles that apply to the exercise of discretionary powers.

Proposal 7

See draft PCC Regulation 1.4.4 at Annex A and draft IC Regulation 1.5.4 at Annex B.

33. In line with the DFSA's approach to the exercise of its administrative powers under the Regulatory Law 2004, we have replaced the 'absolute discretion' with a test based on the applicant's ability to discharge its duties under the applicable legislation (which includes fitness and propriety).

Question

7. Do you have any concerns relating to our proposed criteria for granting the DFSA consent for the establishment of a PCC or IC? If so, what are they, and how should they be addressed?

VI. TRANSITIONAL ARRANGEMENTS

34. We have not included any transitional Rules as part of this CP because the proposed changes are few and are of a facilitative nature. However, if any Person conducting Insurance Business using the PCC structure, or conducting the business of a Fund using the PCC or IC structure, needs time to meet any change proposed (if adopted following public consultation), we would like to hear from them what transitional period would be required. We generally allow transitional relief for 6 to 12 months in appropriate cases.

Question

8. Are there any proposals which you believe could require a transitional period? If so, what are they, and what period of transition would be appropriate?

---

[14] If the DFSA refuses to give its consent, RoC has no power to register a Company to conduct Insurance Business or the Business of a Fund.

General Question

9. Are there any other issues, not included in the package of proposals in this CP, which warrant our attention? If so, what are they, and why, and how, should they be addressed?

Annex C: Table of Comments

Name of commentator:		
Name of entity (if applicable)		
Is your response confidential?	☐ Yes	☐ No
If your response to the previous question is Yes, please state your reasons for such a request:		

Notes:

- The DFSA reserves the right to publish, including on its website, any comments you provide. However, if you wish your comments to be kept confidential, you must expressly request at the time of making comments that this should be the case. You must also provide an explanation of why you wish your comments to be kept confidential.
- Your answers may require explanations. Please include those in the second column.
- If you do not wish to comment on any issue, please select the “no comments” box.

Ref.	Response	Comments on proposal	
Q1:	**Do you have any concerns relating to our proposals to introduce a comprehensive conflict of laws provision in both the PCC and IC Regulations? If so, what are they, and how should they be addressed?**		
	☐ Yes ☐ No		☐ No comments
Q2:	**Do you have any concerns relating to our proposals in paragraph 16? If so, what are they, and how should they be addressed?**		
	☐ Yes ☐ No		☐ No comments
Q3:	**Do you have any concerns relating to our proposals in paragraph 20? If so, what are they, and how should they be addressed?**		
	☐ Yes ☐ No		☐ No comments
Q4:	**What practical difficulties would arise from our proposed approach? How should such difficulties be addressed?**		
	☐ Yes ☐ No		☐ No comments
Q5:	**Do you have any concerns relating to our proposed approach to provide clarity relating to who should comply with the requirements imposed on the PCC? If so, what are they, and how should they be addressed?**		
	☐ Yes ☐ No		☐ No comments
Q6:	**Do you have any concerns relating to our proposed clarifications relating to the internal Fund Manager model? If so, what are they, and how should they be addressed?**		
	☐ Yes ☐ No		☐ No comments
Q7:	**Do you have any concerns relating to our proposed criteria for granting the DFSA consent for the establishment of a PCC or IC? If so, what are they, and how should they be addressed?**		
	☐ Yes ☐ No		☐ No comments
Q8:	**Are there any proposals which you believe could require a transitional period? If so, what are they, and what period of transition would be appropriate?**		
	☐ Yes ☐ No		☐ No comments
Q9:	**Are there any other issues, not included in the package of proposals in this CP, which warrant our attention? If so, what are they, and why, and how, should they be addressed?**		
	☐ Yes ☐ No		☐ No comments