



CONSULTATION PAPER NO. 93

22 DECEMBER 2013

QUALIFIED INVESTOR EXEMPT FUNDS

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Part 1: Introduction and Overview

Why are we issuing this paper?

1. This Consultation Paper seeks public comment on the DFSA's proposals to make amendments to the DFSA's policy framework, as expressed through its rules and through legislation.
2. The amendments relate to the proposed introduction of a new category of Collective Investment Fund, which it is suggested should be called a Qualified Investor Exempt Fund (QIEF), and consequential changes to the DFSA's funds regime, including proposed changes to the Collective Investment Law 2010 (CI Law).

Overview of proposals - QIEFs

3. The DFSA has considered industry feedback on the current categories of Domestic Fund allowed under the DFSA regime, namely Public and Exempt Funds. In response to this feedback, the DFSA now proposes changes to the funds regime so that the following categories of fund would be permitted:
 - (a) Public - unchanged;
 - (b) Exempt - unchanged; and
 - (c) Qualified Investor Exempt Fund (QIEF) – new.
4. The key features of the proposed QIEF category are set out in Part 2, together with changes to the process for establishing such a Fund in the DIFC. A number of consequential changes are also discussed.

Who should read this paper?

5. The proposals in this paper will be of particular interest to the following:
 - (a) Fund Managers and asset managers;
 - (b) other providers of services to Funds, such as Trustees, Fund administrators and depositaries;
 - (c) institutional and other professional investors; and
 - (d) advisors to the above.

Terminology in this paper

6. In this paper, defined terms are identified throughout by the capitalisation of the initial letter of a word or of each word in a phrase and are defined in the Glossary Module (GLO) or in the proposed amendments in this paper. Unless the context otherwise requires, where capitalisation of the initial letter is not used, the expression has its natural meaning.

How to provide comments?

7. All comments should be in writing and emailed to the address specified below. Please refer to the Consultation Paper number in the subject line. You may, if relevant, identify the organisation you represent in providing your comments. The DFSA reserves the right to publish, including on its website, any comments you provide, unless you expressly request otherwise at the time of making comments.

Comments to be addressed or emailed to:

Consultation Paper No. 93
Policy and Legal Services
DFSA
PO Box 75850
Dubai, UAE

Email: consultation@dfsa.ae

Tel: +971(0)4 3621500

8. The deadline for providing comments on the proposals in the paper is **20 February 2014**.

What happens next?

9. Once we receive your comments, we shall consider if any further amendments are required to these proposals. For the proposals in this paper, we may then proceed to recommend the proposed changes to the CI Law to the President for enactment by the Ruler. If those proposed changes to the CI Law are enacted, we shall then proceed to make the relevant changes to the DFSA's Rulebook. You should not act on the proposals until the relevant changes to the CI Law and DFSA Rulebook are made. We shall issue a notice on our website telling you when this happens.

Structure of this paper

10. This Consultation Paper is structured as follows:

Part 1: Introduction and Overview

Part 2: Funds regime: a new category of Fund

Annex 1: List of questions in this Consultation Paper

Appendix 1: Proposed amendments to the Collective Investment Law 2010

Appendix 2: Proposed amendments to the CIR module

Appendix 3: Proposed amendments to the GLO module

Appendix 4: Proposed amendments to the IFR module

Appendix 5: Proposed amendments to the PIB module

Appendix 6: Proposed amendments to the FER module

Part 2: Funds regime: a new category of Fund

Background

11. In 2010 the DFSA reviewed its regime for the authorisation and supervision of Funds. A series of changes were then proposed in Consultation Paper 69 and, after due consideration of consultation responses, subsequently introduced.
12. Amongst other changes, the DFSA at that time introduced a new category of Fund, namely Exempt Funds, and the Private Fund category that existed before that time was phased out, after a two year transitional period that ended in 2012.

Experience in operating the 2010 regime

13. Since the new Exempt Fund regime was established the DFSA has received a number of applications from firms wishing to be authorised as Fund Managers, and wishing to establish Exempt Funds.
14. A common feature of many of these applications has been a large number of concurrent applications for waiver and/or modification of aspects of the DFSA Rules. The waivers and modifications requested have related to governance, valuation, alternative custody arrangements, investment/oversight committees, investment restrictions, use of Special Purpose Vehicles, and approach to affected person transactions. In general, our requirements in these areas have been considered by applicants to be too onerous given the professionalism, knowledge and experience of targeted investors and the intended disclosures in the information memorandum. Dealing with these waiver/modification applications has proved to be time consuming for the DFSA, for applicants, and for their advisors. Amongst other things, this has meant that applications for authorisation in this area have taken greater resources to deal with, and longer to process, than the DFSA believes is desirable, given the relative level of risk posed by Exempt Funds.
15. Exempt Funds are typically characterised by having low numbers of investors all of whom are professional investors, with an emphasis upon disclosure in an information memorandum based on direct discussion between the Fund Manager and prospective investors. In such an environment, principles-based regulation should be emphasised over rule requirements that are more appropriate to the degree of investor protection suitable for Retail Clients.
16. It is evident from this experience that the Exempt Fund regime is not providing the desired degree of flexibility for certain types of Fund Managers, Funds and investors. It is also clear that the 2010 changes – which it was hoped would introduce sufficient flexibility – have not been sufficient.

Benchmarking

17. As is our normal practice, we have looked at the regimes in place in other jurisdictions, to see where the DFSA funds regime sits in comparison to those jurisdictions and, in this case, to help in the process of identifying areas where greater flexibility could be introduced into the DFSA regime.

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18. Benchmarking has focused on a wide review of several jurisdictions' exempt fund regimes, or nearest equivalents, whilst also focusing on those areas which have increasingly been the subject of applications for waivers/modifications since our Exempt Fund regime was established. We have looked at the following jurisdictions and regimes: Bahrain, BVI, Cayman Islands, Guernsey, Hong Kong, Ireland, Jersey, Luxembourg, the Qatar Financial Centre Regulatory Authority (QFCRA), Singapore and the UK.¹
 19. Generally the benchmarking illustrated differing approaches to the equivalent of the DFSA's Exempt Fund regime. Jurisdictions such as Singapore, Hong Kong, the UK, and Jersey place the emphasis on setting out requirements for the fund manager, whilst certain types of funds are exempted from regulation altogether.
 20. Luxembourg, Ireland, Guernsey, Jersey, Bahrain and the QFCRA have adopted dual regulatory approaches covering both the fund manager and fund, similar to that of the DFSA.
 21. Luxembourg, Ireland and the UK have implemented the EU's Alternative Investment Fund Management Directive (AIFMD). The AIFMD means enhanced regulation for firms and funds operating in the private equity, property and hedge fund sectors that may not have previously been subject to regulation.
 22. BVI's new Approved Manager Regime, introduced during 2012, provides for less onerous requirements on the fund manager and a streamlined licensing process. Although the Cayman Islands have a mutual funds regulatory regime, it would appear generally from the benchmarking that there are a number of exemptions available to both fund manager and fund. These exemptions enable such firms seeking to establish a presence in the Cayman Islands effectively to set up an unregulated fund manager and fund, or with minimal requirements at most.

Issue for consideration

Q1: Are there any particular features of regulatory models in other jurisdictions that the DFSA should consider further?

Analysis and proposed changes

Introduction of an additional Fund category

23. The benchmarking shows that all other jurisdictions (except Hong Kong) have at least three categories of funds. The categories generally cover three types of investors including:
 - (a) Retail – ordinary retail clients who are neither sophisticated investors nor high net worth individuals;
 - (b) Sophisticated – are essentially retail clients with extensive investment experience and knowledge, who are better able to understand the risks of

¹ It is worth noting that several of these jurisdictions are themselves in the process of amending their fund regimes.

complex and unusual investments and have a high net worth;

- (c) Professional – includes individuals and commercial undertakings that are knowledgeable and experienced and who invest in such products frequently. They have, in addition to their high net worth, the ability and willingness to risk large sums of money to be invested, e.g., USD 1 million.
24. Under the DFSA’s approach to client categorisation, the first category above is covered by our Retail Client category, while both the Sophisticated and Professional investors are covered by our Professional Client category.
25. We propose to introduce a new category of fund, to be aimed at qualifying professional investors of the type referred to in paragraph 23(c).
26. We have considered further the appropriate name for the new fund category. As we propose to leave the requirements that apply to the existing Public and Exempt Funds categories unchanged, it is simplest similarly to keep the names of these Fund categories unchanged.
27. We propose that the new category of fund should be called Qualified Investor Exempt Funds (QIEFs). The benchmarking shows that other jurisdictions often use a “qualified investor” label for such funds and the name reflects the fact that not all Professional Clients will be investors in such funds.
28. The table below shows what the structure of the DFSA’s regime for Domestic Funds would look like if the proposals in this paper came into effect.

Type of Fund	Public Funds (current)	Exempt Funds (current)	Qualified Investor Exempt Funds (QIEFs) (proposed)
Level of regulation	Detailed regulation in line with IOSCO standards	Somewhat less stringent than for Public Funds	Significantly less stringent than for Exempt Funds
Investors	Retail Clients as investors	Professional Clients as investors	Professional Clients as investors qualifying through a higher minimum subscription

Issue for consideration

Q2: Do you agree with the introduction of a new category of fund? If not, please explain why?

Parameters for QIEFs

29. The current DFSA Exempt Fund definition is as follows:
- (a) have or intend to have 100 or fewer Unitholders;
 - (b) have its Units offered only by way of Private Placement;

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- (c) have only Unitholders each of whom meets the criteria to be classified as a Professional Client; and
 - (d) have a minimum subscription of at least USD 50,000 for a person to become a Unitholder in the Fund.
30. Given the intended target market, the requirements for a QIEF must, inevitably, be narrower than those for an Exempt Fund.
31. In many jurisdictions, the QIEF-equivalent criteria include a high net worth test, coupled with professionalism as evidenced by the size and frequency of transactions in their investment portfolio. In the case of institutional investors, there are tests based on assets under management or operational size of the entity; and a minimum level of investments in the fund.
32. Some of the benchmarked jurisdictions have a minimum subscription level of USD 100,000 - USD 163,000 for QIEF-equivalent funds. The threshold for being able to invest in such funds is often driven by the client categories/definitions which exist in the legislation. The DFSA could increase the net asset test for categorising a client as a Professional Client, which currently sits at USD 500,000 (see COB 2.3.2(1)(a)(i)). Benchmarking shows that there is wide variation in the net asset tests that jurisdictions use for individuals investing in QIEF-equivalent funds, from USD 375,000 to USD 10 million. However, making such a change in the DFSA's client categorisation rules would have a significant impact on the wider DFSA regulatory regime, and on Authorised Firms, so this is not our preferred route.
33. Although the minimum subscription required for investment in current Exempt Funds is set at USD50,000, the large majority of proposals relating to such Funds which we have received during the last 18 months have a minimum subscription level of at least USD 1 million, ranging up to USD 10 million. It is these Funds which, we feel, would appropriately fall into the proposed QIEF category.
34. Combined with the smaller number of investors who could participate in a QIEF, we believe that the proposed minimum subscription level for a QIEF investor set at USD1 million:
- (a) sufficiently differentiates QIEFs from Exempt Funds;
 - (b) ensures that actual investors in QIEFs are the type of qualifying professional and institutional investors capable of protecting their own interests within the regulatory regime we are proposing; and
 - (c) still provides Fund Managers of QIEFs sufficient flexibility to target investors appropriate to the specific nature of the proposed Fund.
35. An alternative, to ensure that only the truly institutional investor targeted by such funds can invest, would be to set a minimum subscription of USD 10 million. However, at this stage we feel that setting the minimum at USD 1 million provides sufficient differentiation from the existing category of Exempt Funds.
36. In addition, we have looked at other jurisdictions to see whether they have
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requirements on the maximum number of unitholders in a QIEF-equivalent fund. While many do not have such a restriction, there are a number of examples where lower limits are in place than the 100 investor maximum for a DFSA Exempt Fund. We have again looked at the proposals we have received for funds in the current Exempt Fund category, to ensure that any proposal for change would provide the sort of flexibility that the relevant Fund Managers have been seeking. Our conclusion, and so the proposal in this paper, is that a QIEF should have a maximum of 50 investors.

37. The key parameters for the proposed QIEF category are, then, that a Fund has:
- (a) 50 or fewer Unitholders;
 - (b) its Units offered to persons only by way of a Private Placement;
 - (c) only Unitholders each of whom meets the criteria to be classified as a Professional Client; and
 - (d) a minimum subscription of at least USD 1,000,000 as the qualification for a person to become a Unitholder in the Fund.
38. The DFSA believes that these parameters provide sufficient differentiation between QIEFs and Exempt Funds, will allow sufficient flexibility for Fund Managers, and are sufficient to justify the regulatory treatment of QIEFs set out in the following sections.

Issue for consideration

Q3: Do you agree with the proposed minimum subscription limit and maximum number of investors for QIEFs? If not, please suggest alternatives and explain why they are preferable.

Specialist fund requirements and QIEFs

39. The DFSA's specialist classes of fund are Islamic Funds, Fund of Funds, Feeder Funds, Master Funds, Private Equity Funds, Property Funds, Real Estate Investment Trusts (REIT), Hedge Funds and Umbrella Funds. The specialist fund requirements apply to all Funds unless specifically stated otherwise.
40. Some firms have applied to waive entire sets of specialist fund requirements (e.g. Property Fund and Private Equity Fund rules) as they believed the rules were too onerous given the professionalism, knowledge and experience of targeted investors and the intended disclosure by the Fund Manager to investors on issues such as valuation, alternative custody arrangements, investment/oversight committees and investment restrictions.
41. Benchmarking shows that the DFSA is no longer aligned to the majority of jurisdictions we have looked at, which do not have specialist fund requirements applied to QIEF-equivalent funds. The exceptions to this are Ireland, Bahrain and the QFC, which impose some requirements relating to QIEF-like funds, but such requirements apply only to certain types of specialist funds available in those jurisdictions.

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42. We propose that the specialist fund definitions remain and still apply to all QIEFs (so providing Fund Managers the flexibility to use the specialist fund names, if they wish). However, we propose to remove the detailed specialist fund requirements in relation to all QIEFs and their Fund Managers, with the exception of certain Umbrella Fund requirements, which are structural in nature, and a rule relating to the use of prime brokers.
 43. Not having specialist fund requirements would not, of course, prevent a QIEF from being, for example, a Private Equity Fund or, indeed, a hybrid fund. Rather, it would provide the Fund with more flexibility with an emphasis on disclosure in an information memorandum given the types of investors being targeted.
 44. These proposals would ensure the DFSA funds regime is in alignment with global and regional practice and provide professional investors and respective fund managers with a greater level of flexibility.

Issue for consideration

Q4: Do you agree with the disapplication of the specialist fund requirements for QIEFs?

Overarching requirements for QIEF Managers

45. Benchmarking has illustrated that many jurisdictions - such as Singapore, Hong Kong, and Jersey - place the emphasis on setting out requirements for the fund manager rather than on the fund itself. Indeed the Alternative Investment Fund model recently implemented in the EU, through the AIFMD, also puts more emphasis upon the fund manager.
46. Although we propose to disapply a number of requirements to QIEFs and to their Fund Managers, key elements of the DFSA funds regime will continue to apply. These include the Fund Manager's general duties and functions in Article 22 of the CI Law and the adequacy of systems and controls required under Article 38 of the CI Law Part 3, as well as the Principles for Authorised Firms in GEN chapter 4.2 These high-level requirements are, in general, believed to provide the DFSA with sufficient regulatory control over QIEFs, given the lower risk that these Funds pose to the DFSA's achievement of its objectives.
47. So, we propose that a Fund Manager of a QIEF would continue to be required to be a DFSA-licensed entity.

Issue for consideration

Q5: Do you agree that it is appropriate to disapply the majority of the requirements in CIR to QIEF Managers and for the DFSA to rely on the provisions in the CI Law? If not, please explain what alternative you prefer, and explain why.

Custody

48. We propose to provide further flexibility for Fund Managers of QIEFs relating to custody arrangements which they could have in place for Fund Property. To provide such flexibility, we propose to disapply the current requirements in the CI Law and CIR Module which require custody of Fund Property to be delegated

to an Eligible Custodian, except in limited circumstances where alternative arrangements are available.² In doing so, we rely on the overarching obligations that continue to apply to the Fund Manager of a QIEF as noted below, subject to two safeguards (see paragraph 52(a) below).

49. Article 22(2)(f) of the CI Law requires a Fund Manager to ensure that Fund Property is clearly identified as Fund Property and held separately from the property of the Fund Manager and the property of any other Fund it manages. As the Fund Property has to be clearly identified as Fund Property, and separated from the Fund Manager's own property (as well as the property of any other Fund which the Fund Manager manages), the Fund Property would not be available to the creditors of the Fund Manager in the event of its insolvency, as they are held by the Fund Manager in trust for the Fund and the Fund Manager has only the legal, and not the beneficial, ownership of such property.
50. We note that the DFSA has spent a lot of time and resources, in relation to pre-application waivers, focusing on the issue of custody and alternative custody arrangements for Exempt Funds. Experience to date with the approach adopted by applicant Fund Managers has been that the DFSA requirements in respect of custody requirements, including alternative arrangements, are not always a best fit.
51. We believe that greater flexibility with regard to custody of Fund Property may be warranted in the case of QIEFs on the basis that investors in a QIEF will be professional investors who can understand the operational process of managing the Fund and any inherent risks. A Fund Manager is - in any case - accountable to investors for the safety of the Fund Property and so must ensure proper safety of Fund Property, including through use of custodians and/or depositories that are, in appropriate circumstances, independent.
52. In order to provide this greater flexibility, while also ensuring that there are sufficient safeguards in place, we propose that the Fund Manager of a QIEF be allowed either to hold Fund Property of a QIEF or appoint an Eligible Custodian to hold such property:
 - (a) where the Fund Manager decides to provide custody, rather than delegate the activity to an Eligible Custodian, we propose to enhance the protection available to investors in such a Fund by:
 - (i) categorising such a Fund Manager as a prudential Category 3B Firm under the PIB Module, instead of Category 3C. This ensures that a Fund Manager undertaking the custody function is appropriately regulated from a prudential perspective, in the same way as a firm carrying out the Financial Service of Providing Custody. The Fund Manager would as a result be subject to a base capital requirement of USD 4 million (instead of USD 500,000 – see below); and
 - (ii) imposing an additional obligation on such a Fund Manager that it must have in place effective arrangements to ensure that the Fund

² The Eligible Custodian requirement does not apply to the Fund Manager, who can take advantage of limited carve outs providing alternative arrangements, in the case of Private Equity and Property Funds.

Property is not available to creditors of the Fund Manager in the event of the Fund Manager's insolvency; or

- (b) where the Fund Manager of a QIEF decides to use the option of delegating the activity of providing custody to an Eligible Custodian, then it will remain a Category 3C Firm under the PIB Module, as is normally the case with an Authorised Firm providing the Financial Service of Managing a Collective Investment Fund. This means it would continue to have a base capital requirement of USD 500,000.
53. An issue we have considered is whether further flexibility needs to be provided relating to the custody arrangements which are permitted in the case of certain types of specialist funds. Although we propose to disapply the specialist fund requirements to QIEFs (see paragraphs 39 to 44), a Fund Manager may still be operating a Fund which has the characteristics of a specialist class of a Fund. For example, a Fund which is investing in private equity, under the current requirements, has the flexibility not to appoint an Eligible Custodian, provided it has an investment committee comprised of three experts who are independent of the Fund Manager to advise it on investments. Although such a Fund Manager holds the Fund Property of the Private Equity Fund, it remains a prudential Category 3C firm.
54. Under the proposals for QIEFs, if the Fund Manager of a QIEF is investing in private equity (and therefore the QIEF is by its nature a private equity fund) and chooses to hold custody of the QIEF, it will be treated as a prudential category 3B firm (paragraph 52 (a)(i)) and be subject to the additional requirement proposed relating to safety of property in the event of insolvency (paragraph 52(a)(ii)). Whilst the latter should have no additional costs, the former would place the QIEF and its Fund Manager at a cost disadvantage compared to a Fund Manager of, for example, an Exempt Private Equity Fund. To address this potential anomaly, we would welcome the views of stakeholders on this question.

Issue for consideration

Q6: Do the proposals on custody arrangements for QIEFs provide sufficient flexibility and sufficient protection for investors?

Q7: Are the capital requirements proposed, depending on custody arrangements, appropriate? If not, please suggest an alternative and explain why it is preferable.

Q8: What custody requirements should apply to a QIEF if it is, by its nature, a Private Equity Fund?

Please explain your answer by reference to the risks inherent in such funds, the nature of the assets (the Fund Property) and the appropriate degree of protection for investors in QIEFs.

Constitution

55. The Constitution of a fund is the instrument creating the legal form of the Fund, in which the Fund Manager sets out provisions relating to any aspect of the management and operation of the Fund. It generally takes the form of:

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- (a) for a body corporate, the instrument of incorporation (e.g., the articles of association);
 - (b) for a trust, the trust deed; or
 - (c) for a partnership, the partnership agreement.
56. Under Article 27(1) of the CI Law, every Fund must have a written Constitution which complies with the Rules. Currently, CIR 7.1.2(1) requires that the Constitution contains the statements and disclosures prescribed in CIR Appendix 5, which wholly applies to a Public Fund and partially applies to an Exempt Fund. Overall the Fund Manager (and/or trustee) must ensure that these requirements are met and is also responsible for the ongoing maintenance of this Constitution.
57. Benchmarking suggests that this current approach is overly prescriptive for the proposed QIEF category, particularly as CIR Appendix 5 is designed to provide an appropriate level of protection for investors in Public/Exempt Funds and not for the more limited set of investors expected to be investing in QIEFs.
58. We propose that the current CIR Chapter 7 Rules in relation to a Constitution are disapplied with the exception of CIR Rules 7.1.2(1)(b)³, 7.1.2(2)⁴ and 7.1.4⁵. This provides flexibility for the Fund Manager to negotiate with potential investors. Maintaining the three requirements specified would require the Fund Manager to ensure that the Constitution of a Fund sets out the relevant parameters of the QIEF and does not contain any provision that is prejudicial to the interests of the Unitholders. The Fund Manager will be responsible for maintaining the Constitution and for making any necessary alterations.

Issue for consideration

Q9: Are the limited requirements proposed for the Constitution of a QIEF sufficient? If not, please explain what additional requirements should apply.

Information Memorandum

59. The information memorandum (CIR 14.3.3 refers to an information memorandum of an Exempt Fund as being a prospectus) of an Exempt Fund is the document which provides investors with the necessary information to assist them in making well-informed decisions as to whether the investment is right for them. It is critical that it contains the relevant information. In relation to QIEFs there may be more negotiation (relative to other types of Fund) between parties in relation to terms and conditions of an agreement. Usually this should lead to fewer requirements in this area for QIEF information memorandums, while also providing the Fund Manager with more flexibility in strategy.

³ CIR Rule 7.1.2(1)(b) requires the Constitution not to contain any provision prejudicial to the interests of a class of Unitholders or of Unitholders generally.

⁴ CIR Rule 7.1.2(2) requires the Fund Manager to maintain the Constitution and make necessary alterations to it.

⁵ CIR Rule 7.1.4 requires the Fund Manager to ensure that the name of the Fund is not undesirable, misleading or in conflict with the name of another Fund.

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60. We believe that the CI Law has adequate high-level provisions to cover the requirements for a QIEF and its Fund Manager, respectively. We propose, therefore, no additional Law or Rule requirements in this area. We do propose to introduce some additional Guidance to the CIR module (similar to that currently located at CIR 14.3.3) setting out expectations for the content of a QIEF information memorandum.

Issue for consideration

Q10: Do you agree that there is no need for detailed provisions on the information memorandum of a QIEF? If you feel detailed provisions are needed, please set out which provisions and explain why they are necessary.

Secondary sales

61. Under the proposed regime for QIEFs, investors in a QIEF would have the following options if they wished to sell their holding:
- (a) redeem the holding with the Fund Manager, on the terms agreed at the time of initial investment, as described in the Information Memorandum;
 - (b) sell to another existing investor in the QIEF, by way of a private placement;
or
 - (c) sell to another investor (who must be a Professional Client) who has not already invested in the QIEF, by way of a private placement.
62. The law and rules as drafted would allow an investor, who initially invested the minimum subscription of USD 1 million, to sell to another Professional Client (under option (c)) for a consideration of less than USD 1 million, if the value of their holding had fallen. This replicates the position for existing Exempt Funds, where an investor could – in theory – sell their holding to another Professional Client for an amount less than the initial subscription minimum of USD 50,000.
63. The benefit of this approach is that the Professional Client (the potential buyer) should have the knowledge and experience to assess the merits of the potential investment, and to reach a judgement on whether a holding that originally cost USD 1 million is worth some lesser amount. The difficulty with this approach is that it potentially opens up investment in QIEFs to a wider range of Professional Clients (i.e. those who do not have to make an initial USD 1 million investment) than would be the case if they were qualified to be initial investors in the QIEF.
64. Investors in a QIEF should be well aware that these are not expected to be liquid investments and that a commitment to a medium/long term holding period is a necessary aspect of the investment decision. Similarly, Professional Clients of the types likely to invest in QIEFs would, if the value of the QIEF had fallen significantly, be likely to get the Fund Manager to wind-up the QIEF. So secondary sales are not expected to be common features of this market. Nonetheless, we would welcome views on the extent to which the regime should allow for secondary sales.

Issue for consideration

Q11: Do you think that secondary sales should be allowed to Professional Clients who did not invest in the initial launch of a QIEF? If not, please explain why.

Reporting

65. Currently the DFSA requires a Fund Manager to produce one interim report and one annual report in respect of each Exempt Fund it manages. Each report must be supplied free of charge to Unitholders and be sent to the DFSA. An annual report for an Exempt Fund is expected to include the full audited accounts for the annual accounting period; the report of the auditor; the report of the fund manager and, if applicable, an Eligible Custodian Report (Hedge Funds) and an Independent Committee Report (Property and Private Equity Funds).
66. Benchmarking shows that most jurisdictions require an annual report with an audit performed.
67. We propose that:
 - (a) the DFSA would require only an annual report for a QIEF, rather than both interim and annual reports. The annual report should include full audited accounts for the annual accounting period; the report of the Auditor; and the report of the Fund Manager only; and
 - (b) where a QIEF is subject to a material change during the year, then it should provide an interim report to the DFSA and to Unitholders.

Transfer and Winding-Up

68. The benchmarking undertaken has highlighted that the CIR module is slightly more prescriptive than other jurisdictions in relation to the transfer, and winding-up, of a Domestic Fund. The CI Law and Regulatory Law 2004 also contain provisions in relation to these matters to ensure that investors are adequately protected and that the DFSA has adequate powers to take action should this be required.
69. However, the DFSA regime in this area has never been fully tested through a transfer or winding-up. For the present, we propose that the existing requirements should remain in place and apply to QIEFs in the same way as to other Funds.

Issue for consideration

Q12: Do you agree with the proposals on:

- (i) reporting, and
- (ii) transfer and winding-up?

If you disagree, please explain what alternative you would prefer.

Changes proposed to the CI Law

70. The recommended changes to the CI Law, set out in Appendix 1, are necessary to establish in the law the category of QIEF; to remove residual provisions dealing with Private Funds; and to move the definition of Private Placement from rules to law, this definition having become well established through use.

Applications and processing times

Applications for authorisation as a Fund Manager of a QIEF

71. The benchmarking shows that there is a wide range of maximum timelines for processing authorisation applications for QIEF-equivalent fund managers, with the DFSA being at the higher end of the scale for time taken. The current average time for processing an authorisation application for an Exempt Fund Manager is 17 weeks.
72. The DFSA aims to move towards a more efficient process for authorising Fund Managers, where the activity to be undertaken by the Fund Manager is confined to managing QIEFs. A maximum 4-6 week timetable should still provide the DFSA with sufficient time to undertake the necessary background checks and make an assessment of an application.
73. The current Exempt Fund Form covers the majority of information that would be required to license a Fund Manager of a QIEF. There are several documents, ranging from controls procedures to third party agreements, which the Fund Manager is required to self-certify as being ready and available for inspection at the point of submitting the application.
74. The benchmarking shows that the DFSA is not excessive in terms of the documentation it requests for a Fund Manager of an Exempt Fund, and that a number of jurisdictions are looking to enable on-line applications.
75. We propose not to change the documents required as part of the authorisation application for a Fund Manager of a QIEF. During 2014/15, the DFSA intends to work on allowing on-line applications.
76. At this stage, the DFSA does not propose to change the fee charged for an authorisation application for a Fund Manager, or for the ongoing supervision of a Fund Manager.

Issue for consideration

Q13: Do you have any comments on our proposals for application to be authorised as a Fund Manager of a QIEF?

Applications for authorisation of a QIEF

77. The DFSA's current timetable, introduced following the 2010 Funds Review, for processing an Exempt Fund notification is five days. The Exempt Fund notification form and process was designed for efficiency with self-certification of the Fund's Constitution and prospectus confirming that such documents are ready and available for inspection. Experience to date has shown that each

case has taken much longer than five days, as a result of:

- (a) the Fund notification being submitted in tandem with the authorisation application for the Fund Manager; and
 - (b) the types of proposed Fund structure.
78. On this latter point, some of the proposed structures, although used in other jurisdictions, had not previously been deployed in the DIFC and this has resulted in lengthier processing times.
79. The benchmarking shows that there is a wide range of timelines for processing a QIEF-equivalent fund application. At one extreme, the Cayman Islands enables a fund to be incorporated on the same day, whilst BVI allows a fund to be set up for a period of no longer than 21 days without providing notification to the regulator, thus enabling flexibility and efficiency of entering the market. Ireland allows for a fund to be authorised within 24 hours of submitting the application to the regulator, if all policy issues have already been resolved.
80. The DFSA intends that a QIEF could be granted consent to launch within 48 hours (two business days) of formal application. For this to be possible:
- (a) the completed notification form will need to be correctly submitted to the DFSA;
 - (b) the Fund Manager, Investment Manager, Eligible Custodian, Trustee and administrator (where relevant for the particular QIEF) must be subject to regulation by a financial services regulator in a jurisdiction acceptable to the DFSA with respect to the activity required in relation to the QIEF in advance of the Fund launch;
 - (c) any policy issues relating to the QIEF must be cleared with the DFSA in advance of a notification being submitted;
 - (d) there will be no prior filing with, or review by, the DFSA of the Fund. Instead, there will be a self-certification regime where certification has to be given by the Fund Manager/Fund legal advisers. The self-certification must accompany the notification form confirming that the notification form is correct, complete and accurately reflects the material documentation of the QIEF and the Constitution, information memorandum, delegation agreements and all relevant DFSA-administered Laws and Rules. Once those certifications can be given, the actual Fund documentation would be negotiated between the Fund Manager, the legal advisers and the other service providers, and then executed. The information memorandum and Constitution should be filed with the DFSA, and all other documentation needs to be available on request; and
 - (e) the Eligible Custodian/Trustee (where relevant) will provide a similar self-certification in relation to the provisions of the custodian agreement/trust deed.
81. Once all necessary documents were completed and submitted to the DFSA, the QIEF would intend to send within 48 hours (two business days) a notice of

consent to launch. A 'spot check' review after launch of the Fund may then take place.

82. Benchmarking shows that the DFSA's fees for establishing and operating an Exempt Fund remain in line with other jurisdictions. The same level of fees is proposed for a QIEF.

Issue for consideration

Q14: Do you have any comments on our proposals for application to authorise a QIEF?

Annex 1: List of questions in this Consultation Paper

- Q1: Are there any particular features of regulatory models in other jurisdictions that the DFSA should consider further?
- Q2: Do you agree with the introduction of a new category of fund? If not, please explain why?
- Q3: Do you agree with the proposed minimum subscription limit and maximum number of investors for QIEFs? If not, please suggest alternatives and explain why they are preferable.
- Q4: Do you agree with the disapplication of the specialist fund requirements for QIEFs?
- Q5: Do you agree that it is appropriate to disapply the majority of the requirements in CIR to QIEF Managers and for the DFSA to rely on the provisions in the CI Law? If not, please explain what alternative you prefer, and explain why.
- Q6: Do the proposals on custody arrangements for QIEFs provide sufficient flexibility and sufficient protection for investors?
- Q7: Are the capital requirements proposed, depending on custody arrangements, appropriate? If not, please suggest an alternative and explain why it is preferable.
- Q8: What custody requirements should apply to a QIEF that is, by its nature, a Private Equity Fund?
- Please explain your answer by reference to the risks inherent in such funds, the nature of the assets (the Fund Property) and the appropriate degree of protection for investors in QIEFs.
- Q9: Are the limited requirements proposed for the Constitution of a QIEF sufficient? If not, please explain what additional requirements should apply.
- Q10: Do you agree that there is no need for detailed provisions on the information memorandum of a QIEF? If you feel detailed provisions are needed, please set out which provisions and explain why they are necessary.
- Q11: Do you think that secondary sales should be allowed to Professional Clients who did not invest in the initial launch of a QIEF? If not, please explain why.
- Q12: Do you agree with the proposals on:
- (i) reporting; and
 - (ii) transfer and winding-up?
- If you disagree, please explain what alternative you would prefer.
- Q13: Do you have any comments on our proposals for application to be authorised as a Fund Manager of a QIEF?

Q14: Do you have any comments on our proposals for application to authorise a QIEF?