

Dubai Financial Services Authority's response to public comments on CP 69: "Proposed Enhancements to the Collective Investment Funds Regime"

This document sets out information relating to key comments we received in response to the proposals in CP 69, and how those comments helped us reshape some of those proposals. It is not meant to be a comprehensive document setting out the DFSA's Funds regime, which is mainly contained in the Collective Investment Law 2010 and the Collective Investment Rules (CIR) module of the DFSA Rulebook. Interested persons should refer to the text of the legislation, which can be accessed through the [DFSA website](#), for comprehensive information relating to the DFSA's Funds regime.

Background

1. CP 69 contained the DFSA's proposals to make significant changes to the DIFC's Collective Investment Funds regime ("the Funds Regime") to better align it with international trends and practices and make it more attractive to both fund managers and participants in the funds industry. These proposals arose out of a review of the Funds Regime by a Market Practitioner Panel appointed by the DFSA, which recommended wide-ranging changes to the Funds Regime without deviating from the International Organisation of Securities Commission's (IOSCO) principles for collective investment schemes (see the [Panel Report](#)).
2. DFSA received 19 written submissions on the CP 69 proposals, and also met with a number of other parties who indicated their interest in informally discussing the proposals with us.
3. The public comments were overall strongly supportive of the proposals, and where major concerns were shown as noted below, we have made further adjustments to the proposals.
4. Set out below are the key aspects of the issues raised by public comments relating to CP 69 proposals, and how we have responded to those comments.

Should DFSA licensed Fund Managers be permitted to establish External Funds in any external jurisdiction of their choice?

5. On the issue whether DFSA licensed Fund Managers should be allowed to establish External Funds in any jurisdiction of their choice, public comments supported the view that jurisdictions should not be limited, as proposed in CP 69, to those jurisdictions either in the DFSA's Recognised Jurisdictions List or otherwise approved by the DFSA. Public comments supported the view that DFSA licensed Fund Managers should be free to set up External Funds in any

jurisdiction outside the DIFC provided proper disclosure is made about the jurisdiction and any applicable laws in that jurisdiction.

6. We have amended our initial proposals so that DFSA licensed Fund Managers are permitted to establish External Funds in jurisdictions of their choice subject to certain safeguards. The Fund Manager, before establishing an External Fund, must demonstrate to the DFSA that it has adequate systems and controls to ensure compliance with the regulatory requirements applicable to the External Fund in its host jurisdiction, and must disclose to the DFSA details relating to the host jurisdiction and its regulatory requirements applicable to the Fund. The Prospectus of the External Fund must also include information about the host jurisdiction and the applicable regulation, and make clear that the Fund is not subject to any form of regulation or approval by the DFSA.

Should the proposed Exempt Funds regime contain a maximum investor limit of 50?

7. On the issue whether Exempt Funds should have a limit of 50 or fewer investors, public comments suggested that such a limit would easily be reached and would result in Fund Managers having to establish multiple identical Funds to cater to small numbers of Professional Clients having similar investment objectives. In light of these public comments, we increased our initial 50 investor limit for Exempt Funds to 100 investors. However, Exempt Funds continue to be restricted to Professional Clients making at least US\$50,000 minimum subscription.

Should Exempt Funds be required to have a 6 monthly audit?

8. Public comments opposed the proposal to subject Exempt Funds to a 6 monthly valuation requirement and noted that in the case certain types of Funds, such as Private Equity or Property, such a requirement would be expensive and unwarranted as the Fund Manager must in any event have valuations as required by the needs of the investors in the Fund and the nature and type of Fund assets. In light of these comments, and also the fact that Funds are subject to annual reporting obligations that require valuation of Fund assets in a manner acceptable to the auditor of the Fund, we removed the proposed 6 monthly valuation requirement for Exempt Funds.

Should there be a completely unregulated small scale Fund carve-out?

9. One public comment suggested that there should be a carve out from regulation for small scale Funds (i.e. Funds open only to less than 20 Professional Clients investing at least US\$1 million). We did not think that such a carve-out is necessary, given the new Exempt Funds regime and the flexibility of regulation provided to such Funds.

Should Exempt Funds be subject to any additional investor warning requirements?

10. One public comment suggested that to address possible risk of mis-selling to Retail Clients, there should be an additional requirement to include in applications forms for subscription in Exempt Fund an investor declaration to the effect that he/she "...has the necessary experience to understand the features and risks of such investments, read and understood the offer document, taken advice if appropriate, and understood that the investment could result in a loss of significant proportion or the entirety of the sum invested". We did not include any such additional warning requirement as an Exempt Fund Information Memorandum (Prospectus) is required to contain a statement that it is not intended for investors other than Professional Clients and therefore, should not be directed to, or relied upon, by Retail Clients.

Is the limit of participation in Exempt Funds subject to any 'look through' restrictions?

11. A public comment raised the issue whether the investor limit applicable to Exempt Funds involves any 'look through' requirements of the kind found in some other jurisdictions. (These would be relevant where institutions invest on behalf of their Clients.) We did not think that any further restrictions or complexity in this regard were warranted, with the Fund Manager remaining accountable to ensure that each investor in the Fund meets the relevant Professional Client criteria and the minimum subscription test.

Should there be a Net Asset Value (NAV) based fee of 0.1% charged to a Fund Manager in respect of each Fund?

12. A number of public commentators strongly argued that Fund Managers should not be subject to a NAV based fee in respect of assets under their control. In light of those comments and also in view of the absence of such fees in other comparable jurisdictions, we have removed the NAV based fee charged to Fund Managers and instead imposed an annual flat fee of US\$4,000 per Fund.

Should the Custody Provider be removed from the category of persons who can be appointed as the local agent of an External Fund Manager?

13. Some public comments stated that the activities that are proposed to be assigned by an External Fund Manager managing a Domestic Fund from a place of business outside the DIFC to a Fund Administrator or Custody Provider appointed as its local agent in the DIFC are generally activities that can be undertaken only by a person holding a Fund Administrator's or Trustee's licence, and not by a person holding a Custody Provider's licence. We have replaced "Custody Provider" with a Trustee as a person who can be appointed as the local agent of a Domestic Fund managed by an External Fund Manager.

Accommodation of certain Islamic structures for Property Funds

14. A commentator raised a concern that because ijara structures which are commonly used in property financing require ownership of property to be held by the bank providing finance, there is a conflict with the current requirement that the Fund Manager must hold “good marketable legal and beneficial title” in all its Real Property either directly or via SPVs controlled by the Fund. There may also be other Islamic mortgage structures which lead to the bank holding legal title in whole or in part, such as diminishing Musharaka which would lead to shared title. To address these concerns, we have provided that any special arrangements entered into in respect of Fund Property for the purposes of Islamic finance arrangements would be acceptable provided those arrangements and their effect are either clearly disclosed to investors in the Fund disclosure document or approved by a Special Resolution of Unitholders.

Are the Shari’a governance requirements proposed for Exempt Funds too flexible?

15. Some public comments suggested that the flexibility proposed with regard to Shari’a governance requirements applicable to Exempt Funds and the scope allowed for relying on widely accepted Shari’a screening methodologies might lead to a dilution of Shari’a governance standards applicable to Exempt Funds. We did not think that a greater level of prescription than initially proposed is warranted in the case of Exempt Funds due to:
 - the nature of clients involved, i.e. Professional Clients making at least a minimum investment of US\$ 50,000, who would have the expertise and resources to undertake their own due diligence; and
 - although Exempt Funds are not required to have an SSB at the Fund level, that a firm managing an Islamic Exempt Fund continues to be subject to an SSB requirement at the firm level, with the option of using its SSB or any member of it for Shari’a sign-off purposes of the Exempt Fund.

Delegation and outsourcing of the Shari’a function

16. One comment noted that where Shari’a function is outsourced to a Shari’a consultant, any changes to the Shari’a scholars used by the Shari’a consultant should not require the approval of the Governing Body of the Fund Manager. We did not think that any exemption from the Governing Board’s approval is warranted for any changes to Shari’a scholars within the consultancy to whom that function has been delegated, to the extent those Scholars are used for Shari’a sign off purposes by the Fund, as any such changes affect the Fund’s Shari’a governance much the same as any direct appointment or replacement of Shari’a Scholars by the Fund.

Should there be more flexibility relating to listing?

17. A public comment noted that that under the current requirements, a Public Property Fund must be immediately listed, whereas in reality this process takes time; to accommodate such timing in other jurisdictions some flexibility is

provided to achieve a listing. We have provided a 6 month grace period for listing formalities to be completed, with requirements for adequate disclosure of this in the Fund Prospectus.

Terminology issues

18. Some commentators argued that the distinction between Fund Managers and Asset Managers (currently drawn on the basis of the legal accountability of the Fund Manager to Unitholders of the Fund on the one hand and the Asset Manager's accountability to only the Fund Manager on the other hand) should be removed as it is difficult to maintain this distinction in practice.
19. In contrast, some commentators strongly supported the retention of the current distinction as, in their view, it gives the flexibility for Fund Managers either to undertake investment management of the Fund in-house under their own licence or to delegate that function or any part thereof to another service provider of their choice.
20. Some commentators also argued that the terms Fund Manager and Asset Manager are too similar to denote the distinction drawn (suggesting alternative terms such as "Fund Manager" and "Investment Manager") and asked for more guidance to highlight the differences in these two roles. While further changes to the terminology beyond the change of "Operator" to "Fund Manager" were not considered warranted, we shall be exploring whether there is scope for amalgamation of these two categories of Financial Services as part of an on-going broader project dealing with Financial Services definitions. In the meantime, we have included further guidance.