April 2024

Offering of Hong Kong Domiciled Funds in Dubai International Financial Centre

I. Overview of asset and wealth management industry in DIFC

Market landscape

1. Dubai International Financial Centre (**DIFC**) is a financial free zone with a separate legal system, and a distinct geographical region and jurisdiction inside the emirate of Dubai (the United Arab Emirates federation (UAE) comprises seven Emirates).

2. The DIFC is empowered to create its own civil and commercial laws which are separate from those of the Emirate of Dubai and the wider UAE. The Federal Penal Code and other Federal criminal laws apply in the DIFC, including Federal Anti-Money Laundering and Counter-Terrorist Financing (AML/CTF) laws.

3. Dubai Financial Services Authority (**DFSA**) is an independent, integrated regulator of financial services conducted in or from the DIFC. The DFSA's main functions are to: (i) authorise and register institutions and individuals who wish to conduct financial services in or from the DIFC; (ii) supervise regulated participants and monitor their compliance with the laws, regulations and rules that apply; (iii) enforce DFSA-administered legislation; and (iv) co-operate with and provide assistance to regulatory authorities and bodies in Dubai, the UAE and other jurisdictions. In particular, the DFSA regulates firms which are responsible for managing or distributing collective investment funds.

4. There are three broad categories of funds offered in the DIFC. They are Domestic Funds (funds domiciled in the DIFC), External Funds and Foreign Funds (both refer to funds domiciled outside of the DIFC). External Funds are managed by fund managers licenced by the DFSA while Foreign Funds are not. The investors in the DIFC are mostly professional and institutional clients.

Regulatory regime for funds in the DIFC

5. There are three types of Domestic Funds in DIFC, namely Public Funds[1], Exempt Funds[2] and Qualified Investor Funds[3]. As of 22 March 2024, there were 41 Public

[1] A Domestic Fund is a Public Fund if (a) some or all of its units are offered to investors by way of a public offer; or (b) its unitholders include, or may include, retail clients.
[2] A Domestic Fund is an Exempt Fund if (a) its units are offered to persons only by way of a private placement; (b) all its unitholders are persons who meet the criteria to be classified as professional clients; and (c) the initial subscription to be paid by a person to become a unitholder is at least USD 50,000.
[3] A Domestic Fund is a Qualified Investor Fund if (a) its units are offered to persons only by way of a private placement; (b) all its unitholders are persons who meet the criteria to be classified as professional clients; and (c) the initial subscription to be paid by a person to become a unitholder is at least USD 500,000.

Funds, 47 Exempt Funds and 75 Qualified Investor Funds[4]. Set out below are some key features of the Collective Investment Funds regime for Domestic Funds:

(a) Public Fund Regime provides protection to the wider market including retail investors through requirements such as the independent oversight of a Fund and detailed disclosure in a Prospectus. A Public Fund is subject to a higher degree of regulatory requirements.

(b) Exempt Fund Regime enables Exempt Funds to benefit from a fast-track notification process, where the DFSA aims to complete the notification process within a period of five business days, with lesser regulatory requirements than a Public Fund.

(c) Qualified Investor Fund (**QIF**) Regime provides proportionate regulation, allowing flexibility for QIF Managers and QIFs, by relying on certain key requirements in the Collective Investment Law and the DFSA Rulebook. Consequently, the regime is predominantly disclosure-driven, requiring self-certification regarding the adequacy of systems and controls. QIFs enjoy a fast-track notification process where the DFSA aims to complete the notification process within a period of two business days.

6. To establish and manage Domestic Funds in the DIFC, the fund manager must be either:

   (a) a Domestic Fund Manager, incorporated in the DIFC, licenced, and regulated by the DFSA for the financial service of Managing a Collective Investment Fund (ie, Domestic Fund Manager); or

   (b) an External Fund Manager, acting as a foreign fund manager permitted to establish and manage a Domestic Fund in the DIFC without having to establish a place of business in the DIFC. This is achieved via a recognition process. The fund manager must be regulated by a Financial Services Regulator in a Recognised Jurisdiction[5] with respect to the activity of Managing a Collective Investment Fund. The fund manager must also (i) subject itself to the DIFC laws and the jurisdiction of the DIFC courts relating to its activities regarding the Domestic Fund; and (ii) appoint a DIFC-based and DFSA-licenced 'Appointed Agent' ie, either a fund administrator or trustee (if the fund is a trust). Hong Kong is a Recognised Jurisdiction and Hong Kong fund managers are recognised to act as External Fund Managers.

7. A fund manager of a Domestic Fund may appoint a Hong Kong asset manager as its delegate to manage the underlying assets of the Domestic Funds, ie, to provide portfolio and risk management services. Fund managers of Domestic Funds can also appoint custodians and fund administrators who are located in Hong Kong.

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[4] Information is from https://www.dfsa.ae/public-register/funds.
[5] List of Recognised Jurisdiction and Designated Funds are published on the DFSA website.

II. Offering of Foreign Funds in DIFC

Are there restrictions or practical hurdles for Foreign Funds to be offered in DIFC?

8. In general, there are no restrictions or practical hurdles for foreign funds (eg, Hong Kong domiciled funds or funds domiciled in other jurisdictions which are associated with Hong Kong entities) to be offered to retail and institutional investors in DIFC. However, there are certain restrictions and limitations on property funds, crypto funds, and credit funds[6]. Essentially, these restrictions ensure that such funds need to have similar controls in place as if they were a Domestic Fund. For example, property, venture capital and credit funds must be closed-ended, and there is no competitive disadvantage to the Domestic Funds.

What are the requirements for Foreign Funds to be marketed in DIFC?

9. Foreign Funds can be marketed in the DIFC by firms authorised by the DFSA for the financial services of either Arranging Credit or Arranging Deals in Investments (**Authorised Firms**). These firms can market units of Foreign Funds if one of the following criteria is met:

   (a) the Foreign Fund meets the criteria for a Designated Fund (*eg, Hong Kong domiciled funds authorised by the SFC under section 104 of the SFO*) in a Recognised Jurisdiction (*eg, Hong Kong*), or

   (b) the Foreign Fund meets the other Foreign Fund Criteria prescribed by the DFSA. In instances where the Fund is not a Designated Fund in a Recognised Jurisdiction, the Investment Manager and Custodian would need to be regulated in a Recognised Jurisdiction; or

   (c) the Authorised Firm makes a suitability recommendation of the investment in units of the Foreign Fund to the particular investor, in light of that investor's investment objectives and circumstances; or

   (d) the Foreign Fund is only offered to investors who meet the criteria to be classified as a professional client[7]. The minimum subscription for each investor is USD 50,000 and Fund units are not offered to investors by way of public offer.

[6] Unlike other types of funds, an External Fund Manager cannot manage a Domestic Fund that is a credit fund, and a Domestic Fund manager cannot manage an External Fund that is a credit fund. However, this topic is currently being consulted on: DFSA Consultation Paper No. 158 – Credit Funds, Public Property Funds & REITS. Authorised Firms cannot market a Foreign Fund that is a credit fund under the criteria set out in paragraph 9 (a) of this document unless the credit fund meets certain conditions.

[7] There are three kinds of professional clients – "deemed" professional client (eg, a supranational organisation whose members are either countries, central banks or national monetary authorities, a collective investment fund or a regulated pension fund, etc.), "service-based" professional client (eg, a client is being provided with financial service of providing credit for business purpose; or advisory and arranging activities relating to corporate structuring and financing) and "assessed" professional client (ie, client assessed by DFSA regulated firms to be a professional client eg, having the net asset of USD1 million).

10. Foreign Funds which are not Designated Funds (*eg, Hong Kong domiciled funds not authorised by the SFC or funds domiciled elsewhere which are associated with Hong Kong entities and groups*) can also be marketed in or from the DIFC by the Authorised Firms if they met criteria (b), (c) or (d) above.

11. Foreign Funds which cannot be marketed to retail investors in their home jurisdiction are prohibited from being marketed to retail investors in, or from, the DIFC.

12. Given that the DFSA regulates and supervises the Authorised Firm marketing the Foreign Fund in or from the DIFC, that Foreign Fund does not require approval from the DFSA. However, the Authorised Firm is required to report the marketing and selling of Foreign Funds on an annual basis to the DFSA.

<u>What are the possible routes for Hong Kong fund managers to offer their Hong Kong domiciled ETFs in the DIFC?</u>

Cross-listing

13. Hong Kong domiciled ETFs that are listed on HKEX may seek direct cross-listing on Nasdaq Dubai provided they fulfil the ETF and listing eligibility criteria, including other specific prospectus-related requirements or conditions as set out in DFSA Rules. The ETFs need to notify the DFSA and obtain listing approval from Nasdaq Dubai by satisfying the mandated ETF and listing eligibility criteria, including other specific prospectus-related requirements or conditions as set out in DFSA Rules.

Master-feeder structure

14. Hong Kong domiciled ETFs may also be cross-listed on Nasdaq Dubai through a master-feeder structure. A Hong Kong fund manager of a Hong Kong domiciled master ETF may partner with a local DIFC fund manager (of the feeder ETF to be listed on the Nasdaq Dubai) or obtain a recognition of external fund manager status from the DFSA[8] itself and set up/list a local feeder ETF to offer the Hong Kong domiciled ETF to retail investors in the DIFC under a master-feeder structure. Please note that the UAE Passporting Regime is not available to External Fund Managers because it only applies to UAE Domestic Fund Managers and Domestic Funds.

15. Although the feeder ETF requires authorisation and listing approval from the DFSA and Nasdaq Dubai respectively, the master ETF does not require such authorisation or approval.

Depositary receipts

16. Alternatively, ETF issuers may choose to offer Hong Kong domiciled ETFs in the DIFC via a depository receipt (**DR**) listed on Nasdaq Dubai, as long as the issuer elects to list the ETF as opposed to a secondary listing. Given DRs are recognised as a specific type of security in DFSA Rules, the requirements and procedures for listing differ from those for listing ETFs. ETF issuers need to collaborate with a DFSA-licenced sponsor in launching the DR on Nasdaq Dubai and must comply with applicable DIFC laws

[8] See paragraph 6(b) of this document.

and DFSA Rules concerning securities such as equity shares, debentures and certificates. Listing approval of the DRs is required from Nasdaq Dubai.

Offering/marketing without cross-listing

17. Hong Kong domiciled ETFs that make use of the Foreign Fund regime discussed in paragraphs 8-12 above may be marketed by Authorised Firms in DIFC without cross-listing on Nasdaq Dubai.

III. Access to investors in the mainland UAE[9] market via DIFC

The UAE-wide Passporting Regime for Funds (**UAE Passporting Regime**)

What is it?

18. In 2019, the Securities and Commodities Authority (**SCA**) of the UAE, the Financial Services Regulatory Authority (**FSRA**) of the Abu Dhabi Global Market (**ADGM**) and the DFSA of DIFC agreed a "Protocol" regarding co-ordinated supervision of the marketing and selling of units of domestic funds within the UAE. The Protocol sets out a common regulatory framework which is implemented by each of the regulators, including notification and registration procedures, allowing for funds passporting between any of the DIFC, ADGM and mainland UAE. The Protocol is codified via the Fund Passporting Rules of the ADGM and of mainland UAE, as well as the Fund Protocol Rules of the DIFC.

How does it work?

19. Under the UAE Passporting Regime, upon completion of a notification and registration procedure in its jurisdiction of establishment or domiciliation (**home jurisdiction**), a collective investment fund (as defined by the DFSA or the FSRA) or an investment fund (as defined by the SCA) that is established or domiciled in the UAE (**domestic fund**) can be promoted in the other jurisdictions (**host jurisdictions**) without the need to obtain additional authorisation.

20. As of 15 March 2024, there were 25 active passported funds on the public register of DFSA.

Who does the regime apply to?

21. The Passporting Regime applies to fund managers of domestic funds, agents or other licenced persons that are: (a) established or domiciled in one of the three aforementioned jurisdictions; (b) authorised by the financial authority responsible for regulating the domestic fund, or, in relation to a fund manager, in the jurisdiction where the domestic fund is established or domiciled (**home regulator**); and (c) promoting a passported fund in or from a jurisdiction. Fund managers, agents and other licenced persons should ensure that they are appropriately authorised by their

[9] Refers to the United Arab Emirates excluding the financial free zones of Abu Dhabi Global Market and Dubai International Financial Centre.

home regulator to conduct the applicable activity for the passported fund in the home jurisdiction.

What needs to be done to benefit from the regime?

22. Fund managers, agents and other licenced persons should ensure that they are appropriately authorised by their home regulator to conduct the applicable activity before seeking to passport to host jurisdictions. In addition, they need to pay the applicable fees to the home regulator: (a) a notification fee and (b) an annual fee.

23. Following notification, the home regulator and host regulator(s) will update their respective registers of passported funds to recognise that the domestic fund qualifies as a "passported fund".

24. If the passported fund is a private fund, it can only be promoted to 'qualified investors' (in the DIFC, ADGM and mainland UAE), pursuant to the applicable definitions in the relevant passporting rules. On the contrary, a passported fund that is a public fund may be offered to any person in the host jurisdiction(s).

25. Under the UAE Passporting Regime, the fund manager must notify the home regulator of material events in accordance with applicable legislation in the home jurisdiction, such as changes to the fund manager, agents, licensed persons or any other material service providers. The home regulators may exercise supervisory and investigatory powers, which include de-registering the passported fund of its own volition, at the request of the fund manager, on commencement of winding up, or at the request of the host jurisdiction regulator.

Ongoing compliance

26. The passporting rules in each home jurisdiction supplement the existing collective investment regimes in that home jurisdiction, which continue to apply to the passported fund.

27. Fund managers, agents, and other licenced persons performing any activities in connection with the promotion of a passported fund need to always comply with the legislation applicable to them in the jurisdiction in which they are domiciled.

<u>How could Hong Kong domiciled funds avail of the UAE Passporting Regime?</u>

28. Hong Kong domiciled funds (whether public or private funds) can access investors in the wider UAE market by using a master-feeder structure. That is, a Hong Kong fund manager may partner with a local DIFC manager to set up a local feeder fund in the DIFC (managed by the local DIFC manager) to offer the Hong Kong domiciled fund (as the master fund) under a master feeder structure to investors in the wider UAE market via the UAE Passporting Regime outlined above.

IV. Other information sources

You may also find further helpful information at:

- https://www.dfsa.ae/what-we-do/collective-investment-funds
- https://www.dfsa.ae/your-resources/regulatory/faqs refer to DFSA Collective Investment Fund Regime.
- https://www.dfsa.ae/your-resources/regulatory/laws-and-rules to reference applicable laws and rules.
- https://dfsaen.thomsonreuters.com/rulebook/past-papers for Fund-related Consultation Papers.
- https://www.dfsa.ae/make-enquiry to make an enquiry.