Marketing Private Funds in the Middle East

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In the past, managers promoting private funds in most countries in the Middle East—with the notable exception of Saudi Arabia—have not found much difficulty navigating local rules. Foreign fund managers would typically fly in, meet with clients, sign subscription agreements, and fly out a few days later without worrying too much about local securities laws, often relying on "reverse solicitation" or "passive marketing" practices, with the tacit approval of regulators. Those days may be over.

Saudi Arabia has enforced tougher rules for some time: the government introduced regulations in 2006 which stipulate that overseas funds may not be marketed in Saudi Arabia without the consent of the Saudi Capital Markets Authority (SCMA), and the consent process is the same as for a public offering. In addition, funds can only be marketed by a fund manager authorised by the SCMA. The rules do include a limited private placement exemption, but under black letter law this only covers domestic Saudi funds.

In the wake of the financial crisis—and the hue and cry from local investors, some of whom suffered substantial losses during the downturn—regulators in two Middle East jurisdictions decided to follow the lead set by their Saudi neighbour, and announced plans for new rules to bolster investor protection.

Kuwait was the first to overhaul its rules in 2010. Until then, local licensing requirements were not vigorously enforced. But under the new regulations, the marketing and sale of any kind of fund interests in Kuwait requires a licence from the Kuwait Capital Markets Authority (KCMA), and they may only be offered through a KCMA licensed local promoter and distributor. In addition, the fund must meet all the requirements applicable to domestic funds established in Kuwait. Some of these requirements are alien to foreign private equity fund managers—such as the requirement for investors in the fund to pay their entire "unit value" at the time of their subscription (rather than having capital called down on an as needed basis), and that employees and officers of the fund manager must not serve on the board of, or hold any position in, any of the portfolio companies owned by the fund.

Not to be outdone by its neighbors, in January 2011 the Security and Commodities Authority (SCA) of the United Arab Emirates (UAE)—which is home to some very significant private equity investors—issued its first draft of new regulations on investment funds. There followed a lengthy period of consultation and commentary. EMPEA, along with many others in the industry, pointed out that the proposed rules would have made it extremely difficult for foreign funds to be marketed in the UAE at all. In July this year, the SCA issued the final form of the rules, which came into force on 27 August 2012.

These new regulations mark a dramatic shift in the way funds are promoted in the UAE. In a surprisingly direct challenge to the Dubai International Financial Centre (DIFC), the regulations treat funds established in one of the UAE's "free zones" as foreign funds, and have therefore relegated the DIFC to the same status as any other "foreign" jurisdiction.

The new rules do introduce a concept of "private offering" within the UAE, which appears to have been a concession introduced during the consultation process. Unfortunately, this regime is subject to so many restrictions that it may be of limited value in practice. In addition to requiring the prior written approval of the SCA, a private offering of foreign fund units is subject to a number of constraints—including a requirement that the offering be conducted through a local bank or investment company licensed by the UAE Central Bank, or by a company licensed for such purpose by the SCA.

This requirement to use a local promoter is relaxed for a foreign fund manager who intends to target only institutional investors, each investing a minimum of 10 million dirhams (€2.1 million)—a modest amount for many private equity funds. If that condition is fulfilled, the foreign fund manager can promote its own fund by setting up a local representative office in the UAE (but apparently not in the DIFC). The foreign fund manager will still be required to obtain the prior approval of SCA and will then be bound by the same duties and obligations that are imposed on local promoters.

Those who want to avoid local regulation altogether and rely on the traditional marketing methods in the Middle East should beware. Reports of a pending claim by a Kuwaiti investor in a fixed income fund managed by The Carlyle Group that collapsed during the financial crisis alleges that the fund in question was marketed without the required license and in contravention to the rules. These reports were swiftly followed by a stern warning from the Saudi regulator that sanctions would be imposed on anyone promoting funds in breach of its rules, and that any contractual agreements by unauthorised persons will be considered to be void. While the outcome of the case is as yet unknown, it has served to highlight the importance of navigating the rules.

It is clear to industry participants that the fund marketing rules in Saudi Arabia, Kuwait and the UAE have created entry barriers, and the rules may make some of these markets

more difficult to reach for fund managers without deep pockets. There may be severe financial and reputational consequences for promoters who have not fully understood the new regimes.

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