

# The SCA consults on proposals to regulate promotion and arranging activities in the United Arab Emirates

The United Arab Emirates' (UAE) regulator of investment services, the Securities and Commodities Authority (SCA), is currently consulting on a set of regulations (the FPARs), which would govern the promotion of financial products and the "arranging" of financial services in the UAE outside the financial free zones. The proposals are far-reaching and would impose a heavy regulatory burden. If implemented, the FPARs would affect UAE-based firms, and could bite on firms carrying on cross-border activities into the UAE. In this client briefing, we take a helicopter view of the proposed FPARs and highlight areas of interest or potential impact.

## Overview

The FPARs are designed to fill a gap in the UAE investment services framework by introducing a general financial promotions regime and the concept of "arranging" activities. The FPARs contain a general prohibition on the promotion of financial products and the arranging of financial services without SCA approval (the Prohibition). There are a number of exclusions to the Prohibition.

The FPARs also impose a licensing regime for promoters' and arrangers' conduct of business standards, and give the SCA significant supervisory and enforcement powers to control promotion and arranging activities and impose sanctions for breaches of the regulations.

The FPARs apply only to investment services and would not cover banking and insurance activities in the UAE. The FPARs' impact on the Dubai International Financial Centre (DIFC) and Abu Dhabi Global Market (ADGM) firms could be significant. These two financial free zones (FFZs), which have their own regulatory regimes, contain a significant number of investment firms which legitimately conduct promotional and arranging activities in respect of investment services with clients in the UAE. The FPARs

appear to potentially constrain such activities by requiring dual licensing and imposing an onerous approval process. Given that the licensing and conduct of business standards in the DIFC and ADGM are at least as high as those imposed by the SCA, an exemption or passporting regime for FFZ firms would seem to be appropriate and proportionate.

The FPARs would also affect non-UAE firms which carry on cross-border promotion or arranging activities in the UAE.

## Key issues

- Prohibition on promotion and arranging of financial products and services in UAE
- SCA approval required and limited exclusions
- Affects cross-border activities (including for DIFC)
- Onerous conduct of business obligations

## The Prohibition

Article 3(1) of the FPAR sets out the Prohibition on the following terms:

"no financial products that are not listed, registered or enrolled at the Authority may be promoted nor may be any financial services or businesses the arrangement of which is not agreed by the Authority be arranged in the State".

This essentially means that any promotion of financial products or arranging of financial services or businesses must be approved by the SCA, unless there is a relevant exclusion.

## The Scope

The FPARs state that "arrangement and promotion" business may only be carried out by:

- companies licensed by the SCA to do so,
- issuers of securities (including foreign issuers) and financial advisers to the issue, and
- fund managers of a fund under the SCA's Mutual Funds Regulations.

The FPARs apply to the promotion of "financial products". This concept is very broad and includes the following:

- securities – defined as including shares, bonds, financial bills issued by companies, bonds and bills issued by federal and local governments, public entities and public institutions and "other local or non-local financial instruments accepted by the SCA". The definition of "securities" seems on the face of it to describe domestic securities. However, the definition does not specify what the concept of "local" means in this context. It is also notable that the definition of securities does not include Sukuk.
- foreign securities – including foreign shares, bonds, Sukuk, mutual fund units, commodities and derivatives as well as other securities, or financial instruments issued by the foreign issuer. This definition is designed to be a very broad catch-all.

The Prohibition also applies to the arranging of financial services or businesses. The concept of "financial services or businesses" is not defined. Therefore, it should be given a wide meaning, following international norms of what activities constitute "financial services" in the context of a securities and markets regulator. However, it would not cover banking or insurance activities, which are within the jurisdiction of the UAE Central Bank and Insurance

Authority, respectively.

The Prohibition applies in the State, which would mean the UAE excluding the FFZs, of which more below.

## Exclusions

Under Article 2(4) of the FPARs, the regulations do not apply to the following:

- "the promotion of foreign securities in case an application is filed for their listing on any market." – on the face of it, this exclusion only applies while a foreign security has filed an application for listing, and would not apply once the security is listed. We wonder if this was intentional;
- the promotion of securities or contracts of commodities or derivatives that are issued by UAE Federal or local Government authorities or companies wholly-owned by any of them or the promotion of foreign securities to any such authorities;
- the reverse solicitation by an investor in the State provided that the record of reverse solicitation is maintained;
- promotions or arrangements by and with group or affiliated/associated companies; and
- brokers, as defined under the SCA Regulations for the Listing and Trading of Commodities and Commodities Contracts.

We would have expected to see an exclusion for promotion or arranging activities to sophisticated investors in the UAE, such as financial institutions, which do not need protection and would not want their activities delayed by their counterparties having to seek SCA pre-approval.

## Issues and potential impact

### What is a "Promotion"

The FPARs define a promotion as:

"the marketing, distribution, advertising or publishing of statements, information or advertisement material related to foreign securities or contracts of commodities or derivatives in any way or form to convince someone in the State to buy any of them."

This definition appears to be aimed solely at "foreign securities", which means that the element of the Prohibition dealing with promotions only appears to apply to the promotion of foreign securities. It is not clear if this was

intentional, but if it is then this is a clear indication that the FPARs were designed to limit the promotion of foreign investment services into the UAE and to curb cross-border activities. We will be interested to see if this limitation in scope survives to the final draft of the regulations.

## Qualified Investors

The FPARs introduce two types of "qualified investors". The first is an investor which is able to manage its own investments, and the second is an investor represented by an investment manager licensed by the Authority. The first category includes the following subcategories:

- UAE Federal or local Government authorities or companies wholly-owned by any of them;
- international institutions and organisations – presumably this refers to supranational organisations;
- a person licensed to engage in any commercial business provided that one of its purposes is investment; and
- a solvent natural person meeting the following criteria:
  - (a) annual income not less than AED1 million per annum; or
  - (b) net assets (excluding principal residence) of at least AED5 million; and
  - (c) who acknowledges that they have the sufficient knowledge and experience, whether by themselves or through a financial adviser, to evaluate the offering document as well as the benefits or risks accompanying or resulting from the investment.

It is notable that despite defining the categories of qualified investors, the FPARs do not contain any substantive regulations which appear to apply to such persons. There is a solitary reference to qualified investors in Article 9(5)(1)(c) in relation to the licensing requirements for foreign mutual fund managers. The concept of qualified investors was also introduced in the SCA's Investment Funds Regulations<sup>1</sup> (IFRs) and is copied in the FPARs.

## Application to FFZ and overseas firms

Although it appears from the licensing requirements and the overall direction of the FPARs that the regulations apply to promotion and arranging activities carried on from a place

of business in the UAE (outside the FFZs), it is quite possible that the FPARs also apply to cross-border activities into the UAE. Indeed the FPARs may apply to the activities of overseas and FFZ firms which promote financial products to, or arrange financial services for persons in the UAE (outside the FFZs).

In relation to the FFZs, given the wide range of financial products promoted and financial services arranged by FFZ firms and the large number of FFZ firms, particularly in the DIFC, it could be both impractical and disproportionate for the FPARs to apply to FFZ companies. For example, a FFZ private bank, which offers a potentially unlimited range of financial products to its client base, may need to seek SCA approval for each and every securities type product which it promotes or financial service which it arranges if no exclusion is available, even if the product has previously been approved by the SCA. Any promotional or arranging activity would take up to 30 days to be approved by the SCA. Such an approval process, and the resulting delays, will create challenges for doing business in today's fast-moving financial markets. This could make doing business with UAE clients potentially difficult unless the UAE client agreed to meet with the firm in the relevant FFZ to discuss the relevant investment opportunity. It could effectively operate as a bar to FFZ firms communicating with clients in the UAE.

The same general issues regarding FFZ firms noted above would also be relevant to overseas firms which carry on cross-border promotion and arranging activities in the UAE.

## Overlap with Investment Funds Regulations

The FPARs appear to overlap with the IFRs in that both regulations would apply to the promotion of mutual funds to investors in the UAE. It is not clear which regulations would take precedence. For foreign promoters of mutual funds, the FPARs would have the advantage of granting additional exclusions to rely on when promoting funds to UAE investors.

## Onerous conduct of business obligations

The FPARs contain some notably onerous conduct of business obligations which deserve highlighting. Below is a sample:

- promoters to provide to the SCA quarterly audit reports issued by the company's independent auditor;
- promoters to notify the SCA immediately of "any material developments" regarding the promoted financial products;

<sup>1</sup> SCA Resolution No. 9 of 2016 Concerning the Regulation of Mutual Funds.

- approval applications to be made on a product-by-product basis;
- approval to be made for the promotion of financial products that are already registered with the SCA;
- approval of the issuer of the relevant financial product to its promotion in the UAE;
- in respect of foreign mutual funds, to create a register of unit holders including various identification information and a catch-all "any other information related to the unit holders"; and
- to provide the SCA with a copy of any arranging agreement as well as to provide details of any change in the document, or termination of the agreement.

## Next Steps

It is too soon to say when the FPARs will be implemented, but we will keep a close eye on developments in this area. We hope that the implementation of the FPARs will be made in coordination with the FFZ regulators, the Dubai Financial Services Authority in the DIFC, and the Financial Services Regulatory Authority in the ADGM, to alleviate any risk of duplicating the regulatory burden for FFZ firms.

## Additional general issues

The drafting of the FPARs also raises the following general questions:

- Do SCA-licensed entities need to seek an additional SCA licence for promotion and arranging activities in the UAE?
- Do UAE Central Bank-licensed entities need to seek a licence from the SCA for the promotion and arranging of investment services in the UAE?
- Will the SCA keep and publish a list of approved financial products or financial services?
- Once an SCA-approved promotion has been made, does a second approval need to be sought for any arranging activity in relation to the same financial product?

## Supervision and enforcement powers

Under the FPARs, the SCA would have competence to receive complaints related to promotion and arranging activities. It would be granted strong enforcement powers, including powers to issue warnings, impose fines and revoke a promoter's licence. Interestingly, the FPARs provide the SCA with a power to publish the names of violators, as well as the penalties imposed on them. Typically, such actions are not published in the UAE.

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