

## THE NEW SCA RULEBOOK: UAE CROSS BORDER CONSIDERATIONS

The new SCA Rulebook expands the scope for cross-border securities promotions and levels the playing field for licensing and oversight of investment firms across the UAE and its financial free zones.

### 1. INTRODUCTION

The UAE Securities and Commodities Authority ("**SCA**") has issued its new rulebook for financial activities under Board of Directors' Decision No. (13 / R.M) of 2021 (the "**Rulebook**"). The Rulebook sets out a new consolidated regime for licensing and prudential requirements for SCA licensed firms and will also consolidate existing regulations for financial activities in respect of securities. Regulations on markets, securities issuances and the general capital markets oversight functions of the SCA will remain subject to separate regulations.

From a cross-border perspective, the main changes relate to an expansion in the class of investors exempted from securities promotion restrictions. This now includes: (i) high net worth individuals; and (ii) firms, of any size, whose main purpose is investment.

The scope of regulated activities has been clarified to include broader forms of brokerage activities including "arranging", as well as dealing in securities – filling some previous uncertainties and clarifying the scope of "introduction" activities.

Similar to the DIFC and the ADGM, licensing categories have been introduced ranging from Class 1 (brokers) to Class 5 (advising and arranging), determining licensing and prudential requirements applicable across the board.

The Rulebook was issued by the SCA on 9 May 2021 (being published in the UAE's Federal Gazette on 16 May 2021), with the required conduct rules applicable immediately. Requirements for licensing and prudential matters will be phased in over one year.

### Changes to the Securities Promotion Rules and broader exemptions

The Rulebook updates the SCA's requirements for securities promotions and contains an expansion to types of financial promotions which are exempt from requiring a local licence.

#### Key Take-Aways

- The SCA has created a much-welcomed new Rulebook which consolidates the requirements for investment firms (repealing previous regulations)
- This includes an updated approach to the regulation of financial promotions in the UAE
- The exemptions for permitted financial promotions without a UAE license have increased to include a broad class of "professional investor" (now including HNWI's)
- The new rules increase alignment with the financial promotion rules in the financial free zones
- The SCA Rulebook includes an expansion in the scope of regulated brokerage/ dealing/ arranging activities – which is well received and aligned with international practice
- Rules for SCA firms using international service providers and have been clarified through outsourcing and cloud provider rules
- A number of other helpful clarifications have been included addressing uncertainties in the market, including client on-boarding requirements and application of suitability assessments.

Promotions of securities made to a broader class of "Professional Investors" (see below) are now exempt, along with all forms of "reverse solicitation" (as exempted at present). This replaces the exemption regarding promotions to institutional "Qualified Investors" under the existing regulations.

Unlike the 2017 regulations for promotions (which have been replaced), the regulations do not limit the exemption for promotions to Professional Investors only to institutions – therefore, promotions made to individuals which fall within the definition of Professional Investors (i.e. High Net Worth Individuals or "HNWIs") will also be captured by the new exemptions.

Regulated promotions are expressed to be in respect of "financial products" (rather than services) but it remains prudent practice to also follow these rules in respect of promotions of overseas financial services which fall within the SCA's remit. We note that the UAE Central Bank's developing oversight of cross border promotions of related banking services remains, to some extent, overlapping, and requires careful consideration by overseas service providers.

The Rulebook includes specific requirements for SCA licensed firms marketing their services, including that their marketing materials must be clear, fair and not misleading and limited only to Professional Investors (where only relevant to such class of investors).

**Comment**

**This is much-welcomed new Rulebook bringing clarity and consistency to the market, enhancing compliance requirements in critical areas and ensuring the UAE strikes a good balance between protecting the local market and permitting overseas players to bring international products. This Rulebook is issued amid a growing focus on permitting foreign investment across the UAE.**

## **2. New SCA Definition of Professional Investor**

### **2.1 [A commentary table of the current definition of professional investors is set out below, with notes on the new approach.](#)**

In summary, the following key changes have been made (compared to the existing definition of Qualified Investors):

- Promotions to all types of Professional Investors are exempt – previously this was just those investors who are not natural persons.
- Professional Investors includes broader classes of government related entities, regulated and financial institutions, as well as single family offices, trusts and other investment vehicles – creating welcome clarity and breadth.
- Similar to the DIFC and ADGM, listed entities are classified as Professional Investors.
- The previous position that exempt promotions can be made to entities who invest as part of their business has been re-introduced – requiring an investment function to be part of the relevant entity's objects/licensed activities.
- All individuals with a net worth of more than AED 4 million (c. \$1.1 million), or, following assessment, those with sufficient experience and understanding of the relevant investments (or those represented by a financial adviser) can be classified as Professional Investors. Individuals who have worked for a regulated financial institution over the past two years are included.
- Classification of joint account holders (required to be family members) has been introduced.

Type	Description	Notes
<b>International Organisations</b>	Supra-national organisations, Central Banks and equivalent regulators.	This reflects the existing class of Qualified Investors with some minor expansions.
<b>Government bodies, companies and sovereign wealth funds</b>	Government institutions, their investment bodies and companies wholly owned by them.	This will more clearly capture sovereign wealth funds, by the inclusion of "investment bodies". Partially owned government entities are not captured in this limb, but are likely to be captured in other definitions for investment focused entities.
<b>Regulated firms and funds</b>	Firms licensed by the SCA or regulated by an equivalent authority, which is likely to include Central Bank, DFSA (DIFC) and FSRA (ADGM) regulated firms along with overseas investment firms and broker-dealers. Regulated investment funds, managers and pension funds are also captured.	This has expanded the previously less certain exemption to cover regulated firms across the board.
<b>Financial Entities</b>	Financial establishments and any entity whose main activity represents investment in financial instruments, asset securitization, or financial transactions	This is reverting the previously permitted position (2017 – 2019) of promoting to entities who invest as part of their business – requiring an investment function to be part of such entities' objects/licensed activities.  The term "financial establishments" is not yet further defined in the Rulebook.
<b>Listed Companies</b>	Any company whose shares are listed or accepted to trade in any market of an IOSCO member country, which includes the UAE and KSA.	This is a new and welcome expansion in line with DFSA/FSRA descriptions.
<b>Investment vehicles and family offices</b>	Licensed family offices with assets of AED 15 million or more, trusts with revenues of AED 35 million or more and joint ventures/associations which have or had, at any time during the past two years, net assets of AED 25 million or more (excluding partner/shareholder loans).	This provides new clarity in the market and an opportunity for engaging with the large number of single family offices (representing HNWIs) in the UAE.
<b>Deemed large undertakings</b>	A body corporate who fulfils on the date of the last financial statements a large undertaking test, whereby it fulfils at least two of the following requirements:  Total assets of AED 75 million;  A net annual revenue of AED 150 million; or  Total of cash and investments on the balance sheet or the total equity after	This largely reflects the current position for large undertakings. The third criteria has narrowed slightly, from our understanding of the current Arabic text, to be equity after deducting paid up capital.

Type	Description	Notes
	deducting paid up share capital is not below AED 7 million.	
<b>Assessed large undertakings</b>	<p>An undertaking which has net equity minus paid-up capital of AED 4 million, but is assessed to have sufficient knowledge and experience in respect of the relevant investments and their risks (following a suitability assessment)</p> <p>This category includes other persons who are controllers of such undertakings (controllers of the majority of the shares or voting rights), holding and subsidiary companies and JV partners.</p>	This is an "assessed" professional client category requiring a specific assessment.
<b>Service based professional investors</b>	Persons receiving credit facilities, their group entities and persons arranging credit facilities and investment transactions related to corporate structuring and financing (note: this is likely to be limited to promotions related to credit facilities and services).	As with practice in the DIFC, this is unlikely to be a significantly used category of professional investor, and limited to credit related services (where Central Bank regulations will also be relevant).
<b>High net worth individuals</b>	A natural person who owns net assets, excluding the value of their main residence, of not less than AED 4 million.	This expands the current definition which also required annual income of AED 1 million and a declaration of adequate expertise of representation.
<b>Sophisticated/ knowledgeable individuals (deemed)</b>	<p>A natural person who is:</p> <p>(i) approved by the SCA or a similar supervisory authority;</p> <p>(ii) an employee of the licensed entity or a regulated financial institution during the past two years; or</p> <p>(iii) represented by a regulated firm.</p>	As above, this is a helpful additional limb for experienced or advised individuals.
<b>Sophisticated/knowledgeable individuals (assessed)</b>	A natural person who is assessed to have sufficient knowledge and experience in respect of the relevant investments and their risks (following a suitability assessment)	This is an "assessed" professional client category requiring a specific assessment.
<b>Joint Account holders and related undertakings</b>	A natural person with a joint account for investment management with a HNWI or a deemed sophisticated / knowledgeable individual (where the person is a member of his/her immediate family and issuing a written confirmation re the joint account arrangement) and SPVs/trusts etc for the purpose of managing assets for such a person.	This is a welcome recognition of joint account arrangements, likely to be most useful for the purpose of client on-boarding arrangements.

### **3. Repealing previous regulations and simplification of funds marketing rules**

As part of consolidating current SCA regulations in respect of investment and securities activities, previous SCA regulations pertaining to such areas have been repealed. This includes certain regulations being fully repealed, such as the promotion and introduction regulations from 2017, and others being partially repealed where the regulations cover both financial activities (repealed) and authorisations/requirements for other matters such as securities issuances/prospectuses/fund establishments (remaining in force). For example, the SCA's IPO/equity issuance regulations from 2016 still apply but not the sections dealing with the requirements for financial advisors and listing advisors, which are now captured by the new Rulebook.

For the marketing of funds in the UAE, this has resulted in an overall welcome simplification, as the Rulebook now consolidates all relevant requirements. Previously, it was necessary to follow fund promotion and registration requirements across the SCA's mutual funds and promotion regulations. The Rulebook neatly sets out the current regime with general promotion obligations across all products, with additional registration requirements and distribution duties specific to investment funds.

Whilst some uncertainties remain, including in respect of the application of the regime for providing access to overseas funds platforms and ETF marketplaces (subject to recent enhancements in the financial free zone rulebooks), the Rulebook presents a strong step forward for the market.

### **4. New Types of Regulated Activity – Arranging and brokerage**

The Rulebook expands the range of brokerage and securities dealing activities, which were previously limited to brokers who are members on the exchanges. "Exchange members" remains a licensing category but the rules also include broader forms of UAE and international brokerage, brokerage for OTC derivatives and currencies in the spot market (previously overseen together with the Central Bank) and acting as securities dealer.

From the new forms of activities, it is clear that when a person takes responsibility for executing trades in securities in the UAE, that will be captured as brokerage. Broader forms of arrangement activities (receiving and transmitting orders to an overseas broker for example), remain potentially outside of these forms of brokerage. However, such arranging activities conducted in the UAE are likely to be captured in some form, which may be as regulated "financial introductions" (which includes introductions to financial services providers for the purposes of dealing in financial products). We note that the new "Class 5" licensing category is entitled "advising and arranging" which contemplates broader arrangement of securities transactions in the UAE as within the SCA's remit.

We look forward to further guidance from the SCA on the scope of the new regulated activities as the rules are implemented in the market.

### **5. Outsourcing Service Providers and Cloud Providers**

In common with the other regulators in the region, the SCA has bolstered its requirements for outsourcing of services by SCA regulated firms. This includes adopting controls to ensure appropriate suppliers are chosen for the relevant tasks, with proper oversight and requirements for written outsourcing controls. SCA approvals will be required for outsourcings with the relevant contracts available for its review. The rules suggest enhanced SCA oversight of outsourcing by regulated firms and the main functions of firms may not be outsourced. Cross border outsourcing is contemplated, with certain additional controls required to ensure the outsourcing provider is not prevented from providing the services in accordance with SCA requirements.

As part of this, cloud services providers are also expressly contemplated in the Rulebook, which requires that firms using cloud services must ensure a clear understanding of the risks and robust protection of its information held with cloud services providers from loss and unauthorised access. An annual external data security audit is required, which must be submitted to the SCA. Importantly, the rules suggest that the data servers of the cloud provider are required to be in the UAE.

## **6. Accessing from the financial free zones (DIFC and ADGM)**

The Rulebook includes, in its general provisions on licensing, that a firm applying for a licence may be a company in a financial free zone (FFZ). However, this remains subject to a specific legal form being required by the SCA for particular types of activity.

The activities for which an entity established in an FFZ could obtain an SCA license are yet to be identified exhaustively, but may include advisory, promotion and introduction activities (within the "Class 5" licensing category noted above). This welcome development is demonstrative of a trend of increasing collaboration between the SCA and the FFZs, and in line with recent amendments to the Dubai establishing laws for the DIFC (Law No. (5) of 2021) which indicate a greater scope for DIFC firms to promote and supply products and services within Dubai from the DIFC. However, the rules still require that all commercial activities conducted outside of the FFZs in the UAE require a commercial licence and UAE based establishment. Therefore, whilst the SCA's licensing requirements develop as its Rulebook is implemented, existing cross-border restrictions should be considered to apply.

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