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DIFC Venture Capital Funds

Introduction: Amendments were recently introduced to several of the Dubai Financial Services Authority (the "**DFSA**") Rulebook Modules incorporating provisions for Venture Capital Funds ("**VCFs**" or "**VCF**") in the Dubai International Financial Centre (the "**DIFC**"). These amendments are contained in the Collective Investment Rules module ("**CIR Module**"); the General Module ("**GEN Module**"); the Prudential-Investment, Insurance, Intermediation and Banking Business Module ("**PIB Module**"); the Fees Module and the Glossary Module. The amendments came into force on 1 November 2020. This paper provides a brief overview of several of the salient amendments to the CIR Module, the GEN Module and the PIB Module in the context of VCFs.

Background: The Collective Investment Law DIFC Law No.2 of 2010 (as amended) (the "**Law**") provides for matters relating to a Collective Investment Fund ("**Fund**") in the DIFC. The Collective Investment Rules (i.e. the CIR/CIR Module) is made, in present context, for the purposes of the Law. A Fund is either a Domestic Fund or a Foreign Fund. A Fund is a Domestic Fund if it is either: established or domiciled in the DIFC or an External Fund. An External Fund is a Fund which is: established or domiciled in a jurisdiction other than the DIFC and managed by a Fund Manager which is an Authorised Firm (i.e. licensed by the DFSA). A Fund that does not meet the Domestic Fund criteria under the Law is a Foreign Fund. The Law divides Domestic Funds into the following three categories: (i) a Public Fund; (ii) an Exempt Fund; and (iii) a Qualified Investor Fund. Pursuant to the Law and the amendments to the CIR Module, a VCF is a specialist class of Fund and a Domestic Fund that falls within the criteria of a VCF under the CIR Module is prescribed to be a Domestic Fund of that specialist class, whilst a Foreign Fund that falls within the criteria of a VCF under the CIR Module, is prescribed to be a Foreign Fund of that specialist class for the purposes specified in the CIR Module.

The VCF related amendments: In terms of the guidance provisions in the CIR Module, a VCF is expected to finance small to medium businesses which are in the early stages of business development and growth. The CIR Module provides for a definition of a VCF in the following terms: a Fund is a Venture Capital Fund if it is an Exempt Fund or a Qualified Investor Fund and its investment objective is to invest: (a) at least 90% of its committed capital in unlisted business ventures that have been incorporated for no more than ten years at the time of the Fund's initial investment in each business; and (b) by means of Shares, convertible debt or other instruments carrying participation rights or reward that are directly issued by the unlisted business ventures. The CIR Module provides guidance on the terms "committed capital" and "unlisted", as well as with respect to the types of investments referred to in (b) above. It should be noted that the guidance provisions in the CIR Module state that where an established large-scale business spins off subsidiaries to expand existing businesses and operations, this would not be considered to be a start-up or small to medium sized business in which a VCF should invest.

Regarding the legal structure of a VCF, the CIR Module provides that the Fund Manager must ensure that the investment vehicle used for a VCF is: (a) a Closed-ended legal structure; and (b) either an Investment Company or an Investment Partnership. The type of entity formed will depend on the structure and requirements for the VCF. Due to a change to the definition of a 'Private Equity Fund' in the CIR Module, a Fund cannot be both a Private Equity Fund and a VCF.

In terms of the GEN Module, a Person who intends to carry on one or more Financial Services in or from the DIFC must apply to the DFSA for a License. In the context of Managing a VCF, the amendments to the GEN Module provides that if the application is for Managing a VCF, the applicant must be a Body Corporate incorporated under the DIFC Companies Law. 'Managing a Venture Capital Firm' (i.e. Managing a VCF) is defined in the Glossary Module as: "Acting as the Fund Manager of a Venture Capital Fund".

Several other provisions of the CIR Module, the PIB Module and the GEN Module have been amended in the context of a VCF. In essence, these include:

- specific parts of the applicable 'Capital Requirements' and related matters under the 'Capital' provisions of the PIB Module not applying to an Authorised Firm if the only Financial Service it carries on is Managing a VCF – however, in addition to those parts of the 'Capital' provisions of the PIB Module which do apply, the amendments to the PIB Module provide that if the only Financial Service carried on by an Authorised Firm is Managing a VCF, the Authorised Firm must ensure that it has and maintains at all times, liquid assets (comprising of the types specified in the PIB Module) and access to financial resources which are adequate in relation to the nature, size and complexity of its business to ensure that there is no significant risks that its liabilities cannot be met as they fall due;

- the non-applicability of the requirement in the Law to appoint an Eligible Custodian with whom the legal title to the Fund Property would be registered to the Fund Manager of a VCF that is an Exempt Fund or a Qualified Investor Fund – however, if the Fund Manager of a VCF itself holds Fund Property, it must have in place effective arrangements which ensure that the Fund Property is not available to creditors of the Fund Manager, or of any other Fund it manages, in the event of the Fund Manager's insolvency;

- no requirement for a Fund Manager of a VCF to have an internal audit function or to appoint a Finance Officer if the Fund Manager only manages a VCF;

- the non-applicability or applicability (as the case maybe) of specific provisions of the 'Management and Operations of a Fund' provisions of the CIR Module to a Fund Manager of a VCF that is an Exempt Fund or a Qualified Investor Fund;

- in connection with the 'Reporting to the DFSA' provisions of the PIB Module – the requirement to prepare and submit certain specified returns, not applying to an Authorised Firm if the only Financial Service it carries on is Managing a VCF;

- the CIR Module by way of guidance providing for those matters under the GEN Module and the CIR Module with respect to which the DFSA may consider granting temporary relief to a Fund Manager of a VCF;

- where a Fund Manager of a VCF obtains the services of special advisers, the guidance under the CIR Module providing that those advisers should not be held out as being an investment committee of the type referred to in the context of Rule 13.3.1 of the CIR Module (i.e. which applies to Private Equity Funds) and further provides that such a description would be misleading, unless the Fund Manager chooses to follow the requirements in the said Rule; and

- with the VCF being a specialist fund (see above), additional Prospectus disclosure for the Prospectus of a VCF that is a Qualified Investor Fund now being provided for in the CIR Module covering the risk warning and additional disclosures required.

The above discussion revolves around a VCF in the context of a Domestic Fund. As regards a Foreign Fund, the requirements for an Authorised Firm to Offer a Unit of a Foreign Fund in or from the DIFC are contained in the CIR Module and in the case of a VCF, now includes requirements that the Prospectus in the case of an Offer of a Unit in a VCF, contains the risk warning and additional disclosures required by the CIR Module. In the context of the criteria for a Foreign Fund to be a Designated Fund under the provisions of the Law and the CIR Module, the CIR Module provides that a VCF, amongst other requirements, be a 'Closed-ended Fund'.

In addition to the foregoing, the provisions of applicable laws, rules and regulations of the DIFC, including other provisions of the Law, the CIR Module, the GEN Module and PIB Module, will need to be considered in the context of any type, structure, management, operations and other matters relevant to a VCF contemplated by the CIR Module. Please note that unless otherwise defined herein, any of the above defined terms identified by the capitalization of the initial letter of a word or a phrase, are defined in applicable laws, rules and regulations and which are necessary to consider with respect to a VCF.

Conclusion: Access to VCFs in the DIFC, balanced by laws, rules and regulatory oversight, should ultimately result in the growth of a vibrant, yet measured and responsible VCF ecosystem in the DIFC. For further information on the amendments and compliance requirements for VCFs, please contact us at: aly@alyiantconsultancy.com

Alyiant Consultancy Limited.
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| Alyiant Consultancy Limited |
| Registered Address: GV-00-02-03-BC-09-0, Level 3, Gate Village Building 2 |
| Dubai International Financial Centre, Dubai, United Arab Emirates | PO Box: 113355 |
| E-mail: aly@alyiantconsultancy.com | Tel: +971 4 4019390 | M: +971 50 9131027 | Fax: +971 4 4019392|