Private Equity in the United Arab Emirates: Market and Regulatory Overview

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A Q&A guide to private equity law in the United Arab Emirates.

The Q&A gives a high level overview of the key practical issues including the level of activity and recent trends in the market; investment incentives for institutional and private investors; the mechanics involved in establishing a private equity fund; equity and debt finance issues in a private equity transaction; issues surrounding buyouts and the relationship between the portfolio company's managers and the private equity funds; management incentives; and exit routes from investments. Details on national private equity and venture capital associations are also included.

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Market Overview

1. What are the current major trends and what is the recent level of activity in the private equity market?

Market Trends

The private equity (PE) market in the UAE has felt the impact of the slowdown in the global economy, the US-China trade dispute and the geopolitical issues of the Middle East. The UAE continues to lead the regional market in terms of volume and value, but the collapse of Abraaj Capital reduced investor confidence in regional PE firms. Nevertheless, as Expo 2020 draws closer, we anticipate seeing a reversal of this trend.

Fundraising

The fundraising environment in 2020 was challenging. More time was invested in growing portfolio companies than on fundraising. Overseas investors remain cautious in view of current regional geopolitical factors. Therefore, investors have become more selective and UAE fund managers are relying more on a deal-by-deal approach to fundraising rather than blind pools.

Investment

There has been a trend into consumer-driven sectors, such as healthcare, Fintech, education, retail, food and beverage, and tourism, where value added opportunities have arisen. Venture capital (VC) firms tend to invest heavily in companies in the technology-media-telecommunications (TMT) sector.

Transactions

Preqin data shows there were 12 Middle East PE buyout deals closed in 2019, which is four fewer than in 2018, but the aggregate value rose to USD1.5 billion, compared to USD600 million in 2018. This was largely due to the USD1 billion buyout of Dubai-based Gems Education.

Exits

Given the soft market conditions in 2020, PE exits have been challenging. Most of the exits were completed as a trade sale or on the secondary market, which has been growing in recent years.

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2. What are the key differences between private equity and venture capital?

PE investments in the UAE can overlap with what are traditionally considered to be VC investments, particularly in the case of small and medium-sized enterprises (SMEs) and in the growth phase of the target company. However, PE investments differ markedly from VC investments in a number of ways. While PE funding is available for expansion projects for SMEs, it is more commonly used to finance infrastructure and development in mature companies. In addition, PE investments pull funding from different sources than those traditionally available in the VC market, and are generally used for more capital-intensive industries.

Funding Sources

3. How do private equity funds typically obtain their funding?

PE funds obtain their funding from:

- Banks, companies, pension funds, insurance companies and government institutions in Dubai and Abu Dhabi.
- Sophisticated high net-worth individuals and wealthy local family businesses.

Investors also include sovereign funds and family investment offices from the Gulf Cooperation Council (GCC) that includes countries such as Saudi Arabia and Kuwait.

The most common sources of funding for VC and early stage companies are:

- Personal finance.
- Funding from family and friends.
- Angel investment (often from high net-worth individuals).
- VC funds.
- Funding from strategic investors.
- Bank finance (to a lesser extent).
- Crowdfunding.

Tax Incentive Schemes

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4. What tax incentive or other schemes exist to encourage investment in unlisted companies? At whom are the incentives or schemes directed? What conditions must be met?

Incentive Schemes

There is no federal income tax law in the UAE, or any federal taxes on income (except as noted below). Accordingly, the pre-federation income tax decrees of the individual Emirates remain applicable.

Corporate income tax statutes have been enacted in each of the Emirates (that is, the Abu Dhabi Income Tax Decree 1965 (as amended) and the Dubai Income Tax Decree 1969 (as amended), but they are not implemented. Instead, corporate taxes are collected with respect to branches of foreign banks (at the Emirate level) and courier companies (at the federal level). Further, Emirate-level "taxes" are imposed on the holders of petroleum concessions at rates specifically negotiated in the relevant concession agreements. There is no personal income tax.

Within the Emirate of Dubai there is a free zone known as the Dubai International Financial Centre (DIFC). Activities conducted in or from the DIFC are subject to regulation and supervision by the Dubai Financial Services Authority (DFSA). The DIFC also has its own legal, regulatory and court system. The DIFC Foundation Law (Dubai Law 5 of 2021) provides the overarching framework regulating the functioning of the DIFC free zone and all businesses established in or operating from the DIFC. The DIFC Foundation Law grants "Centre Establishments" a "zero rate of tax" for 50 years from the date of enactment of the DIFC Foundation Law. The other free zones in the UAE, such as the Abu Dhabi Global Market (ADGM), also have 50-year tax-free periods.

At Whom Directed

Foreign investors in the relevant free zones benefit from these rules.

Conditions

Foreign investors must be licensed in the relevant free zone.

Fund Structuring

5. What legal structure(s) are most commonly used as a vehicle for private equity funds?

Outside the DIFC

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A local mutual fund must be established by an eligible sponsor, which includes:

- Companies licensed by the Securities and Commodities Authority (SCA) "in the area of securities" or to manage funds.
- Local and foreign banks licensed by the UAE Central Bank.
- UAE branches of foreign companies licensed by an International Organization of Securities Commissions (IOSOCO) regulator with an operating history of at least five years.

The sponsor must have a minimum share capital of AED5 million and cannot own more than 30% of the fund units.

While UAE Law No. 2 of 2015, as amended (Companies Law) contemplates local funds having corporate personality, it does not prescribe a specific form for funds. As with the previous regime, a UAE fund is established through the contractual relationship between the sponsor and its investors, and each investor will have a balance sheet entry in the accounts of the fund administrator (which must meet comparable eligibility requirements as those of the sponsor).

Previously, few funds were domiciled in the wider UAE due to a lack of suitable fund structures. The recent SCA regulations from 2016 and earlier in 2017 changed the way funds are regulated in the UAE, including in respect of the marketing of funds in onshore UAE. With regards to private funds, these are mutual funds established in the UAE and target "qualified investors" with a minimum subscription of AED180,000. A qualified investor is one that can run its own investments (such as governmental bodies, international organisations, licensed practitioners or an individual with an annual income of at least AED1 million or with property value of at least AED4 million, excluding their main residence) or an investor represented by a SCA-licensed investment manager.

DIFC

The three types of corporate entity that can be used to establish a domestic fund in the DIFC are:

- Investment companies.
- Investment trusts.
- Investment partnerships.

Trust structures are predominately used for property funds and investment partnerships are commonly used for private equity funds. An investment partnership is a limited partnership registered with the DIFC, comprising general partners and limited partners. The general partner must be authorised by the DFSA to act as the fund manager.

The three types of funds that can be established in the DIFC are:

- **Public Funds.** These are open to retail investors and more extensive regulatory requirements apply to these funds. As such, PE funds are most commonly established as either exempt funds or qualified investor funds.

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- **Exempt Funds.** Exempt funds are only open to professional clients who must make a minimum subscription of USD50,000. These funds can have no more than 100 investors and cannot be offered to the public (distribution is only allowed through private placement).
- **Qualified Investor Funds.** The qualified investor fund (QIF) regime was introduced in 2014 to provide a lower cost and less regulated alternative to the exempt fund. The QIF regime is specifically targeted at experienced investors such as high net worth individuals and family offices. To qualify as a QIF, the fund must meet all the following criteria (both at inception and on an ongoing basis):
  - the QIF must be limited to a maximum of 50 unit holders;
  - units in the QIF must only be offered by way of private placement to unit holders who meet the "professional client" criteria (*see Question 11*); and
  - unit holders must subscribe for at least USD500,000 of units in the QIF.

Fund managers of QIFs are exempt from many of the detailed requirements applicable to public funds or exempt funds.

Similar structures are available in the ADGM.

In 2018, the DFSA also introduced the concept of an open-ended real estate fund and real estate investment trusts. These structures are particularly useful for PE firms that invest in real estate.

6. Are these structures subject to entity level taxation, tax exempt or tax transparent (flow through structures) for domestic and foreign investors?

There are no taxes imposed on the structures discussed in *Question 5*.

7. What foreign private equity structures are tax-inefficient in your jurisdiction? What alternative structures are typically used in these circumstances?

This is not applicable (*see Question 4*).

Fund Duration and Investment Objectives

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8. What is the average duration of a private equity fund? What are the most common investment objectives of private equity funds?

Duration

The average life of a fund is three to five years.

Investment Objectives

In line with previous years, PE funds continue to be cautious as a result of the market conditions, but sectors considered include the consumer, logistics, health care, education, infrastructure and TMT sectors.

Fund Regulation and Licensing

9. Do a private equity fund's promoter, principals and manager require authorisation or other licences?

Outside the DIFC

SCA regulations require a PE fund's promoter, principals, and manager to be licensed by the SCA. As with the fund manager and its principals, a "local promoter" in relation to the offering of a foreign fund in the UAE (or a local fund that is not promoted by the licensed sponsor of that fund) must be a UAE entity licensed by the UAE Central Bank or the branch of a foreign entity that meets local regulatory requirements (including SCA registration and licensing obligations) and whose parent is subject to the supervision of an IOSOCO regulator (*see Question 5*). The rules are the same for VC funds.

DIFC

There are two categories of persons that can establish and manage a fund in the DIFC:

- DFSA-licensed fund manager.
- External fund manager.

DFSA-Licensed Fund Manager. To obtain a DFSA licence, the applicant must demonstrate that:

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- There are adequate systems and controls to manage the type of fund that it proposes to establish.
- The individuals performing certain functions within the company (for example, board members and senior management) meet the relevant suitability and integrity criteria.

Once a licence has been granted, the DFSA supervises the fund manager's activities on an ongoing basis.

If the applicant only intends to establish and manage exempt funds or QIFs, there is a fast-track process that involves self-certification relating to the adequacy of the systems and controls. However, the DFSA still supervises these fund managers on an ongoing basis.

External Fund Manager. An external fund manager is a fund manager from a jurisdiction other than the DIFC who can establish a domestic fund without having to obtain a DFSA licence. To do this, the fund manager must:

- Be a body corporate.
- Manage the domestic fund from a place of business located in a jurisdiction that is either:
    - included in the DFSA's recognised jurisdictions list; or
    - assessed by the DFSA as providing an adequate level of regulation.
- Make itself subject to DIFC laws and the DIFC courts.
- Appoint a DFSA-licensed fund administrator or trustee who must undertake certain functions.

The ADGM also maintains a funds regime, which is very similar in structure to that maintained in the DIFC.

10. Are private equity funds regulated as investment companies or otherwise and, if so, what are the consequences? Are there any exemptions?

In the DIFC

In the DIFC, PE funds usually take the form of exempt funds or qualified investor funds (*see Question 5*). The fund manager of an exempt fund is not required to keep the fund property with an eligible custodian. The fund manager must instead both:

- Appoint an investment committee for the fund.
- Make certain disclosures in its prospectus relating to the method of holding the fund's assets.

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The marketing of funds is based on generally accepted principles of disclosure through prospectus requirements. The level of prospectus disclosure required for public funds (which are open to retail investors) is higher than for exempt funds (which are open to professional investors only).

Foreign funds can only be marketed in or from the DIFC by DFSA licensed firms holding advisory or arranging authorisations. A foreign fund must meet the eligibility criteria set by the DFSA.

The ADGM also maintains a funds regime, which is very similar in structure to that maintained in the DIFC.

Outside the DIFC

The Central Bank and SCA are generally responsible for the regulatory oversight of financial activities in the UAE outside the DIFC and the ADGM (where the DFSA or the FSRA, as applicable, carries out these functions).

Local onshore funds offered in the UAE must comply with the SCA Regulations. In particular:

- Each local fund must obtain a licence issued by the SCA.
- A fund must be a UAE joint stock company, an LLC, or a UAE branch of a duly licensed foreign company.

A foreign fund seeking to market its units in the UAE must:

- Obtain SCA approval to promote its units in a public offering.
- Be licensed to promote public offerings in its home country.
- Be subject to the control of a supervisory authority similar to the SCA.

Foreign funds can also be promoted in private offerings within the UAE after obtaining SCA approval, provided that the fund is marketed by a local promoter (which must be a bank licensed by the Central Bank, an investment company licensed by the Central Bank, or a company licensed by the SCA to promote funds).

These rules apply equally to VC and PE funds.

11. Are there any restrictions on investors in private equity funds?

Outside the DIFC

Funds in the UAE are established by sponsors that are subject to ownership restrictions as set out in the Companies Law. Until very recently, UAE nationals had to own at least 51% of any sponsor of a PE fund. However, see *Question 14* on recent changes to the Companies Law with regards to amendments to ownership restrictions.

A foreign fund that is registered with the SCA must be promoted by a local promoter or engage solely in reverse promotion (passive marketing of the fund, which is loosely defined by SCA and is evaluated on a case-by-case

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basis). The composition of such a fund's investor base is restricted by the regulations in the fund's jurisdiction of incorporation.

See *Question 5* for a description of "qualified investors" under the SCA regulations.

DIFC

PE funds in the DIFC tend to be exempt funds and therefore are only open to professional clients. In addition, units in the exempt funds can only be offered by way of private placement. A person can be classified as an "assessed professional client" if all of the following apply:

- The person either:
  - has net assets of at least USD1 million; or
  - is or has been in the previous two years an employee of the authorised firm associated with the fund or an employee in a professional position at another authorised firm.
- The person appears on reasonable grounds to the authorised firm to have sufficient experience and understanding of the relevant financial markets, products or transactions and any associated risks.
- The person has not elected to be treated as a "retail client".

The DFSA can impose any additional restrictions on any fund that it regulates.

12. Are there any statutory or other maximum or minimum investment periods, amounts or transfers of investments in private equity funds?

Outside the DIFC

In 2016, the UAE's Securities and Commodities Authority (SCA) issued Chairman Decision No. 9/RM of 2016 concerning the regulations on investment funds, which decreased the minimum subscription limit per investor to AED180,000 from AED500,000.

DIFC

In the DIFC, professional clients must make a minimum subscription of USD50,000 to participate in an exempt fund and unit holders of a QIF must subscribe for at least USD500,000 of units in the QIF.

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13. How is the relationship between the investor and the fund governed? What protections do investors in the fund typically seek?

In a PE fund, the fund manager typically controls almost all activities of the fund. Investors are usually not involved in the operations of the fund. However, investors can negotiate side agreements with the fund.

Examples of protections that investors typically seek includes:

- Investment restrictions, including restrictions on borrowing.
- Restrictions on conflicts of interest.
- The ability to remove a fund manager.
- The appointment of an investors' advisory committee.

Aside from the negotiated side agreements, investors are typically passive investors.

Investors in VC funds often seek information rights, which would require the fund manager to provide both:

- Periodic reports of the fund's activities.
- Notice of any material changes to the fund (such as the appointment and removal of board members) or laws applicable to the fund.

However, given the very small number of VC funds in the UAE, investment managers are generally granted significant powers over the fund.

Interests in Portfolio Companies

14. What forms of equity and debt interest are commonly taken by a private equity fund in a portfolio company? Are there any restrictions on the issue or transfer of shares by law? Do any withholding taxes or capital gains taxes apply?

Most Common Form

PE funds commonly take equity in a portfolio company. It is not common for PE funds to provide debt funding. However, Islamic banks commonly invest through equity and financing. Conventional banks are not permitted to take equity. The use of convertible loan notes has also become more commonplace in the UAE.

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In the UAE, as in most other jurisdictions, the advantage of taking equity in a portfolio company is the ability to obtain the maximum return on the investment as a result of an exit. The disadvantage of taking equity is the financial loss if the portfolio company performs badly and/or goes into liquidation.

The advantage of debt funding (particularly emergency funding) is the ability to negotiate a high rate of interest on the debt. In addition, the debt will rank in the event of liquidation and it is possible to secure the debt with the company's assets.

Other Forms

Taking equity in a portfolio company is generally the most commonly used form of instrument.

Restrictions

In a limited liability company, there are statutory pre-emption rights which must be respected on a transfer of shares. Shareholders can sell their pre-emption rights to other shareholders or third parties (*Companies Law*). Regulations in respect of the procedure in selling the pre-emption rights have not yet been issued.

Federal-Decree Law No. 26 of 2020 (Amendment Law) made key amendments to the Companies Law that will have a significant impact on investments in the UAE. The Amendment Law repealed Federal Decree Law No. 19 of 2018 on Foreign Direct Investment. It also introduced changes that affect foreign direct ownership and investment in the UAE, particularly in relation to onshore limited liability companies and onshore branches, branches of foreign companies, and public joint stock companies. The Amendment Law removed, with some exceptions, the long-standing requirement for UAE companies to have one or more UAE shareholders holding at least 51% of the issued share capital of the company. Changes relating to foreign ownership of companies took effect from the beginning of April 2021. Additionally, the recently enacted Cabinet Decision No. 55 lists the following as "Strategic Impact Activities":

- Security and defence activities, and activities of a military nature.
- Banks, money changers, finance companies, and insurance activities.
- Printing currencies.
- Telecommunications.
- Hajj and Umrah services.
- Quran Memorisation Centres.

Strategic Impact Activities are subject to the approval and requirements of the relevant regulatory authority in terms of:

- Determining the percentage of the UAE nationals' contribution and/or the percentage of the foreign investor's contribution to the capital.
- Determining the percentage of the UAE nationals' contribution and/or the percentage of the foreign investor's contribution to the membership of the Boards of Directors.
- Any other conditions or rules deemed proper by the relevant authority.

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Local licensing authorities (that is, the relevant economic departments) of each Emirate can determine a list of activities for which up to 100% foreign ownership is permitted (*Amendment Law*). This also raises the question as to whether there will be policy differences between Emirates as to percentages of permitted ownership and the level of capital contribution required for higher levels of foreign ownership. Accordingly, foreign companies, with some exceptions, are now able to invest up to 100% in UAE limited liability companies (outside the free zones).

Certain entities may be required to seek merger clearance from the UAE Ministry of Economy (*Competition Law*) (*see Question 33*).

Taxes

There are no taxes imposed on the structures discussed above in the UAE or DIFC (*see Question 4*).

Buyouts

15. Is it common for buyouts of private companies to take place by auction? Which legislation and rules apply?

It is not common for buyouts of private companies to take place by auction.

16. Are buyouts of listed companies (public-to-private transactions) common? Which legislation and rules apply?

Buyouts of listed companies are not common.

Principal Documentation

17. What are the principal documents produced in a buyout?

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The principal documents produced in a buyout, whether in an acquisition of a private company or a public company, and which are not required to be made publicly available, are:

- Equity documents:
  - investment agreement;
  - articles of association (this must be provided to the relevant licensing authority); and
  - employment agreements.
- Acquisition documents:
  - share purchase or asset purchase agreement; and
  - disclosure letter.
- Finance documents (if any):
  - bank facility agreement; and
  - bank security documents.

Buyer Protection

18. What forms of contractual buyer protection do private equity funds commonly request from sellers and/or management? Are these contractual protections different for buyouts of listed companies (public-to-private transactions)?

PE funds usually seek protection through warranties in relation to various aspects of the target company's business. In addition, covenants regarding the following matters are usually provided:

- Future revenue or net profits of the target company.
- Recoverability of receivables.
- Continued employment of key employees.
- Key customer and supplier contracts.

Information about the management team can be requested and indemnities are sought if there are particular areas of concern.

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The PE shareholder will also have veto rights with respect to certain key decisions of the portfolio company.

Shareholders holding 5% or more of the company can apply to the competent authority or a competent court claiming the affairs of the company have been conducted to the detriment of any of the shareholders. The aim is to provide better protection for minority shareholders.

The market for warranty and indemnity insurance is not well developed.

19. What non-contractual duties do the portfolio company managers owe and to whom?

Outside the DIFC

For company directors:

- A director is liable for an error in management. There is no exhaustive list of what constitutes an error in management. Further, the UAE does not recognise the concept of binding precedents and the definition of error in management may vary from judge to judge and is highly context specific.
- Managers of an LLC are liable towards the LLC's shareholders and creditors for distribution of profits in violation of the provisions of the Companies Law or distribution of fictitious profits.
- Other circumstances in which a director may be held liable for failure to adequately discharge their duties include:
  - failure to invite the general assembly in case of losses;
  - failure to keep accounting records; or
  - violation of the provisions of the Companies Law.
- Any decision passed by the General Assembly to relieve the directors does not prevent the filing of a liability lawsuit against the directors due to the errors committed by them during the performance of their duties. If the act giving rise to liability has been presented to and approved by the General Assembly, the right to bring a liability lawsuit is forfeited on the expiry of one year from the date of that meeting. However, if the relevant act is a criminal act, the right to bring a liability lawsuit is not forfeited until the public criminal case is closed (*Companies Law*.)

There are also general obligations under UAE law in relation to privacy and the divulging of trade secrets, as well as the obligation of confidentiality and the duty to avoid causing harm.

DIFC

Directors' duties in the DIFC include the duty to:

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- Act within their powers.
- Promote the success of the company.
- Exercise independent judgement.
- Exercise reasonable care, skill and diligence.
- Avoid conflicts of interests.
- Not accept gifts from third parties.
- Declare any interest in a proposed transaction or arrangement.

20. What terms of employment are typically imposed on management by the private equity investor in an MBO?

The terms of employment typically imposed on management include comprehensive restrictive covenants. It is also usual for management to be obliged to transfer any shares that they hold in a target company on termination of their employment. The value received for the shares usually depends on the circumstances under which the manager's employment has ended. Senior executives (CEOs) tend to receive the majority of their compensation by way of performance-based bonus schemes rather than fixed compensation.

In addition to this, employee share options are sometimes included.

21. What measures are commonly used to give a private equity fund a level of management control over the activities of the portfolio company? Are such protections more likely to be given in the shareholders' agreement or company governance documents?

PE funds can have a right to appoint directors to the board of the portfolio company, and this is commonly exercised. PE funds can also be given veto rights where their votes do not control the board. These protections are usually found in the shareholders' agreement.

Debt Financing

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22. What percentage of finance is typically provided by debt and what form does that debt financing usually take?

Debt financing by PE funds is uncommon. Investment is usually made through equity investments. However, Islamic banking institutions commonly provide debt and equity funding (*see Question 14*). The debt financing is usually in the form of loans or convertible loans. These transactions are structured to ensure compliance with Sharia law.

Lender Protection

23. What forms of protection do debt providers typically use to protect their investments?

Security

Debt providers commonly take a mortgage over the borrower's real estate. Assignment of receivables, insurance policies and commercial mortgages can also be entered into. A commercial mortgage is a registrable form of security over the business premises, which includes all tangible and intangible assets of the company. Perfection of the commercial mortgage is by way of registration in the commercial register of the relevant Emirate in the UAE.

Federal Law No. 4 of 2020 on Guaranteeing Rights Related to Movables came into force on 1 June 2020, repealing Federal Law No. 20 of 2016 on the Mortgaging of Movable Property as Security for Debts. It introduced a new regime for registering a security interest over movable assets located in the UAE and addressed a number of previous shortcomings in the security registration regime. This included the ability to create a security interest similar to a common law floating charge over future assets and dispense with the need to deliver possession of the secured asset. It also made it possible to perfect a security interest through registration and created a public register for registered security interests. A new security registry will be established by a Ministerial Decision and will replace the Emirates Movable Collateral Registry established under the 2016 Law.

Shares in a limited liability company can be pledged to another partner or third party in accordance with the memorandum of association of the company (*Companies Law*). Such a pledge is not valid until registered in the commercial register with the competent authority. This makes it easier for UAE limited liability companies to raise debt financing, by giving lenders a strengthened security package. The mechanism for the registration of share pledges has now been established by certain competent authorities.

Contractual and Structural Mechanisms

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Covenants can be obtained from the company to prevent it taking any further debt which ranks before that of the lender. Alternatively, taking any new debt can be made subject to the existing lender's consent.

Financial Assistance

24. Are there rules preventing a company from giving financial assistance for the purpose of assisting a purchase of shares in the company? If so, how does this affect the ability of a target company in a buyout to give security to lenders? Are there any exemptions?

Rules

Outside the DIFC. A public joint stock company and its subsidiaries cannot in any circumstances provide financial assistance to any shareholder to enable that shareholder to acquire shares or bonds in the company (*Companies Law*). The prohibition is broad and includes loans, gifts or donations, assets of the company as security and a security or guarantee of the obligations of another person.

DIFC. In the DIFC a company cannot provide financial assistance for a person to acquire shares in the company or a holding company of the company unless the financial assistance falls within certain exemptions provided for in the Companies Law (*Article 45, Companies Law (DIFC Law No. 5 of 2018)*) (*see below, Exemptions*).

Exemptions

Exemptions include instances where:

- Financial assistance:
    - does not materially prejudice the interests of the company or its shareholders or the company's ability to discharge its liabilities as they fall due;
    - is only an incidental part of some larger purpose of the company and is given in good faith in the interest of the company.
- The company's ordinary business includes providing finance and the financial assistance is given in the ordinary course of that business and on ordinary commercial terms.
- The financial assistance is:
    - approved by a resolution of the shareholders holding at least a 90% nominal value of the shares;
    - given in connection to an employee share scheme.

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Insolvent Liquidation

25. What is the order of priority on insolvent liquidation?

Outside the DIFC

On a company's insolvent liquidation, priority is granted to certain preferred claims, including the payment of:

- Unpaid end of service gratuity, wages and salaries due to employees for the 30-day period before the declaration of insolvency.
- Any amounts payable to government bodies.
- The costs and expenses of the insolvency proceedings.
- Debts of maintenance paid by the debtor in accordance with a court order.

Payment is then made to secured creditors and lastly to unsecured creditors. The priority order is the same regardless of whether the insolvent is a corporation, trust or partnership (or similar).

DIFC

The DIFC Preferential Creditor Regulations apply to any company to which the DIFC Insolvency Law (DIFC Law No. 1 of 2019) applies. Together, the Insolvency Law and the Preferential Creditor Regulations provide that on the winding up of a company, its preferential debts must be paid after the expenses of the winding up, in priority to all other debts whether secured or unsecured. The following are deemed to be preferential debts:

- Sums owed by the company in connection with an employee's pension or an end of service gratuity payment.
- Remuneration of a company's employees for up to four months preceding the date of the appointment of a provisional liquidator or the winding up order in the case of a compulsory winding up.
- Any payments due in lieu of notice.
- Compensation in respect of accrued holiday entitlement.

Equity Appreciation

26. Can a debt holder achieve equity appreciation through conversion features such as rights, warrants or options?

Investment can be provided through convertible loan notes where the investor has the option to convert the debt into equity at a certain price (not less than the nominal value of the shares). An investor can use this mechanism to achieve more upside.

Portfolio Company Management

27. What management incentives are most commonly used to encourage portfolio company management to produce healthy income returns and facilitate a successful exit from a private equity transaction?

Management incentives are commonly granted through the issue of shares or a higher participation in the company's profits. Employee share option schemes can also be implemented. This is similar for VC funds.

28. Are any tax reliefs or incentives available to portfolio company managers investing in their company?

At present there are no taxes imposed in the UAE on portfolio managers investing in their company (*see Question 4*).

29. Are there any restrictions on dividends, interest payments and other payments by a portfolio company to its investors?

Limited liability companies must set aside 10% of their net profit each year for the formation of a statutory reserve (*Article 103, Companies Law*). Accumulation of this reserve can be suspended if it reaches half the capital. The shareholders can agree to form other reserves if desired. Dividends can only be paid from the distributable profits of the company.

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30. What anti-corruption/anti-bribery protections are typically included in investment documents? What local law penalties apply to fund executives who are directors if the portfolio company or its agents are found guilty under applicable anti-corruption or anti-bribery laws?

Protections

There is a statutory requirement that the directors in a portfolio company must be liable to the company, the shareholders and third parties for all:

- Acts of fraud or abuse of power.
- Violations of the law or of the bye-laws.
- Errors in management.

Penalties

The UAE authorities have recently taken firm steps towards addressing corrupt practices in the private sector. Many individuals who have engaged in corrupt conduct have been subject to investigation and prosecution in recent years. The Penal Code imposes a punishment of a fine and/or imprisonment on those who engage in corrupt conduct. The UAE law criminalises bribery in both the public and private sectors.

Exit Strategies

31. What forms of exit are typically used to realise a private equity fund's investment in a successful company? What are the relative advantages and disadvantages of each?

Forms of Exit

Corporate divesture by way of a sale to a trade purchaser or an asset sale are the most common and most effective forms of exit strategy.

For VC funds, the most likely liquidity events for successful companies are in the form of trade sales and secondary buyouts. While some investors have exited VC investments by way of an initial public offering (IPO), this is very uncommon.

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Advantages and Disadvantages

In a corporate divestiture, the seller usually has more flexibility around the negotiation of the purchase price. This can be due to the fact that the trade purchaser is looking to make a strategic acquisition, to expand into a new market or offer a new product or service to its customers that complements their current offering. Another advantage of a corporate divestiture is having multiple potential purchasers involved in a bidding war or formal auction process for the portfolio company.

A disadvantage of a corporate divestiture is that it can take up significant management time and nearly always takes longer than expected, even for smaller companies.

32. What forms of exit are typically used to end the private equity fund's investment in an unsuccessful/distressed company? What are the relative advantages and disadvantages of each?

Forms of Exit

It is usual for a PE and VC funds to invoke a put option in the event of an unsuccessful investment. The investor can usually invoke the put option if certain financial thresholds concerning the company's revenue or net profits have not been met. Deferred payment clauses are also possible. The mechanism is used to reduce the investment cost or to avoid making further investment where the portfolio company is not achieving certain financial milestones.

Many VC funds negotiate a right to force the sale of the company after a certain period, in which case the founders (or any other shareholders) have no right to vote on the exit transaction.

Advantages and Disadvantages

On a practical level, a disadvantage of invoking a put option is that specific performance (or any other equitable remedy) is at the discretion of a UAE court and, in general, equitable remedies are not available in cases where an award of damages is considered to be an adequate remedy.

Reform

33. What recent reforms or proposals for reform affect private equity?

Foreign Direct Investment Developments

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The Amendment Law (*see Question 14, Restrictions*) introduced the possibility of majority foreign ownership of UAE companies. This new legislation is welcome news to many foreign investors and supports the UAE's development objectives.

Securities and Commodities Authority Fund Regulations

Various new SCA regulations relating to funds have been enacted in the last five years. These are:

- Board of Directors' Chairman Decision No. (9/R.M) of 2016 concerning the regulations as to mutual funds, regulating the marketing of funds in onshore UAE.
- Board of Directors' Chairman Decision No. (10/R.M) of 2016 concerning the fees of mutual funds, outlining the fees payable to SCA in respect of application fees and licence renewals for public and private mutual funds.
- Administrative Decision No. 49 of 2016 regarding exchange-traded funds (ETFs), regulating the incorporation and prospectus requirements for ETFs.
- Administrative Decision No. 52 of 2016 regarding cash investment funds (CIFs), regulating the investments permissible for CIFs.
- Administrative Decision No. 1 of 2017 regulating real estate investment trusts (REITs).
- Administrative Resolution No. (2/R.T) of 2017 regarding private ownership funds, which has introduced rules relating to the obligations of both the general and limited partner and places restrictions on the investments a private ownership fund can make. This means that a fund must invest the majority of its monies in purchasing:
    - shares in limited liability, joint partnership, joint ventures or private shareholding companies; or
    - securities of public shareholding companies that are intending to commence conversion into private shareholding companies or before the commencement of the liquidation process.
- Administrative Decision No. 3 of 2017 regulating venture capital funds.
- Board of Directors' Chairman Decision No. (3/R.M) of 2017, as amended, concerning the regulation of promotion and arranging activities.
- Board of Directors' Chairman Decision No. (4 / R.M) of 2017 concerning the regulation of the activity of administrative services for investment funds.
- Administrative Decision No. (39/R.T) of 2017 concerning investment policy of the public open-ended investment fund.
- Administrative Decision No. (57/R.T) of 2017 concerning the adjustment of positions mechanisms for investment funds.
- Administrative Decision No. (6/R.T) of 2019 concerning the real estate investment fund controls.
- Board of Directors' Chairman Decision No. (8/R.M) of 2019 concerning the mechanism of investment funds operations.

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- Administrative Decision No. (63/R.T) of 2019 concerning evaluation of in-kind shares of investment funds.
- Board of Directors' Chairman No. (13/R.M) of 2021 on the rules handbook of financial activities and mechanisms of status regularisation (SCA Rulebook).

The SCA regulations constitute the UAE fund regime for onshore local funds and foreign funds that are marketed in the UAE (outside its financial free zones). The fund regulations set out, among other things, registration and licensing procedures for local funds, promotion rules for local and foreign funds, and additional obligations and key exemptions for certain specialty funds.

The SCA regulations apply to all mutual funds and parties that are "related" to mutual funds. A "mutual fund" is defined as a financial pool engaged in accumulating investors' assets for investment against the issue of fund units of equal value and SCA broadly interprets this definition.

The new SCA regulations provide for (or otherwise contemplate) the following types of funds:

- Public and private funds.
- Master/feeder funds and umbrella fund/sub-funds.
- Open ended and closed ended funds.
- Specialty funds, including Islamic funds, REITs, VC funds, PE funds, ETFs, and cash investment/money market funds.

The provisions related to these funds are based on the Undertakings for Collective Investment in Transferable Securities model, which creates a harmonised regulatory regime that permits funds to be sold to any investor in the EU. While the GCC states have not adopted a comparable framework, it appears that the new SCA regulations have been prepared with this possibility in mind.

The SCA Rulebook, which will introduce considerable changes to the SCA's regime regulating the promotion of financial products in the UAE (outside the financial free zones), will come into effect the day following its publication in the *Federal Gazette*.

DIFC Regulations

The DIFC has made a series of changes to the regulations applicable to collective investment funds, to encourage the establishment of these funds in the free zone. The Emirate of Abu Dhabi has established the ADGM which has a funds regime that is very similar to that of the DIFC.

Tax Regime

With a few exceptions, the UAE is generally a tax-free jurisdiction (*see* Question 4). However, from January 2018, the UAE has introduced value added tax (VAT). Businesses will collect taxes on behalf of the government and file tax returns accordingly. Although the tax is collected at each stage of value addition, the primary tax burden falls on the end consumer as suppliers in intermediate stages can claim a refund.

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