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inBrief

The Private Equity, Venture Capital, and Start-up Ecosystem in the UAE: Recent Developments

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In the lead up to the Expo 2020, the UAE government has taken a number of measures to promote economic diversification, foster growth, and stimulate the region's innovation environment. The government's push to develop the private equity, venture capital, and start-up eco-system is a central component of this agenda. In this inBrief we summarize the recent developments implemented in the UAE that enhance the ease of doing business for private equity and venture capital funds as well as start-up companies.

New Regime for Fund Establishment and Management

Over the last three years, the UAE Securities and Commodities Authority (**SCA**) has issued two important laws concerning the regulation of private equity and venture capital funds in the UAE. They are, (1) SCA Board of Directors' Chairman Decision No. (9/R.M) of 2016 and (2) SCA Administrative Decision No. (3/R.T) of 2017. Some of the key provisions of these laws include:

- establishing local mutual funds and marketing and promoting of foreign funds to investors in the UAE;
- conferring corporate personality on the fund and limitation of investor liability; and
- defining "Venture Capital Fund" as well as the conditions for venture capital funds to satisfy.

Despite these positive laws, onshore funds tend to be uncommon in the UAE due to foreign ownership restrictions and regulatory requirements imposed by the SCA. Consequently, many private equity and venture capital funds are established in the economic free zones of the Dubai International Financial Centre (**DIFC**) and Abu Dhabi Global Market (**ADGM**) (collectively, the **Financial Free Zones**), which are regulated respectively by the Dubai Financial Services Authority (**DFSA**) and the Financial Services Regulatory Authority (**FSRA**) (collectively the **Offshore Regulators**).

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Silvia Pretorius is a senior associate at Afridi & Angell's Abu Dhabi office. She is involved in the firm's corporate and commercial, banking, real estate, and project finance practices. Silvia holds an LLB and BA from the University of Natal, South Africa. She is a member of Side Bar (Natal and Transvaal Provincial Divisions), South Africa.

The Financial Free Zones permit fund managers located both within and outside the Financial Free Zones to establish funds within the Financial Free Zones through a range of fund vehicles that include investment companies, investment partnerships, and investment trust structures. The fund managers based in the Financial Free Zones also have the flexibility to establish and manage funds outside the Financial Free Zones. Firms authorised or licensed by the respective Offshore Regulators can also promote and sell both domestic and foreign funds in or from the Financial Free Zones. In addition, the SCA and the Financial Free Zones have recently begun implementing a passporting regime that will allow for the mutual promotion and oversight of domestic funds established in these respective jurisdictions.

Also, the Financial Free Zones have taken several steps to create a favourable regulatory environment for private equity and venture capital funds. For example, they apply a risk-based regulatory approach for their funds regime that includes exempt funds (which are funds available for professional clients) and qualified investor funds, which have less stringent requirements than exempt funds and are specifically targeted at sophisticated investors such as high net worth individuals and family offices. In addition, the FSRA has introduced a risk-proportionate regulatory framework for managers of venture capital funds, which among other things, exempts venture capital fund managers from base capital or expenditure-based capital requirements.

New Trends

Several recent legislative developments have also collectively provided more opportunities for funds and regulators have sought to stimulate disruptive industries. For example, each of the DIFC and the ADGM established a FinTech regulatory sandbox to create a progressive regulatory environment for the growth of the FinTech industry in the UAE.

In addition, the new pledge law enables pledgees to perfect their security interest over movable assets. This law will substantially enhance and create certainty in commercial lending. As a result, start-ups lacking immovable property will find it easier to avail bank financing by pledging movable assets such as their receivables, raw materials, or future assets.

Finally, the UAE's new bankruptcy law introduces a regime that allows for protection and reorganisation of distressed businesses. It offers some protection for issuers of dishonoured cheques for the duration of any preventive composition or restructuring procedure. In addition, the new law provides debtors with the ability to raise new finance during the preventive composition or restructuring process, with court approval. Together, these changes

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Deniz is responsible for the delivery of all aspects of legal knowledge management for Afridi & Angell, including the monitoring of legal, regulatory, and market developments in the UAE. She has been a practicing corporate lawyer since 2001 and has experience in the US as well as in Turkey advising on cross-border acquisitions, capital markets transactions, and financing. Deniz is admitted to practice law in the US in New York, California and New Jersey.

provide entrepreneurs with further confidence to take calculated risks and comfort banks/investors with exposure to such investments.

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The above positive changes will result in the establishment of new funds and attract more entrepreneurs and investors to the UAE. Ultimately, such policy reforms will cement the UAE's position as the private equity, venture capital, and the start-up hub of the Middle East. ■

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Afridi & Angell

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