Guest Article:

Private Equity in the Middle East: Some Legal Considerations

By Neil D Miller and Judy Kawaf[1]

Although interest in private equity investment in the Middle East has increased, the majority of Middle Eastern focussed private equity funds are still structured as offshore funds. Most private equity houses are still more comfortable creating a traditional limited partnership structure which then invests into the region. This is due to the level of comfort and familiarity that investors have with limited partnerships established in the United Kingdom, the Channel Islands, the Cayman Islands and other jurisdictions. However, as local regulatory authorities become more established and sophisticated, it is likely that the number of private equity funds established from within the region will increase.

The Middle East region has welcomed the emerging private equity market, and regulatory infrastructures have been created in Bahrain and Dubai to encourage private equity investment. The Central Bank of Bahrain ("CBB")(formerly known as the Bahrain Monetary Agency) is a well respected and internationally recognised regulatory authority. More recently, the Dubai government created the Dubai International Financial Centre ("DIFC") which provides a comprehensive legal structure regulating the provision of financial services. Both the CBB and the DIFC allow for 100% foreign ownership of companies under their respective authority.

In Bahrain the typical structure of a private equity fund consists of a Bahraini closed-ended joint stock company which establishes a collective investment scheme. Units in the closed-ended joint stock company are then issued to investors. The investors have no right to control the management or operation of the company. Instead, control over the management and operation of the company and over the assets of the fund is governed by the company's constitution, the Instrument of Deed Poll. The fund itself is not a separate legal entity. The fund manager appointed must also be a Bahraini joint stock company and the appointed administrator must be registered with the CBB.

The DIFC permits the establishment of domestic private equity funds (i.e., private equity funds established and operated in the DIFC). It also has specific regulations for specialist funds such as Islamic funds and property funds. A domestic fund must be established as an investment company, investment trust or investment partnership. The operator of a domestic fund must be an authorised firm established in the DIFC and must also be licensed by the Dubai Financial Services Authority ("DFSA"), the DIFC's regulatory arm, to provide financial services. The incorporation and licensing applications normally run in parallel. If the fund is established as an investment trust, it must also have a trustee licensed by the DFSA.

The DIFC and the DFSA have expressed the wish to create a regulatory system operated in accordance with international standards and encourage feedback from companies established in the DIFC to ensure that the regulatory system is tailored to their needs. A recent example of this is the change in marketing rules relating to the marketing of foreign funds.

Established private equity houses have sought and obtained authorisations and licences to operate in the DIFC. For the most part, the majority of these private equity houses have established foreign private equity funds prior to becoming authorised by the DIFC. The DIFC regulates all operations undertaken from or within the DIFC, and until recently a foreign fund could only be marketed in or from the DIFC if it either qualified as a Designated Fund (i.e., a fund established in a Recognised Jurisdiction) or if both the fund manager and the custodian were located in the DIFC or in a Recognised Jurisdiction. The list of Recognised Jurisdictions included several established jurisdictions such as the United Kingdom and the United States but notably excluded the Cayman Islands and British Virgin Islands; in August 2006 the DIFC amended its rules to provide for marketing of non-designated funds in or from the DIFC where the fund manager and custodian are appointed by a person subject to regulation and supervision by a financial services regulator in a Recognised Jurisdiction or where the fund is rated as investment grade by an international rating agency such as Moody's, Fitch or Standard & Poor's.

The establishment of regulatory authorities such as the CBB and the DIFC is encouraging private equity houses to have a presence in the Middle Eastern region. Similarly, the international regulatory standards applied by the CBB and DIFC are expected to result in an increase in the number of domestic private equity funds being established and for the private equity market in the Middle Eastern region continuing to grow.

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