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Fundraising In The Middle East: Enforcement Spotlight – Kuwait

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Raising money for investments in Kuwait comes with complexities and certain risks, as in all jurisdictions. The author of this article – who has penned a number of analyses published here – considers the territory.

The following article, from Cathy Brand (pictured), CEO ***Sales Road Maps Online®****, explores the issues that face asset managers, including alternative investment fund managers (AIFMs) when raising money in the Gulf region of the Middle East. This article pays particular attention to Kuwait. This is the kind of detailed analysis that this publication is pleased to share, as we know it contains invaluable information for wealth managers and others working with clients in this region.*

As is always the case, the editorial team stress that the views here are not necessarily shared by this publication. If you wish to comment, please email tom.burroughes@wealthbriefing.com

As part of global fundraising campaigns, AIFMs and asset managers are increasingly expanding their fundraising (geographical) reach to investors in the Middle East region. Target investors may include sovereign wealth funds, high-net-worth individuals, government-owned entities and national pension funds.

Many fund managers typically target six jurisdictions (the "core 6") within the Middle East for their fundraising efforts: United Arab Emirates (the UAE 7 Emirates including Dubai and Abu Dhabi), Bahrain, Kuwait, the Kingdom of Saudi Arabia, Oman and Qatar. There is no standardised cross-border fund marketing regulatory regime in the Middle East region: Each country has different regulations for the purposes of cross-border fund marketing.

Global Sales Compliance Ltd® has been tracking the development of country marketing regulations in the Middle East (and globally) for the past two decades. Our CEO shares insights into how Middle East country fund marketing regulations are transforming. They are changing to not only meet the needs of their constituents investing in foreign funds managed by offshore AIFM/asset managers but also to deploy new enforcement techniques that protect the country's local investors.

In this article, we provide insight into the recent enforcement movement in Kuwait.

What is the regulatory playing field in the Middle East for cross-border marketing?

The Middle East region's regulations pertaining to foreign AIFM/asset managers marketing their funds cross-border into each of the six countries could be described as "developing." Looking at fund marketing regulations "evolutionary scale" across the globe (60+ countries), Middle East jurisdiction regulations are still less "developed" than those of many jurisdictions in the West or Asia. This is especially true with respect to offshore marketing exemptions. The exception is Israel, which sits geographically in the Middle East region yet has a sophisticated regulatory regime on par with Western jurisdictions.

Some foreign AIFMs/asset managers seem to believe in an industry myth that fundraising in Middle East countries is still equivalent to the "Wild West" of 30 years ago, when regulators wouldn't enforce fund marketing rules … because there were no rules to follow.

We're here to say, the days of "Cowboy (Wild West) Marketing" in Middle East countries are over.

The power of investor demand shaping national financial regulations in the Middle East

Increasingly, institutional and private clients in each of the Middle East countries are investing in unique investment opportunities managed by foreign AIFMs/asset managers' overseas-unique investment strategies that are not available from local asset managers. Government owned entities, sovereign wealth funds and government pension funds are increasingly in search of alpha and portfolio diversification, resulting in demand for funds managed by overseas AIFMs/asset managers. Private wealth management clients also invest globally, demanding access to a range of diversified investment strategies and products from foreign fund providers.

National Country Authorities (NCAs) in Middle East jurisdictions are responding to this constituent investor activity with overseas managers by overhauling, clarifying and "modernizing" their country's regulations. They're doing this to balance protection of their investor constituents and to benefit their own economy (i.e., the requirement to appoint local licensed agents/fund distributors, etc.).

What's our downside risk for fundraising in the Middle East?

If you breach country fund marketing regulations while fundraising in the Middle East – as in all jurisdictions – your five key distribution risks could apply:

1. Sanctions risk;
2. Litigation risk;
3. Investor rescission rights claims risk;
4. Reputation risks; and
5. Business franchise risk.

What tools do Middle East NCAs use to enforce their sanctions?

Fines seem to be most popular enforcement mechanism by NCAs in the Middle East (administrative sanctions as opposed to criminal sanctions, such as imprisonment).

Some AIFMs/asset managers fundraising in the Middle East region have become understandably nonplussed about the likelihood of sanctions enforcement by NCAs in the region. According to our Kuwait Counsel, some regulators such as Kuwait's Capital Markets Authority (CMA) have historically stated informally (off the record) that "their primary concern is not the marketing of securities to institutional or 'high profile' clients, but rather to 'less sophisticated investors'." In the past, Kuwait's CMA has chosen to enforce sanctions such as fines against unlawful conduct with retail investors but not institutional investors.

But don't get complacent and think you can breach Kuwait's private placement fund regime because CMA won't intervene and enforce sanctions against institutional marketing. If you do get caught out with sanctions, your downside risk could go well beyond having to pay a relatively "reasonable fine" to get you out of hot water.

After many years of "selective enforcement," Kuwait's CMA has initiated enforcement action for breaches of its fund private placement regime in the following 2024 example:

In January 2024 CMA announced disciplinary board resolution no. 52/2023 pursuant to which fines of KWD30,000 ($97,650) were imposed on Al Ahli United Bank for marketing units of a foreign collective investment scheme in Kuwait without obtaining a license from Kuwait's CMA.

These administrative sanctions (fines) may seem paltry in terms of "downside risk" but they can be just the tip of the iceberg: the real risk "sucker punch" for anyone in breach of Kuwait's private placement regime is litigation risk. This is particularly impactful and not in a good sense: investor lawsuits can lead to reputational and business franchise risks. And those can be a lot more difficult to shake off: they are the types of distribution risk that hurt your bottom line the most.

You think institutional investors, even quasi-government investors in Kuwait, won't sue? Think again.

Our Kuwait case study below demonstrates how fundraising can go so wrong in Kuwait.

Distribution risk case study: Kuwait

By way of background, Kuwait's private placement regulatory regime – applicable to fundraising in foreign funds from investors resident in Kuwait – is notoriously strict, costly, unyielding and practically impossible for a non-Kuwaiti asset manager to fulfil in terms of successful and timely completion of foreign fund registration with CMA. Plus, there are no offshore marketing exemptions from licensing and fund registration to market your fund into Kuwait from offshore.

We advise clients to be very cautious about dealing with Kuwait investors. Litigation risk is a key factor based on several high-profile lawsuits brought by Kuwait institutions and government pension funds against AIFMs.

Examples include a 2019 lawsuit brought by a large Kuwaiti government pension fund against one of the world's largest listed hedge funds (a London-listed company) in the High Court of Justice in London. Bringing the case to the UK hedge fund manager's home turf in London ensured maximum reputational and business franchise damage to the UK-headquartered hedge fund.

Another key case occurred in 2009 (resulting from the 2008 financial crisis) whereby a Kuwaiti institution (a quasi-governmental institutional investor) brought a contentious lawsuit against a leading US private equity firm after the Kuwaiti investor lost money in a fund managed by the PE firm. It claimed that the US PE firm breached Kuwait's laws when they marketed their fund to the Kuwaiti investor – flying US sales teams into Kuwait City to solicit the PE firm's fund onshore in Kuwait, in breach of Kuwait's private placement and licensing regime.

What ensued were years of wrangling between the parties to establish the jurisdiction of jurisprudence in a Kuwait court vs. the US private equity firm which wanted the case heard in US courts. This contentious and high-profile lawsuit was costly to the US AIFM and – some would argue – caused significant damage to their reputation and business franchise, a costly exercise that CAN be avoided with the right compliance tools.

Summary

Fundraising in your AIF [alternative investment fund] from investors in the Middle East can be an attractive business strategy. It is also accepted industry practice.

AIFMs/asset managers need to know that fundraising in the Middle East is not the "Wild West" of two to three decades ago: there are rules you need to follow and NCAs across the region are in enforcement mode as the Kuwait case study demonstrates.

However, don't think you can just pay a fine and walk away if you breach country fund marketing regulations: as Kuwait's history shows, Kuwait institutions will seek redress in the courts and have done so when they lose money in your fund, and especially when you breach their country's laws.

Keep your distribution risk mitigated by complying with each country's fund marketing regulations at all times.

Your Middle East business franchise, hard-earned reputation and client base are too valuable to lose. As Middle East investor-driven demand for your unique investment opportunities grows, cross-border marketing compliance just makes good business sense.