

Regulatory Updates in the DIFC

November 2016

New Intermediate SPV Vehicles

The DFSA and DIFC held a joint seminar on 31 October on structuring and the new 'Intermediate SPV' regime with the focus being on fund structuring. ('Intermediate' referring to such vehicles sitting in an intermediate position in a structure).

The Intermediate SPV is a recent development by the DIFC Authority which provides a cost effective option for establishing SPVs in the DIFC (i.e., only US\$1,000) not just in respect of fund structures but across the board.

There has been the option to establish Special Purpose Companies in the DIFC previously, and this option remains, but these are comparatively expensive and process-heavy to set up. The new Intermediate SPVs will be cheaper and easier to establish. No change of law or rules has occurred as yet, but the entities are available now through standardised waivers which will apply when an application is made to the DIFC Authority.

However, the Intermediate SPVs will only be available to entities that already have a substantive presence in the DIFC (i.e., fund managers, asset managers, family offices etc).

This development is a step closer to what the ADGM offers by way of SPVs and will make life easier and cheaper as far as structuring options go for existing DIFC entities, but doesn't go quite as far as the ADGM regime due to the requirement to already have a substantive DIFC presence.

Amendments to DFSA Legislation

On 22 June 2016, the DFSA published a notice of amendments to the DFSA Rulebook based on the changes proposed in consultation paper 103 and consultation paper 105. This includes changes to the insurance regime, the AML Annual Return deadline and stipulations for communications with the DFSA. These amendments came into effect on 1 August 2016.

Changes to the insurance regime

The recent amendments have provided for the below changes to the DFSA's insurance regime:

- Clarification that Insurers Effecting Contracts of Insurance can give advice and undertake Insurance Intermediation activities relating to their own products and those of Group members.
- The definition of Insurance Intermediation has been expanded to cover operators of aggregation sites.
- The exclusions to Insurance Intermediation and Insurance Management have been amended to cover various activities which are not intended to be regulated as financial services.
- Removal of the overlap between Insurance Intermediation and Insurance Management.
- Introduction of the new defined terms 'Insurance Agents' and 'Insurance Brokers'.
- Clarification around the application of the Conduct of Business requirements to reinsurance activities.
- More clarity around disclosure requirement in relation to conflicts of interests arising from ownership links.
- The Expenditure Based Capital Minimum requirement applicable to Insurance Intermediaries handling Insurance Monies has been lowered from 18 weeks of operational expenditure to 9 weeks of operational

expenditure.

- Requirements for Insurance Managers to give some additional declarations in their annual return.
- The introduction of new reporting requirements for Insurers, including branches, and also for Insurance Managers which conduct underwriting activities.

Online Applications and Submission of Data to the DFSA

The legislative changes that were set out in Consultation Paper No.105 have now been implemented. Essentially the DFSA intend to increase the range of transactions, and interactions, which can take place online. The DFSA will introduce an online portal that will allow entities and individuals to submit electronic data directly to the DFSA. The portal will be accessible from the DFSA website, in the same way as is currently the case for the Electronic Prudential Reporting System.

In the first phase of work, which is intend to be complete by the end of 2016, various DFSA authorization application forms and the Annual AML return will be made available through the online portal.

Additionally, the timing of submission of the annual AML return has changed. Instead of being due four months' after the end of the Relevant Person's financial year, this return will in future be due by the end of September each year and the report must cover the period from August of the previous year up to and including July of the lodgement year.

Regulatory Actions

Authorised Firm conducting prohibited insurance activity in the UAE

On the 21 September 2016 the DFSA issued a Decision Notice and imposed a fine of USD 85,191 on an Authorised Firm, who is licensed to provide the Financial Service of Insurance Intermediation. The fine was imposed following a DFSA investigation conducted in collaboration with the United Arab Emirates Insurance Authority.

Under the DFSA Rulebook Authorised Firms are prohibited from intermediating a Contract of Insurance for a risk situated in the UAE unless:

- the risk is situated in the DIFC; or
- the contract is one of re-insurance.

The DFSA's investigation identified that the Authorised Firm intermediated contracts of Insurance for customers with risks situated in the UAE and outside the DIFC, which were not contracts of re-insurance in breach of the abovementioned DFSA Rules. The Authorised Firm also failed to have adequate systems and controls in place to detect, monitor and prevent such activities from occurring.

DFSA concerns over Authorised Firm's AML systems and licensed activities

On the 18 of October 2016 the DFSA accepted an Enforceable Undertaking from an Authorised Firm as a result of the DFSA concerns about the firm's anti-money laundering systems and controls, and about whether it had carried out the Financial Service of Providing Custody to its clients without being licensed to do so. Although the firm did not agree with the DFSA's findings, it acknowledges the DFSA's concerns and agrees to engage an independent expert to ensure that the concerns are remedied.

The firm also agreed to pay a financial penalty of USD 60,000 to the DFSA of which USD 30,000 is payable on or by 17 November 2016. The remaining USD 30,000 is suspended indefinitely and becomes payable if the firm fails to comply with the Enforceable Undertaking.

Future Amendments to DFSA Legislation

To complete our summary of regulatory updates in the DIFC, we also feel is of importance to mention the

following proposed amendments to the DFSA Rulebook that have been addressed in the below listed consultation papers. Please note all three of these consultation papers have finished their consultation period and the proposed amendments to the DFSA Rulebook will be implemented when the relevant Rulemaking instruments are issued by the DFSA. Below is a summary of the changes that each Consultation paper has proposed.

Please note the proposed changes will not come into force until the relevant Rulemaking instrument has been published by the DFSA and please also be aware that the proposals contained within the consultation papers may change. Therefore ultimately only the text of the amended Rulebook and/or Law as published in the Rulemaking instrument can be relied upon.

Consultation paper 106

The DFSA issued Consultation paper 106 due to what they felt was a lack of clarity in some areas of regulation. Therefore Consultation paper 106 proposes to provide greater clarity to the meaning and scope of 'arranging' related Financial Services, Operating a Representative Office and the Financial Promotions regime.

In summary, the Consultation paper proposes to make the following changes:

- combine arranging and advising activities relating to credit into a new separate Financial Service of 'Arranging and Advising on Credit';
- provide clarity on how arranging activities can be distinguished from the Financial Service or financial product to which that activity relates, such as the distinction between:

1. 'Arranging Deals in Investments' and 'Dealing in Investments as Agent'; and

2. 'Arranging Custody' and 'Providing Custody'.

- introduce clarifications about what Financial Services an Insurance Broker and an Insurance Agent require;
- provide for some changes to the activities excluded from regulation under arranging and advising;
- provide guidance to create clarity about the intended scope of a Representative Office licence;
- remove the application of the Client Asset provisions to firms 'Arranging Custody'; and
- refine the Financial Promotions regime to minimise the risk of abuse of that regime.

In light of the above proposals, when they come in force, some Authorised Firms may need Licences for a different type of activity than they currently hold. It is proposed that the DFSA would generally allow a period of six months for the firms to complete the necessary formalities to obtain the right type of Licence. Representative Offices and persons carrying out Financial Promotions which act beyond the scope of their Licences or of the DFSA Rules, as would be clarified under these proposals, would need to cease such activities immediately.

Consultation paper 107

In consultation paper 107, the DFSA is proposing changes to the Anti-Money Laundering, Counter-Terrorist Financing and Sanctions Module ('AML Module') in order to make sure that the regime remains up-to-date in light of the 2012 Financial Action Task Force Recommendations and the recent amendments made to the UAE Federal Law No.4 of 2002 and other UAE AML Legislation.

In summary, the Consultation paper proposes to make the following changes in the AML Module:

- Amend various definitions in order to reflect updates to the UAE Federal AML Laws.
- Provide further clarity in relation to applying a Risk Based Approach.
- updates relating to the prohibition on dealing with Shell Banks and opening anonymous accounts.

- Provide further guidance on what measures should be taken to understand a client's source of wealth and source of funds and when identifying ultimate beneficial owners.
- Amend the guidance regarding outsourcing customer due diligence.
- Amend the application of the 'Sanctions and other international obligations', the 'Money Laundering Reporting Officer' and the 'Suspicious Activity Reports' Chapters to apply to all persons that the AML Module applies to.
- Provide guidance about the application of United Nations Security Council resolutions.
- Provide guidance around the DFSA's processes in relation to freezing of funds or assets.
- Provide further guidance around what activities are captured under the current Designated Non-Financial Business or Professions definition.

Consultation paper 108

In consultation paper 108 the DFSA is proposing amendments to the capital requirements for managers of collective investment funds and amendments to the rules regarding reporting suspicions of market abuse.

In relation to capital requirements for managers of collective investment funds, it is proposed to leave the required expenditure based capital minimum as it is. However the DFSA proposes to reduce the Base Capital Requirement for: a) managers of Public Funds to USD 140,000; and b) managers of Exempt Funds and QIFs to USD 70,000.

An obligation to report suspicions of market abuse to the DFSA is currently imposed on market operators (i.e. Operators of Authorised Market Institutions and of Alternative Trading Systems). However there is not an explicit obligation on Authorised Firms to report suspicions of market abuse by others for whom the firm may be acting. Therefore the DFSA proposes to amend the DFSA Rulebook so that Authorised Firms and Recognised Members are under an explicit obligation to report suspicions of market abuse to the DFSA.