Regulatory Updates in the DIFC

Margaret Elder - Senior Associate - Banking and Finance
- Dubai International Financial Centre

Introduction

This article is a summary of some key financial services regulatory developments that have taken place in the Dubai International Financial Centre ('DIFC') in recent months. In this article we highlight some of the more recent regulatory developments in the DIFC and to the Dubai Financial Services Authority ('DFSA') Rulebook that may be of interest to those persons who are either already present in the DIFC or who are looking to establish a presence in the DIFC.

The DFSA publishes their Client Classification and Suitability Thematic Review

The DFSA recently published the findings of their thematic review which assessed Authorised Firms' adoption of and compliance with the DFSA's client classification rules and practices in respect of suitability assessments. We encourage all DFSA regulated persons to read the DFSA's review and take into consideration improvements which could be made to their existing policies and processes.

The DFSA highlighted several concerns with Authorised Firms' existing systems as summarised below.

Client classification weaknesses:

Lack of training and guidance is provided to employees on client classification, especially front office staff, who are responsible for collecting and assessing client classification criteria. For example, front office staff and relationship managers who best know the potential client would be most likely to document the knowledge and experience of the client. Because such assessments can be difficult due to the lack of documentary evidence, it is essential that sufficient details and files notes are kept in order for the final classification to be made. Adequate staff training must be provided on what client classification entails, including practical elements and examples of how to carry out assessments and record keeping.

Not clearly documenting client classifications by specifically recording the Professional Client sub-category for either 'deemed', 'service-based' or 'assessed' Professional Clients. The DFSA feels the specific sub-category of the Professional Client must be clearly recorded internally.

Where there was reliance on client classification made by the firm's head offices or other members of their Group, there seemed to be weaknesses regarding the awareness of other office's classification procedures and whether their assessments met requirements in accordance with the DFSA rules. Where relying on client classification undertaken by a group member, due diligence should be performed on the client classification procedures of the group member and any gaps should be addressed.

Sole reliance on a client's self-declaration that they qualify as a Professional Client or that they possess sufficient net assets or relevant knowledge and experience. A separate assessment must be carried out by the Authorised Firm and supporting documentation and evidence must be taken for the firm to duly consider the persons' net assets and knowledge and experience. Sufficient and clear documentation must be maintained to support client classification assessments, for example, obtaining account statements and tax returns to provide good insights into net assets.

Too much emphasis or reliance on simple questionnaires or a 'tick-box' assessment of a client's classification rather than conducting a higher quality or more measured assessment.
Some firms failed to demonstrate full compliance with the DFSA's requirements to sufficiently notify their clients of their right to be classified as a Retail Client.

Weaknesses identified by the DFSA in relation to suitability assessments were as follows:

Failures to demonstrate that client suitability assessments in connection with advice or discretionary transactions had been carried out in accordance with the DFSA's Rules. Weaknesses here included not maintaining appropriate documentation of the assessment undertaken and the low quality of some suitability assessments. Firms need to adequately perform and document client suitability assessments in order to protect them from legal and compliance risks. For example, firms should be able to demonstrate by the client files that advice given and investments made for clients were in fact suitable for them.

The use of suitability waivers or limiting the extent of a firm's suitability consideration in Client Agreements. The DFSA has identified that the best practice where an Authorised Firm seeks to limit the extent of any suitability considerations, is that the firm should stipulate the agreed limitations in a separate document, independent of the general terms and conditions to ensure that the client's express consent is obtained in relation to the agreed suitability approach.

General overall weakness in internal policies and procedures concerning relevant suitability and client classification obligations.

Implementation of new DFSA fees

In 2017 the DFSA amended the Fees Module of the DFSA Rulebook, these amendments came into force on 1 January 2018. The following is a high-level summary of some areas of change, but it should be noted other amendments have been made to DFSA fees that are not mentioned below.
Other than there now being additional fees for certain types of DFSA applications there are also either new or additional fees for various changes that may happen in the life time of an Authorised Firm. For example there is an increased fee for amending the scope of a DFSA authorisation, applying for a Retail Client endorsement or applying for a waiver or modification of a DFSA Rule.

More significantly, as of the start of this calendar year, the DFSA increased their basic fixed annual fees for Authorised Firms carrying out the following Financial Services: (i) Accepting Deposits; (ii) Providing Credit; (iii) Dealing in Investments as Principal; (iv) Effecting or Carrying Out Contracts of Insurance (excluding Captive Insurers, Protected Cell Companies or Insurance Special Purpose Vehicles); (v) Insurance Management; and (vi) Operating a Credit Rating Agency. The fixed annual fees for Authorised Firms carrying out these Financial Services will again further increase as of the 2019 calendar year. This phased approach to increasing these particular annual fees was to allow affected Authorised Firms to better plan for the increases. All Authorised Firms will also pay an extra $500 for each additional Financial Service featuring on their DFSA Licence (excluding the relevant Financial Service with the highest fee that applies). The sum of these fees will be added to the DFSA basic fixed annual fee. This amount will be increased to $1,000 for each additional Financial Service for the 2019 calendar year.

Separately as of the 2020 calendar year, there will be: (i) an additional annual fee for Authorised Firms designated as a systemically important financial institution, if they are licenced as Authorised Firms in Prudential Categories 1, 2, 5 or are an Insurer; and (ii) also an additional annual fee for Authorised Firms for which the DFSA acts as the consolidated prudential supervisor of its Financial Group or as a lead supervisor of part of its Group.

Enhancement of the DIFC Funds Regime

At the end of 2017, the DFSA proposed changes to their current regime for regulating Collective Investment Funds by issuing Consultation Paper (No. 115), titled 'Enhancing Our Funds Regime'. The most significant proposals in the paper stem from the DFSA's desire to keep the funds regime up to date.

The consultation period is over and although the amendments to relevant legislation have not been issued yet, it would be reasonable to expect to see the changes proposed in the consultation paper issued soon. However, it should be noted that the proposed changes will not come into force until the relevant

rulemaking instrument has been published by the DFSA. Proposals contained within the consultation papers may also change so market participants will need to wait for the final text of the amended Rulebook and/or Law to confirm the changes.
Some key proposals include:

Removing the investor number-based criteria in the Exempt Fund and Qualified Investor Fund (QIF) definitions. Currently the definitions of an Exempt Fund and QIF include limits on their number of investors (i.e. an Exempt Fund being limited to 100 or fewer investors and a QIF being limited to 50 or fewer investors, in each case whom meet the Professional Client criteria). These number-based limits will be removed creating more flexibility for Fund Managers of Exempt Funds and QIFs.

Under the current regime, there is nothing that deals with the unique features of Exchange-Traded Funds (ETF’s). Thus, the DFSA has proposed to introduce ETF’s as a specialist class of funds with clearly identifiable features. These open-ended funds, listed and traded on exchanges, have become popular with investors in other jurisdictions. The consultation paper proposes to introduce certain rules and guidance for ETF’s in line with what is envisaged under International Organisation of Securities Commissions Principles.

The DFSA has proposed several enhancements relating to Property Funds. These include (i) introducing guidance regarding the distinction between property companies which are commercial companies, and those which are investment companies (funds) (ii) the proposed removal of the current prohibition against a Property Fund being open-ended, if it is a Property Exempt Fund or a QIF (iii) extending the period that a Public Property Fund has to list and trade, from the date on which it first offers its Units to the public, to three years (currently a Public Property Fund must be listed and traded within six months of the date on which its Units are first offered to the public); and (iv) allowing the use of the name ‘REIT’ by an Exempt Fund or a QIF provided it meets the key REIT criteria in the DFSA’s Rules and complies with other relevant requirements that would normally apply to a Public Property Fund.

Introducing a new model for internal management of an Investment Company, where such a company can be internally managed by its licensed sole Corporate Director, subject to certain requirements. The DFSA regime currently allows an Investment Company to be managed by one director, which may be a body corporate, i.e. a sole Corporate Director. However, it does not expressly provide that such a Corporate Director can be the Fund Manager of an Investment Company (where the Articles of Association allow it). The new proposals will allow for greater flexibility of choices available to Funds which are Investment Companies, and their Fund Managers.

Al Tamimi & Company’s Banking & Finance team regularly advises on DIFC regulatory matters. For further information please contact Margaret Elder (m.elder@tamimi.com) or Divya Abrol Gambhir (d.abrol@tamimi.com).