

Appendix 1

In this appendix underlining indicates new text and striking through indicates deleted text.

The DFSA Sourcebook



Regulatory Policy and Process (RPP Sourcebook)

2-5 START-UP ENTITIES IN THE DIFC

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Entities seeking authorisation as Banks

2-5-3 Considering the restriction in Article 4(1)(a) of the Federal Law No 8 of 2004, the DFSA may not authorise a new entity proposing to form in the DIFC to carry out banking activities, unless it is a branch or a wholly owned subsidiary of an existing bank or a joint venture between parties, in which each party must be an existing bank. An entity seeking authorisation to be a Bank, and to carry on its activities in or from the DIFC, will be either:

- (a) a branch of an existing bank; or
- (b) a subsidiary of an existing bank (wholly or partially owned); or
- (c) a start-up entity.

2-5-4 Where the applicant falls into categories (a) and (b) above, the DFSA will pay particular attention to the soundness of the existing bank of which the proposed DIFC entity is a part. It is our expectation that the existing bank will be a source of strength¹ for the DIFC entity. The DFSA will also pay particular attention to the supervisory relationships it has, or will need to establish, with the supervisor(s) of the existing bank, whichever jurisdiction(s) that is based in. Being able to exchange supervisory information with other relevant supervisors is a cornerstone of the DFSA's regulatory approach.

2-5-5 Where the applicant falls into category (c) above, and so is a start-up entity, the DFSA will, clearly, not be able to place reliance on existing banking entities or the strength of a larger group. The credibility and financial soundness of the proposed shareholders of the start-up Bank will, therefore, be a key consideration for the DFSA, as it is these proposed shareholders that the DFSA would need to look to, to provide support to the Bank, should it encounter difficulties.

2-5-6 The DFSA will have a greater degree of comfort with proposed shareholders who are themselves regulated financial institutions or who have a track record of investing in financial institutions and of providing support to those institutions, if and when such support has been needed. Similarly, if proposed shareholders demonstrably have the financial means to provide further support to the start-up Bank, then this will allow the DFSA to take greater comfort.

2-5-7 Applicants who wish to establish a start-up Bank in the DIFC should consider carefully the implications of the absence of a central bank in the DIFC. For example, the DFSA would expect applicants to address how this fact would affect their:

- (a) business plan, including any impact on current or prospective credit ratings;
- (b) adequacy of capital and capital management plan;

¹ The 'source of strength' doctrine is a well-established and understood concept in banking regulation. It is an expectation that the parent company of a regulated bank will be a source of financial strength and support to that regulated bank should it experience distress.

(c) plans for liquidity management; and

(d) ability to deal with stressed situations, including a resolution plan.

2-5-8 In formulating this policy the DFSA recognises that it is not practical to provide information on the application of the policy to every possible scenario. Therefore, interested parties are invited to contact the DFSA if they have questions about the application of the policy to their particular circumstances.

The DFSA's Risk-Based Approach to Start-Up Entities: Broad Risk Categories

2-5-49 Any consideration of an application for authorisation received by the DFSA is likely to involve an assessment of the risks posed to the objectives of the DFSA by the proposed activities of the applicant. Whilst the broad categories of risks for all applicants will be the same, the nature of those risks within start-up entities will be unique, as start-ups do not have a regulatory track record upon which the DFSA may place reliance. In the case of a new business, even where senior management has substantial experience and relevant competence in the business sector, this does not necessarily imply an ability to create and sustain an adequate management control environment and compliance culture, particularly when faced with all the other issues of establishing a new business.

2-5-510 In the case of an existing, but previously unregulated business, any existing control environment and compliance culture may not have been subject to external independent regulatory scrutiny and the additional regulatory reporting requirements which apply to an authorised firm.

2-5-611 The broad categories of risk and some of the unique elements of those risk categories that apply to start up entities include financial risk, governance risk, business/operational risk and compliance risk.

2-5-12 The DFSA will consider each application for a start-up separately and determine accordingly if further tailored regulatory requirements, in addition to the DFSA's existing requirements, may be necessary. Tailored requirements could include – but not be limited to – capital, liquidity, credit or investment limits.

Financial Risk

2-5-713 All applicants are required to demonstrate a sound initial capital base and funding and to meet the relevant prudential requirements of the DFSA rulebook, on an on-going basis. This may include holding sufficient capital to cover expenses on a zero revenue basis. Inevitably, start-up entities face greater financial risks as they seek to establish and grow a new business.

2-5-814 In addition to the risks associated with the financial viability of the start-up entity, particular attention may be given to the clarity and the verifiable source of the initial capital funding. Start-up entities may be required to disclose the source of their funds and the history of those funds for at least the previous 12 months.

Governance Risk

2-5-915 All applicants are required to demonstrate robust governance arrangements together with the fitness and integrity of all controllers, directors and senior management. The DFSA is aware that management control, in smaller start-ups especially, may lie with one or two dominant individuals who may also be amongst the owners of the firm. In such circumstances, the DFSA would expect the key business and control functions (i.e. risk management, compliance and internal audit) to be subject to appropriate oversight arrangements which reflect the size and complexity of the business. Applicants can assist the DFSA by describing in detail the ownership structure, high level controls and clear reporting lines which demonstrate an adequate segregation of duties.

2-5-106 The DFSA may request details of the background, history and ownership of the start-up entity and, where applicable, its Group. Similar details relating to the background, history and other interests of the directors of the start-up entity may also be required. Where it considers it necessary to do so, the DFSA may undertake independent background checks on such material. A higher degree of due diligence will apply to individuals involved in start-up entities and there would be an expectation that the entity itself will have conducted detailed background checks, which may then be verified by the DFSA.

Business/Operational Risk

2-5-147 All applicants are required to establish appropriate systems and controls to demonstrate that the affairs of the firm are managed and controlled effectively. The nature of the systems and controls may depend on the nature, size and complexity of the business. Start-up entities may wish to consider which additional systems and controls may be appropriate in the initial period of operation following launch, such as increased risk or compliance monitoring. Due to the unproven track record of start-up entities, the DFSA may, for example, impose restrictions on the business activities of the entity or a greater degree and intensity of supervision until such a track record is established.

Compliance Risk

2-5-128 The Senior Executive Officer within all Authorised Firms is expected to take full responsibility for ensuring compliance with the DFSA rules by establishing a strong compliance culture which is fully embedded within the organisation. A start up entity will be required to appoint a UAE resident Compliance Officer and Money Laundering Reporting Officer (MLRO) with the requisite skills and relevant experience in compliance and anti-money laundering duties. The individuals fulfilling these roles within start up entities may be expected to demonstrate to the DFSA their competence to perform the proposed role and adequate knowledge of the relevant sections of the DFSA rulebook and, in the case of the MLRO, the wider anti-money laundering legislation and related provisions.

Main Information Requirements

2-5-139 The main information requirements are the same for all applicants, including start-ups, and each application will be assessed on its own merits. It may help if start-up applicants

consider the risk categories set out above and how they will address the particular risks raised by their start-up proposition.

2-5-1420 A key document will be the regulatory business plan submitted in support of the application. It will facilitate the application process if applicants cover the following areas within this submission:

- (a) An introduction and background;
- (b) Strategy and rationale for establishing in the DIFC;
- (c) Organisational structure;
- (d) Management structure;
- (e) Proposed resources;
- (f) High level controls;
- (g) Risk management;
- (h) Operational controls;
- (i) Systems overview; and
- (j) Financial projections.

2-5-1521 Start-up applicants may find it useful to include diagrams illustrating corporate structures, and, where applicable, group relationships, governance arrangements, organisational design, clear reporting lines, business process flows and systems environments.

2-5-1622 Comprehensively addressing these areas and detailing how the key risks will be identified, monitored and controlled may significantly assist the DFSA in determining applications from start-up entities.

3-7 BUSINESS TRANSFER SCHEMES

General background

3-7-1 This section sets out information relating to a financial services business transfer scheme, i.e., a scheme by an Authorised Firm to transfer all or a part of a financial service business to another body. A reference in this section to “the Law” is to the Regulatory Law, to an “Article” is to an Article of the Law and to a “transfer scheme” is to a financial services business transfer scheme.

3-7-2 Part 9 of the Law sets out requirements applying to financial services business transfer schemes. In particular, Article 106 provides that no transfer scheme is to have effect unless a Court order has been made in relation to the scheme.

3-7-3 Article 107 defines a “transfer scheme” as a scheme where:

- (a) the whole or part of the business carried on through an establishment in the DIFC by an Authorised Firm (“the firm concerned”) is to be transferred to another body (“the transferee”) and the business to be transferred consists in whole or in part of financial services business; or
- (b) the Fund Property of a Fund, or of a sub-fund of an Umbrella Fund (“the Fund concerned”), is to be transferred to another Fund.

3-7-4 The need for a Court order sanctioning a transfer scheme arises because a transfer of business may interfere with agreements between an Authorised Firm and its clients (without the consent of each client), and may also affect the rights of other persons, such as creditors. The Court is best placed to hear and consider representations from persons who may be adversely affected by the scheme. It is then able, if appropriate, to make various orders binding all persons concerned that are necessary to give legal effect to the transfer.

Applying to the Court

3-7-5 Under Article 108 the Authorised Firm concerned, the transferee or both may apply to the Court for an order sanctioning a transfer scheme.

3-7-6 If an Authorised Firm or transferee is considering a transfer scheme, it should discuss the scheme with the DFSA as soon as practicable, to enable the DFSA to consider whether any particular issues are likely to arise, and to establish a practical timetable for the scheme.

3-7-7 It is important for an applicant to plan a timetable as there are various steps it must take under Article 111 (some of which involve the DFSA) before the Court may determine an application. For example, an applicant to the Court must:

- (a) arrange for a report on the terms of the transfer scheme (a “scheme report”) to be prepared by a person nominated or approved by the DFSA who appears to have the skills necessary to enable him to make a proper report (an “independent expert”);
- (b) give written notice of the transfer scheme to all interested parties (as determined by the DFSA); and

(c) publish a notice in a newspaper best suited to bringing the transfer scheme to the attention of any persons who may be affected by it. Depending on where the Authorised Firm's business and clients are located, notice may be necessary in more than one newspaper.

3-7-8 The scheme report is a key document in the process that will assist and be relied upon by the Court in deciding whether or not to approve the proposed scheme and will also inform and be relied upon by the DFSA and persons potentially affected by the scheme. The DFSA will, therefore, only nominate or approve a person to make the report if the person has appropriate expertise and is independent of both the proposed transferor and transferee. That is, the person should be neutral and not have any potential conflicts of interest, so that the report is objective. The scheme report, as well as being objective, must set out clearly and in sufficient detail, the independent expert's opinion as to the likely effects and impact of the scheme on clients and third parties and each opinion must be supported by appropriate analysis and rationale.

3-7-9 In limited circumstances the DFSA may direct that a scheme report or notice is not required. However, the DFSA may only do so if it appears to the DFSA that, by reason of urgency, it is in the interests of the DIFC that the scheme report or notice is not provided (see Article 111).

3-7-10 Article 109 provides that when an application is made to the Court, the following persons may be heard by the Court:

- (a) any person who alleges that he would be adversely affected by the carrying out of the scheme; and
- (b) the DFSA.

3-7-11 Under Article 108 the Court may grant an order sanctioning the transfer scheme if it considers that, in all the circumstances of the case, it is appropriate to do so. Under Article 112 the Court must also be satisfied that:

- (a) before the transfer takes effect, the transferee will have any authorisation necessary to enable the business to be carried on in the place in which it is to be transferred; and
- (b) the transferee will possess adequate financial resources to carry on that business in accordance with the legislation applicable in that place.

3-7-12 Article 110 sets out the various types of orders that the Court can make relating to a transfer scheme.

Alternative Arrangements

3-7-13 Under Article 113 the DFSA may, by Rules, modify the provisions in Part 9 in specified cases. The DFSA has made such Rules in Chapter 12 of GEN and in Chapter 16 of CIR.

3-7-14 The effect of GEN Chapter 12 is that a business transfer scheme is not required to be sanctioned by a Court order to be effective if certain other alternative arrangements have been

made. These alternative arrangements apply only to transfer schemes that do not involve a transfer of:

- (a) Banking Business;
- (b) Insurance business; or
- (c) Fund Property.

3-7-15 The first type of arrangement is if the Authorised Firm or transferee has been able to obtain the consent of each client who will be affected by the scheme. This option recognises that sometimes, if there are only a small number of clients, it may be practicable to obtain the agreement of all clients whose interests may be affected. Any communication sent to the client should set out clearly what the client is being asked to consent to. Also, it should then be clear that the client has provided its consent.

3-7-16 The second type of arrangement is if the transfer of business is expressly permitted under agreements between clients and the Authorised Firm or transferee concerned and the procedures in those agreements have been complied with. For example, in some cases agreements expressly provide for the transfer of accounts or novation of contracts to another person in accordance with a specified procedure.

3-7-17 Finally, in limited cases, a person may apply to the DFSA for its written consent to the transfer scheme. The DFSA does not expect Authorised Firms to regard this as their first option. The DFSA expects to receive applications seeking its consent to a transfer scheme only in very limited circumstances if the scheme is not complex or contentious. Under GEN 12.1.5, the DFSA may give its consent only if it is reasonably satisfied of a number of matters including that:

- (a) it is more appropriate and proportionate, and in the overall interests of clients, for the DFSA's consent to be sought rather than an application being made to the Court;
- (b) the applicant has taken all reasonable steps to pursue other options for giving effect to the scheme (e.g. seeking the consent of clients or using procedures in existing agreements);
- (c) the scheme is not likely to result in any material prejudice to the interests of clients of the Authorised Firm; and
- (d) implementation of the scheme will not result in the Authorised Firm or transferee contravening a law or Rule.

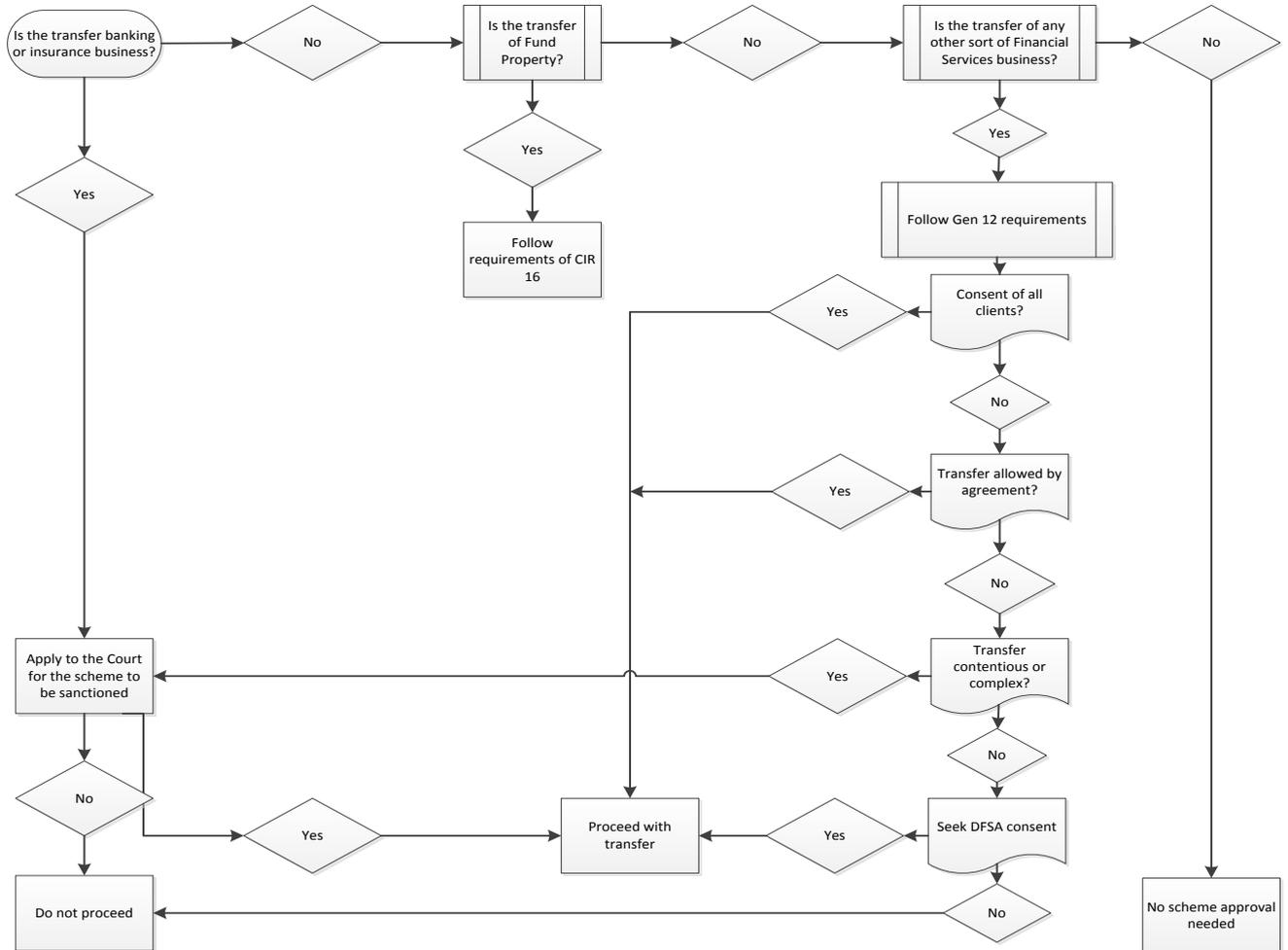
3-7-18 The onus is on the Authorised Firm and the transferee to ensure that a transfer of business under an alternative arrangement is legally effective. For example, obtaining the consent of the DFSA may mean that it is not necessary to apply for a Court order, but it does not of itself give legal effect to the transfer.

3-7-19 Further, just because an alternative mechanism in GEN 12 may be available does not prevent the Authorised Firm or transferee from applying for a Court order sanctioning a transfer scheme under Part 9 of the Law if they consider it appropriate to do so. For example,

an application for a Court order is likely to be more appropriate if the scheme is complex (e.g. there are complex property interests involved), is likely to be contentious, is likely to affect a large number of persons or if additional legal certainty is sought.

3-7-20 The following flowchart sets out in simplified form some of the options available to an Authorised Firm or transferee. The flowchart and the information in this Chapter is only intended to be a summary of the procedures for a transfer of business. For full information a person reading this Chapter should also read Part 9 of the Law, Chapter 12 of GEN and Chapter 16 of CIR.

BUSINESS TRANSFER SCHEMES



8-3 RELEVANT LEGISLATION

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Exercising Regulatory Powers on Behalf of Other Authorities

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8-3-18 As a matter of policy the DFSA will assist an Article 39 authority unless:

- (a) the request would require the DFSA to act in a manner that would violate applicable UAE criminal laws, DIFC laws or DFSA policies;
- (b) ~~the request involves a country boycotted by the UAE;~~
- (~~e~~) the request is in relation to criminal or enforcement proceedings that have already been initiated in the DIFC or UAE relating to the same facts or same persons, or the same persons have already been penalised or sanctioned on substantively the same allegations or charges and to the same degree by the DFSA or the competent authorities in the UAE;
- (~~c~~) the request would be prejudicial to the “public interest” of the DIFC;
- (~~d~~) the requesting authority refuses to give corresponding assistance to the DFSA;
- (~~f~~) complying with the request would be so burdensome as to prejudice or disrupt the performance of DFSA regulatory functions and duties; or
- (~~g~~) the authority fails to demonstrate a legitimate reason for the request.

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