

Appendix 2

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

*This text includes amendments made following CP106: Regulation of Arranging, Representative Offices and Financial Promotions.



The DFSA Rulebook

Conduct of Business Module

(COB)

2 CLIENT CLASSIFICATION

.....

2.2 Overview

Guidance

1.

.....

Professional Clients

5. There are three routes through which a Person may be classified as a Professional Client:
 - a. ‘deemed’ Professional Clients under Rule 2.3.4. As these Persons have significant assets under their control, and, therefore, either possess, or have the resources to obtain, the necessary expertise to manage such assets, they can be classified as ‘deemed’ Professional Clients without having to meet any additional net asset and expertise criteria;
 - b. ‘service-based’ Professional Clients under Rule 2.3.5, ~~or Rule 2.3.6~~ or Rule 2.3.6A. Due to their inherent nature, certain Financial Services activities such as credit provided to an Undertaking for business purposes (‘commercial credit’), ~~and~~ advisory and arranging activities relating to corporate structuring and financing and crowdfunding services provided to a Body Corporate that is a borrower, are generally provided to Persons with sufficient expertise to obtain such services or are of relatively low risk to the Client. Therefore, a Person to whom such a Financial Service is provided can be classified as a ‘service-based’ Professional Client; and
 - c. ‘assessed’ Professional Clients under Rules 2.3.7 and 2.3.8. These Persons are either individuals or Undertakings which can be classified as a Professional Client only if they meet the specified net assets and expertise requirements set out in Rules 2.4.2 and 2.4.3.

.....

2.3 Types of Clients

.....

Professional Clients

- 2.3.3** (1) An Authorised Firm may classify a Person as a Professional Client if that Person:
- (a) meets the requirements to be:
 - (i) a “deemed” Professional Client pursuant to Rule 2.3.4;
 - (ii) a “service-based” Professional Client pursuant to ~~either~~ Rule 2.3.5, ~~or~~ Rule 2.3.6 or Rule 2.3.6A; or
 - (iii) an “assessed” Professional Client pursuant to either Rule 2.3.7 or Rule 2.3.8; and
 - (b) has not opted-in to be classified as a Retail Client in accordance with the requirements in Rule 2.4.1.
- (2) If an Authorised Firm becomes aware that a Professional Client no longer fulfils the requirements to remain classified as a Professional Client, the Authorised Firm must, as soon as possible, inform the Client that this is the case and the measures that are available to the firm and the Client to address that situation.

.....

‘Service-based’ Professional Clients

Guidance

Rule 2.3.5, ~~and~~ Rule 2.3.6 and Rule 2.3.6A each set out different circumstances in which a Person can be classified as a ‘service-based’ Professional Client. The professional status allowed under these ~~three two~~ ‘service-based’ Professional Client categories can only be used for those ~~three two~~

Financial Services and not for any other Financial Service provided to the same Client. If such a Client also obtains other Financial Services from the same firm, unless the Client can qualify either as a 'deemed' or 'assessed' Professional Client, that Client will need to be classified as a Retail Client for those other Financial Services.

.....

2.3.6A For the purposes of Rule 2.3.3(1)(a)(ii), a Person is a 'service-based' Professional Client if:

- (a) the Financial Service provided to that Person is "Operating a Loan-based Crowdfunding Platform"; and
- (b) the Person is a Body Corporate and is using the service to borrow funds from lenders.

.....

3 CORE RULES – INVESTMENT BUSINESS, ACCEPTING DEPOSITS, PROVIDING CREDIT, AND PROVIDING TRUST SERVICES AND OPERATING A CROWDFUNDING PLATFORM

3.1.1 This chapter applies to an Authorised Firm which carries on or intends to carry on:

- (a) Investment Business;
- (b) Accepting Deposits;
- (c) Providing Credit; ~~or~~
- (d) Providing Trust Services; or
- (e) Operating a Loan-based Crowdfunding Platform,

except where it is expressly provided otherwise.

.....

6 ADDITIONAL RULES - INVESTMENT BUSINESS

6.1 Application

- 6.1.1** (1) The Rules in this chapter apply to an Authorised Firm when conducting Investment Business.
- (2) Sections 6.11, 6.12 and 6.14 also apply to an Authorised Firm in respect of Client Money that it holds or controls (within the meaning of Rule 6.11.4) in the course of, or in connection with, Operating a Loan-based Crowdfunding Platform.
- (3) The requirements in this chapter apply to an Authorised Firm regardless of the classification of the Client, unless expressly provided otherwise.

Guidance

The requirements in chapter 3 also apply to the conduct of Investment Business.

.....

6.12 Client money

- 6.12.1** All Money held or controlled on behalf of a Client in the course of, or in connection with, the carrying on of Investment Business or Operating a Loan-based Crowdfunding Platform in or from the DIFC is Client Money, except Money which is:
- (a) held by the Authorised Firm as a Bank in an account with itself, provided the Authorised Firm notifies the Client in writing that the Client Money is held by it as a Bank and not in accordance with this chapter;
 - (b) immediately due and payable by the Client to the Authorised Firm;
 - (c) belonging to another Person within the Authorised Firm's Group unless that Person is an Authorised Firm or Regulated Financial Institution and that Person has confirmed to the Authorised Firm, in writing, that the beneficial owner of the Money is a Person who is not part of the Authorised Firm's Group;

- (d) in an account in the Client's name over which the Authorised Firm has a mandate or similar authority and who is in compliance with Rule 6.11.3 (2);
- (e) received in the form of a cheque, or other payable order, made payable to a third party other than a Person or account controlled by the Authorised Firm, provided the cheque or other payable order is intended to be forwarded to the third party within 1 business day of receipt; or
- (f) Fund Property of a Fund.

Guidance

1. Authorised Firms are reminded that the exemption in Rule 6.12.1(a) would not apply to Money which is passed to a third party i.e. not held in an account with the Authorised Firm itself.
2. Pursuant to Rule 6.12.1(b), examples of Money which is immediately due and payable to an Authorised Firm includes Money which is:
 - a. paid by the way of brokerage, fees and other charges to the Authorised Firm or where it is entitled to deduct such remuneration from the Client Money held or controlled;
 - b. paid by the Authorised Firm in relation to a Client purchase or in settlement of a margin payment in advance of receiving a payment from the Client; or
 - c. owed by the Client to the Authorised Firm in respect of unpaid purchases by or for the Client if delivery of Investments has been made to the Client or credited to his account.
3. The CIR module contains specific provisions relating to the handing of Fund Property and also provisions relating to a Fund Administrator holding or controlling monies or assets belonging to third parties.

.....

11 CROWDFUNDING

11.1 Operating a Loan-based Crowdfunding Platform

Guidance

1. This section applies to an Authorised Firm that is Operating a Loan-based Crowdfunding Platform (an “operator”).
2. In addition to the Rules in this section, an operator must comply with other parts of COB such as chapters 1, 2 and 3 and, if it holds or controls Client Money, sections 6.11, 6.12 and 6.14. It should be noted that if the operator is a Category 4 firm, it may control Client Money but it is not permitted to hold Client Money (see Rule 6.12.2).
3. An operator will have two types of Clients: borrowers and lenders. COB requirements will apply in relation to both types of Clients. Under section 3.3 and App 2, additional terms must be included in Client Agreements with Clients who are borrowers or lenders (see Rules A2.1.5 and A2.1.6).
4. An operator will also need to comply with relevant requirements in the AML module, such as carrying out customer due diligence on Clients who are borrowers or lenders.

Application

- 11.1.1** This section applies to an Authorised Firm with respect to the Operation of a Loan-based Crowdfunding Platform.

Interpretation

- 11.1.2** In this section:

- (a) “borrower” means a Person that has borrowed or is seeking to borrow money using the platform;
- (b) “commitment period” means the period specified by the operator during which lenders may commit to lending money to a particular borrower;
- (c) “lender” means a Person who:
 - (i) lends money under a loan agreement; or
 - (ii) by assignment has assumed the rights and obligations of a Person who has lent money under a loan agreement;

- (d) “loan agreement” means a loan agreement between a borrower and lender referred to in Rule 11.1.7;
- (e) “operator” means a Loan-based Crowdfunding Operator;
- (f) “platform” means the website or other electronic media used to provide the service;
- (g) “service” means Operating a Loan-based Crowdfunding Platform; and
- (h) “transfer”, in relation to a loan agreement, means the assignment by a Person who has lent money under a loan agreement of his rights and obligations under the agreement to another Person.

Crowdfunding risk disclosure

11.1.3 An operator must disclose prominently on its website the main risks to a lender of using a Loan-based Crowdfunding Platform including that:

- (a) the lender may lose all or part of their money or may experience delays in being repaid;
- (b) borrowers may include new businesses and, as many new businesses fail, a loan to such a borrower may involve high risks; and
- (c) if for any reason the operator ceases to carry on its business, the lender may lose all or part of their money or experience delays in being repaid.

Information about default rates

11.1.4 (1) An operator must disclose prominently on its website the actual and expected default rates of borrowers who obtain loans using its service.

(2) The information referred to in (1) must:

- (a) for actual default rates, cover the period since the operator began providing the service;
- (b) for expected default rates, set out a summary of the assumptions used in determining those expected default rates; and
- (c) be presented in a way that is fair, clear and not misleading.

Guidance

Rule 11.1.4 requires an operator to disclose historical information about the proportion of borrowers that have defaulted on loans provided using the platform (i.e. the actual default rates). It also requires the operator to set out the expected default rates in the future. These disclosures are intended to assist potential lenders to assess the risks of lending using the platform.

Information about the service**11.1.5 An operator must disclose prominently on its website key information about how its service operates including:**

- (a) details of how the platform functions;
 - (b) details of how the operator is remunerated for the service it provides, including fees and charges imposed;
 - (c) any financial interest of the operator or a Related Person that may create a conflict of interest;
 - (d) the eligibility criteria for borrowers;
 - (e) the minimum and maximum amounts, if any, of loans that may be sought by a borrower using the service;
 - (f) what, if any, security is usually sought from borrowers, the circumstances in which it might be exercised and any limitations on its use;
 - (g) the eligibility criteria for lenders;
 - (h) the limits on the amounts a lender may lend using the service: both to an individual borrower and over any 12 month period;
 - (i) if applicable, the circumstances in which a lender may withdraw a commitment to make a loan;
 - (j) what will happen if loans sought by a borrower either fail to meet, or exceed, the target level;
 - (k) steps the operator will take if there is a material change in a borrower's circumstances and the rights of the lender and borrower in that situation;
 - (l) how the operator will deal with overdue payments or a default by a borrower;
 - (m) arrangements and safeguards for Client Monies held or controlled by the operator;
-

- (n) any facility it provides to facilitate the transfer of loans, the conditions for using the facility and any risks relating to the use of that facility;
- (o) measures it has in place to ensure the platform is not used for money-laundering or other unlawful activities;
- (p) measures it has in place for the security of information technology systems and data protection; and
- (q) contingency arrangements for the orderly administration of loans in the event that the operator ceases to carry on its business.

Providing regulated and unregulated crowdfunding services

- 11.1.6** If an operator provides both regulated and unregulated crowdfunding services, it must take reasonable steps to ensure that lenders can clearly distinguish between, and are not misled about, which parts of the service are regulated and unregulated.

Guidance

Examples of steps an operator may take to comply with Rule 11.1.6 include using different legal entities to provide the regulated and unregulated parts of the service, using separate platforms for the different services or making clear and prominent disclosures on its platform about which parts are regulated and unregulated.

Written loan agreement

- 11.1.7** An operator must ensure that, when a loan is made using its service, there is a written loan agreement in place between the borrower and lender that is legally enforceable and sets out sufficient details of the loan, the terms of repayment and the rights and obligations of the borrower and lender.

Due diligence on borrowers

- 11.1.8** An operator must not permit a borrower to use its service unless the borrower is a Body Corporate.
- 11.1.9** An operator must conduct due diligence on each borrower before allowing it to use its service, including as a minimum taking reasonable steps to verify:
- (a) the borrower's identity including details of its incorporation and business registration;

- (b) the identity and place of domicile of each director, officer and controller of the borrower;
- (c) the fitness and propriety of the Persons referred to in (a) and (b);
- (d) the financial strength of the borrower, including checking financial statements;
- (e) the financial history and past performance of the borrower;
- (f) the credit history of the borrower, including checking with external credit agencies;
- (g) any credentials or expertise that the borrower claims to have;
- (h) the valuation of the borrower's business, its current borrowing levels and the source of any existing borrowing;
- (i) the borrower's business proposal;
- (j) the commitment of the borrower and its directors, officers and controllers to the business, including how much capital they have provided and any potential flight risk; and
- (k) that the borrower is complying with applicable laws in the jurisdiction in which it is incorporated.

Guidance

The type of background checks the DFSA expects an operator to conduct under Rule 11.1.9(c) include, for example, whether the Person has been:

- a. found guilty of a criminal offence;
- b. the subject of any finding in a civil proceeding of fraud, misfeasance or other misconduct or a judgment or agreed settlement in a civil proceeding exceeding \$10,000;
- c. disqualified from acting as a director or taking part in the management of a company; or
- d. bankrupt or the director or a person concerned in the management of a company which has gone into liquidation or administration.

Disclosure of information about the borrower

11.1.10 An operator must disclose prominently on its website relevant information about each borrower including as a minimum:

- (a) the borrower's name and the full name and position of each director and officer of the Body Corporate and the full names of its controllers;
- (b) the place of incorporation of the borrower and the place of domicile of each director, officer and controller;
- (c) a description of the borrower's business;
- (d) the most recent financial statements, if any, of the borrower;
- (e) the valuation of the borrower's business, its current borrowing levels and the source of its borrowing and its liquidity;
- (f) a detailed description of the proposal for which it is seeking funding including the total funding sought;
- (g) full details of how the funds will be used;
- (h) the results of the due diligence carried out by the operator on the borrower and any limits on the due diligence that could be carried out;
- (i) any grading or rating by the operator of the borrower's creditworthiness, including:
 - (i) how the grading or rating has been assessed;
 - (ii) an explanation of what the different grading or rating levels mean; and
 - (iii) a clear statement that this should not be taken as advice about whether money should be lent to the borrower;
- (j) the duration of the loan, the target level of funding that must be obtained and what will happen if that target is not met or is exceeded;
- (k) whether any security has been provided by the borrower, the circumstances in which it might be exercised and any limitations on its use; and
- (l) if applicable, any other reward or benefit attaching to the loan and the terms on which it is available.

Material changes affecting a borrower

- 11.1.11** (1) An operator must disclose prominently on its website:

- (a) details of any material change relating to a borrower, its business or the carrying out of its proposal;
 - (b) any change in the rights of the lenders and the borrower arising from the material change; and
 - (c) further steps, if any, the operator is proposing to take as a result of the change.
- (2) The disclosures under (1) must be made as soon as practicable after the operator becomes aware of the material change referred to in (1)(a).

Guidance

1. A borrower is required under its Client Agreement to give reasonable advance notice to the operator of any material change in its circumstances (see Rule A2.1.6). An operator is required to specify on its website what steps it will take, and the rights of a lender and borrower, if a material change occurs (see Rule 11.1.5(k)).
2. A 'material change' is likely to be any factor that could significantly affect the borrower's ability to meet its payment obligations under the loan agreement. This might include, for example, a change in the management, control or structure of the business, an event affecting its profitability, a change relating to its assets or a default in meeting another obligation.

Borrower not to use other platforms

11.1.12 An operator must take reasonable steps to restrict a borrower from using another loan crowdfunding platform to obtain funding during the commitment period.

Guidance

Allowing a borrower to use different platforms at the same time creates the risk that the borrower might offer different interest rates, repayment maturities and information about the proposal, causing potential confusion for lenders and creating the potential for arbitrage by a borrower. This restriction only applies during the commitment period for the borrower i.e. the period when it is open to lenders to commit to making loans to that borrower.

Lending limits

11.1.13 An operator must maintain effective systems and controls to ensure that a Retail Client using its service does not lend more than:

- (a) US\$5,000 to any single borrower; and
- (b) US\$50,000 in total in any calendar year using the service.

Equal treatment of lenders

11.1.14 An operator must ensure that lenders who use its service are able to have access to the same information on its website about a borrower or lending proposal.

11.1.15 If an operator provides an auto-lending system, or any other facility, that provides some lenders with the opportunity to lend money ahead of other lenders, the operator must disclose prominently on its website that some lenders may have preferential access to better proposals.

Guidance

An ‘auto-lending system’ is a facility that automatically allocates certain loans to a lender according to parameters chosen by the lender. The availability of this type of facility creates the risk that other lenders may not be aware that the best lending opportunities have already been allocated and that remaining lending opportunities may be of lower quality.

Operator not to permit staff to use the platform

11.1.16 An operator must take reasonable steps to ensure that its officers and employees and their family members do not:

- (a) lend money or provide finance to a borrower;
- (b) borrow money from a lender; or
- (c) hold any direct or indirect interest in the capital or voting rights of a borrower or lender.

Forums

11.1.17 If an operator provides a means of communication (a “forum”) for lenders and borrowers to discuss funding proposals made using the service, it must:

- (a) refer lenders to the forum as a place where they can find, or take part in, further discussion about proposals, while clearly stating that the operator does not conduct due diligence on information on the forum;
- (b) restrict posting of comments on the forum to Persons who are Clients using the service;
- (c) ensure that all Clients using the forum have equal access to information posted on the forum;

- (d) require a Person posting a comment on the forum to disclose clearly if he is affiliated in any way with a borrower or is being compensated, directly or indirectly, to promote a proposal by a borrower;
- (e) take reasonable steps to monitor and prevent posts on the forum that are potentially misleading or fraudulent;
- (f) immediately take steps to remove a post, or to require a post to be deleted or amended, if the operator becomes aware that (d) or (e) have not been complied with; and
- (g) not participate in discussions on the forum except to moderate posts or to take steps referred to in (f).

Facility for transfer of loans

11.1.18 If an operator provides a facility that assists the transfer of rights or obligations under a loan agreement, it must ensure that:

- (a) the facility relates only to loans originally facilitated using its service;
- (b) the facility allows only lenders (and not borrowers) to transfer their rights and obligations under loan agreements;
- (c) transfers can take place only between lenders who are already Clients using the service and have initially lent money under loan agreements;
- (d) a lender must transfer the rights and obligations relating to the whole of a loan made (and not just a part of the loan);
- (e) potential transferees have access to all information on the website about the borrower that was available to earlier lenders; and
- (f) fees it charges for the use of the facility are designed to recover its costs of providing the facility, rather than generating additional income.

Guidance

1. A facility for the transfer of rights and obligations under loan agreements should exist mainly to provide an exit route for lenders rather than being a facility for the active trading of loans. For example, the operator should ensure that transferees are Clients who already initially lent money to either the particular borrower or another borrower. That is, the facility should not be used by persons who are only involved in secondary buying of loans.

2. The conditions in Rule 11.1.18 apply only to the transfer of rights and obligations using the transfer facility. They do not affect transfers of rights and obligations that may occur outside that facility, for example, by operation of law such as under a will or by a Court order.

Information technology

- 11.1.19** (1) An operator must have adequate measures in place to ensure:
- (a) its information technology systems are resilient and not prone to failure;
 - (b) business continuity in the event that an information technology system fails;
 - (c) protection of its information technology systems from damage, tampering, misuse or unauthorised access; and
 - (d) the integrity of data forming part of, or being processed through, its information technology systems.
- (2) An operator must review the measures referred to in (1) at least annually to ensure they are adequate.

Business cessation plan

- 11.1.20** The operator must maintain a business cessation plan that sets out appropriate contingency arrangements, including measures that have already been put in place, to ensure the orderly administration of loan agreements in the event that it ceases to carry on its business.

Guidance

The business cessation plan may, for example, set out arrangements for another appropriately regulated third party to take over the administration of existing loans. The plan must set out what steps have been taken to ensure that the arrangements can be implemented immediately if the operator ceases to carry on its business (for example, any existing agreement with a third party).

.....

APP2 KEY INFORMATION AND CLIENT AGREEMENT

A2.1 Key Information and content of the Client Agreement

General

A2.1.1 The key information which an Authorised Firm is required to provide to a Client and include in the Client Agreement with that Client pursuant to Rule 3.3.2 must include:

- (a) the core information set out in:
 - (i) Rule A2.1.2 (1) if it is a Retail Client; and
 - (ii) Rule A2.1.2(2) if it is a Professional Client; and
- (b) where relevant, the additional information required under Rules A2.1.3 for Investment Business and Rule A2.1.4 for Investment Management; and
- (c) the additional terms set out in Rules A2.1.5 and A2.1.6 if the Client Agreement relates to the use of a Loan-based Crowdfunding Platform.

Core information

- A2.1.2** (1) In the case of a Retail Client, the core information for the purposes of A2.1.1(a) is:
- (a) the name and address of the Authorised Firm, and if it is a Subsidiary, the name and address of the ultimate Holding Company;
 - (b) the regulatory status of the Authorised Firm;
 - (c) when and how the Client Agreement is to come into force and how the agreement may be amended or terminated;
 - (d) sufficient details of the service that the Authorised Firm will provide, including where relevant, information about any product or other restrictions applying to the Authorised Firm in the provision of its services and how such restrictions impact on the service offered by the Authorised Firm. If there are no such restrictions, a statement to that effect;

- (e) details of fees, costs and other charges and the basis upon which the Authorised Firm will impose those fees, costs and other charges;
 - (f) details of any conflicts of interests for the purposes of disclosure under Rule 3.5.1(2)(b);
 - (g) details of any Soft Dollar Agreement required to be disclosed under Rules 3.5.6 and 3.5.7; and
 - (h) key particulars of the Authorised Firm's Complaints handling procedures and a statement that a copy of the procedures is available free of charge upon request in accordance with GEN Rule 9.2.11.
- (2) In the case of a Professional Client, the core information for the purposes of A2.1.1(a) is the information referred to in (1)(a), (b), (c) and (e).

.....

Additional terms for Loan-based Crowdfunding Platforms

A2.1.5 The following terms must be included in a Client Agreement between a Loan-based Crowdfunding Operator and a Client that is a lender:

- (a) the operator's obligations to administer the loan, including how repayments made by the borrower will be transferred to the lender and steps that will be taken if repayments by a borrower are overdue or the borrower is in default;
- (b) the steps that will be taken by the operator and lender to ensure that the lender complies with any applicable limits relating to the amounts of loans that may be made using the platform; and
- (c) the contingency arrangements that the operator will put in place to deal with a platform failure or the operator ceasing to carry on its business.

A2.1.6 The following terms must be included in a Client Agreement between a Loan-based Crowdfunding Operator and a Client that is a borrower:

- (a) a restriction on the borrower using any other crowdfunding service to raise funds during the commitment period;
- (b) a restriction on the borrower or any Person Connected to the borrower, lending or financing, or arranging lending or finance for, a lender using the service;



CONDUCT OF BUSINESS (COB)

- (c) a restriction on the borrower advertising its proposal, or soliciting potential lenders, outside the platform during the commitment period, except by referring to, or providing a link to, the platform;
- (d) a restriction on the borrower making any material change to its proposal during the commitment period;
- (e) a requirement on the borrower to give reasonable advance notice to the operator of any material change affecting the borrower, its business or the carrying out of its proposal; and
- (f) the obligations of the borrower if there is any material change after funds have been provided.