CONSULTATION PAPER NO. 108

19 SEPTEMBER 2016

PROPOSED MISCELLANEOUS AMENDMENTS

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Why are we issuing this paper?

1. This Consultation Paper seeks public comment on the DFSA's proposals to make a variety of amendments to the DFSA's policy framework, as expressed through its Rules. The DFSA has gathered together a number of miscellaneous amendments to the modules of the DFSA Rulebook; each item in this paper is a discrete amendment.

Who should read this paper?

2. The proposals in this Paper would generally be of interest to Authorised Firms and to their advisers. Item 1 will be of particular interest to managers of Collective Investment Funds. Item 2 will be of particular interest to Authorised Firms and to Recognised Members.

How to provide comments

3. All comments should be emailed to the address specified below, using the Table provided in Appendix 1. Please refer to the Consultation Paper number in the subject line. You may identify the organisation you represent in providing your comments. The DFSA reserves the right to publish, including on its website, any comments you provide, unless you expressly request otherwise at the time of making comments.

   Comments to be emailed to: **consultation@dfsa.ae**

What happens next?

4. The deadline for providing comments on the proposals in this paper is 19 October 2016.

5. Once we receive your comments, we shall consider if any further amendments are required to these proposals. We shall then proceed to make the relevant changes to the DFSA's Rulebook. You should not act on the proposals until the relevant changes to the DFSA Rulebook are made. We shall issue a notice on our website telling you when this happens.

Terminology in this paper

6. In this paper, defined terms are identified throughout by the capitalisation of the initial letter of a word or of each word in a phrase and are defined in the GLO Module or in the proposed amendments. Unless the context otherwise requires, where capitalisation of the initial letter is not used, the expression has its natural meaning.

Structure of this paper

7. The remainder of this Consultation Paper is structured as follows:

(a) Item 1: capital requirements for managers of a Collective Investment Fund;

(b) Item 2: reporting suspicions of market abuse;

(c) Item 3: other matters;

(d) Appendix 1: template for providing comments on this consultation paper;

(e) Appendix 2: draft amendments to the PIB Module;

(f) Appendix 3: draft amendments to the GEN Module;

(g) Appendix 4: draft amendments to the REC Module;

(h) Appendix 5: draft amendments to the Code of Market Conduct;

(i) Appendix 6: draft amendments to the COB Module;

(j) Appendix 7: draft amendments to the IFR Module;

(k) Appendix 8: draft amendments to the AMI Module;

(l) Appendix 9: draft amendments to the MKT Module;

(m) Appendix 10: draft amendments to the CIR Module; and

(n) Appendix 11: draft amendments to the GLO Module.

ITEM 1 CAPITAL REQUIREMENTS FOR MANAGERS OF COLLECTIVE INVESTMENT FUNDS

8. Under our current rules, firms undertaking the financial service of Managing a Collective Investment Fund (CIF) are allocated to Prudential Category 3C, provided that they do not undertake any other financial service that would justify allocation to a higher prudential category (examples of other financial services that would result in a higher prudential categorisation include Accepting Deposits, Providing Credit or Dealing as Principal).

9. This means that CIF Managers face an initial, or base, capital requirement (BCR) of USD 500,000. They then face an ongoing capital requirement of the higher of the BCR amount or an expenditure based capital minimum (EBCM), calculated on the basis of 13/52s of the firm's annual expenditure. These capital requirements have been in place since 2006.

10. Over the years, we have heard criticism from firms established in the DIFC, and from firms considering setting up in the Centre, that these capital requirements are, in general, too high in relation to the prudential risks that these firms pose and, in particular, are out of line with capital requirements in comparable jurisdictions.

11. As part of our ongoing efforts to ensure that our regulatory framework remains up to date, and that the requirements we impose on firms are linked to the risks that they pose through their activities, we have looked again at these capital requirements.

Benchmarking

12. We have looked at the capital requirements in place in other established jurisdictions, including the EU[1], Guernsey, Hong Kong, Jersey and Singapore. We have also looked at the BVI and the Cayman Islands, given the role they play in some parts of the funds industry.

13. We have looked at the capital requirements that jurisdictions have in place for fund managers where these vary dependent on the type of fund managed. That is, jurisdictions with fund categories similar to the DFSA's categorisation of funds as Public, Exempt and Qualified Investor Funds.

14. Benchmarking reveals, in summary, that for the BCR our requirements are on the high side for this type of financial services business. The EBCM component of our prudential regime is consistent with many other jurisdictions.

Proposals

15. We think it is appropriate to adjust the BCR for all types of managers of CIFs.

16. We propose to do this while leaving the existing prudential categories undisturbed (i.e., to leave firms undertaking the relevant activities in Category

[1] In benchmarking the EU rules we have looked both at the EU-wide rules that apply, as set out in EU Directives and Regulations, as well as the rules that are in place in specific EU Member States, namely Ireland, Luxembourg, Malta and the UK.

3C), by simply reducing the BCR applicable to these activities.

17. We propose to make a further distinction between firms managing Public Funds, or equivalent, and those firms managing only Exempt Funds or QIFs. Our regime already recognises that the risks associated with non-Public funds are best dealt with by limiting the types of client who can invest in the funds and by setting a (relatively) high minimum level of investment.

18. We do not propose any changes to the EBCM. As noted above, this requirement is in line with many benchmarked jurisdictions.

19. We propose that:

    (a) the Base Capital Requirement for managers of Public Funds should be reduced to USD 140,000; and

    (b) the Base Capital Requirement for managers of Exempt Funds and QIFs only should be reduced to USD 70,000.

Q1:	Do you have any concerns about these proposals? If so, what are they and how should they be addressed?

ITEM 2 REPORTING SUSPICIONS OF MARKET ABUSE

20. An obligation to report suspicions of market abuse to the DFSA is currently imposed on market operators (i.e. Operators of Authorised Market Institutions (AMIs) and of Alternative Trading Systems (ATSs)). The requirement for an AMI is set out in AMI Rule 5.11.2(1)(b). The equivalent requirement for an ATS is set out in COB Rule 9.6.9(1)(b).

Authorised Firms

21. An Authorised Firm needs to have systems and controls in place to prevent the firm and its employees from engaging in market abuse and to ensure that the firm does not facilitate others to engage in market abuse (GEN Rule 5.3.20). There is an obligation on the firm to report if it or its employees breaches a law or Rule (e.g. market abuse provisions). There is also an obligation to report suspicions as regards AML/CTF activity. But there is not an explicit obligation to report suspicions of market abuse by others for whom the firm may be acting.

22. Our main concern here is that the absence of such a reporting obligation could impair our ability to detect and deal with market abuse.

23. We think it is a relatively simple and straightforward matter to introduce an obligation on an Authorised Firm to report suspected market abuse to the DFSA. As these firms are already required to have systems and controls in place to prevent market abuse (see paragraph 21), we do not think that it should be onerous or difficult for firms to report in the manner required by the rules.

24. We have also looked at benchmarks in other jurisdictions which contain similar obligations to report suspected market abuse e.g. Article 16 of the EU Market Abuse Regulation.

Proposals

25. In summary, we propose to amend the GEN Module (and make consequential changes in the REC Module and in the Code of Market Conduct) so that Authorised Firms and Recognised Members are under an explicit obligation to report suspicions of market abuse to the DFSA.

Q2:	Do you have any concerns about these proposals? If so, what are they and how should they be addressed?

ITEM 3 OTHER MATTERS

26. We have also identified a number of other matters that require clarification or where references need to be corrected in other Rules. The proposed changes we are consulting on are:

    (a) COB 2.3.2 – the reference in COB 2.3.2 should be to an Authorised Firm rather than an Authorised Person;

    (b) COB 3.2.4.(1)(c) – the rule does not reflect the fact that – after the revisions made to our Client Classification regime in 2015 - it is possible to become a Market Counterparty without first being a Professional Client. The rule should be amended to refer to marketing material that is aimed solely at Market Counterparties;

    (c) IFR Guidance 2.4.5 – this guidance should have been updated when the definition of a financial product was last changed. The guidance needs to be updated so that Profit Sharing Investment Accounts are included in the definition of advising on a financial product;

    (d) GEN 5.3.20 and AMI Guidance under 5.11.2 and 9.10.4 – mentions of Market Misconduct should be references to Market Abuse;

    (e) GEN 3.1.2 – some guidance is included on this exclusion to clarify the circumstances in which a communication is governed by the requirements under the Markets Law and Collective Investment Law instead of the Financial Promotions regime in GEN chapter 3;

    (f) MKT 6.4.1 and CIR 8.3.1(2) and 13.3.2(b) – the defunct term Affected Person is still used and needs to be removed and replaced by Related Party; and

    (g) GLO definition of Third Party Agent – this definition is not sufficiently clear at present. It needs to be amended to make it absolutely clear that for an entity to be a Third Party Agent that entity must be a separate legal entity from the Authorised Firm that establishes the Client Account.

Q3:	Do you have any concerns about these proposals? If so, what are they and how should they be addressed?