Dubai Financial Services Authority

CONSULTATION PAPER NO.117

MISCELLANEOUS CHANGES

5 MARCH 2018

PREFACE

Why are we issuing this consultation paper (CP)?

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 collected 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 CP?

The proposals in this Paper should generally be of interest to Authorised Firms, to applicants and to their advisers. Item 2 will be of particular interest to firms with discretionary mandates; Item 3 to banks; and Item 4 to Fund Managers and their advisers.

Terminology

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

What are the next steps?

All comments should be emailed to **consultation@dfsa.ae** using the table provided in Appendix 7. Please refer to the CP 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.

The deadline for providing comments is **4 April 2018**.

Once we receive comments, we shall consider whether any changes to these proposals are required and then seek approval from the DFSA Board for the finalised proposals. Once the proposals are approved, we shall issue a notice on our website to this effect.

Structure of this CP

This Consultation Paper contains:

(a) Item 1: Definition of Credit Facility;

(b) Item 2: Holding Client Assets and Client Money;

(c) Item 3: Calculation and reporting of the Maturity Mismatch Ratio;

(d) Item 4: Fees applicable to Funds;

(e) Item 5: Other matters;

(f) Appendix 1: draft amendments to the GLO Module;

(g) Appendix 2: draft amendments to the COB Module;

(h) Appendix 3: draft amendments to the PIB Module;

(i) Appendix 4: draft amendments to the FER Module;

(j) Appendix 5: draft amendments to the GEN Module;

(k) Appendix 6: draft amendments to the MKT Module; and

(l) Appendix 7: template for providing comments on this consultation paper.

Specific issues

1. Definition of Credit Facility

Please see proposed changes to GLO Module in Appendix 1.

1. The term Credit Facility is currently defined in the Glossary (GLO) Module as:

   "Any facility which includes any arrangement or agreement which extends monetary credit whether funded or unfunded to a Person including but not limited to any loan or syndicated loan, mortgage, overdraft, financial lease, letter of credit, financial guarantee, trade finance, transaction finance, project finance or asset finance."

2. The inclusion of the phrase "including but not limited to" in this definition indicates that other contracts or financing arrangements, not included in this list, may nonetheless fall within the definition.

3. During recent discussions, it has become clear that a number of types of business that we consider to be credit facilities are not always seen as such by stakeholders. This has arisen, in particular, in relation to "invoice financing" and "factoring".

4. To put the position beyond doubt, we propose to add to the definition of Credit Facility the items "invoice financing or discounting" and "factoring".

2. Holding, and reporting on, client assets and client money

Mandates

Please see proposed change to COB 6.12.1 in Appendix 2.

5. As part of the changes made in 2017, arising from CP106[1], we introduced into the COB Module Rule 6.11.4(d), which states:

   6.11.4 Client Assets are held or controlled by an Authorised Firm if they are:

   …

   (d) held in the Client's own name, but the Authorised Firm has a mandate from the Client to manage those assets on a discretionary basis.

[1] CP106: Regulation of Arranging, Representative Offices and Financial Promotions, 21 June 2016.

6. This clarified that the Client Assets rules do apply in those situations where a firm holds a discretionary mandate, often through a Power of Attorney, regardless of whether the assets are held in the Client's own name. However, when making this change we did not make a necessary consequential change in COB 6.12, which sets out the Rules on Client Money. COB 6.12.1(d) states:

> ***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 the Operation of a Crowdfunding Platform in or from the DIFC is Client Money, except Money which is:*
>
> *…*
>
> *(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);*
>
> *…*

7. Some firms have read COB 6.12.1(d) as meaning that no monies held under a mandate are Client Money, even though COB 6.11.4(d) confirms that assets held under a discretionary mandate are Client Assets. This is not the outcome intended by the changes made as part of the CP106 process, which was, as noted above, to clarify that the Client Assets rules do apply to assets, including monies, held under a discretionary mandate.

8. Given the above, we propose to amend COB 6.12.1(d) to remove the potential for confusion.

Disclosure to clients when their assets and/or money are held in another jurisdiction

Please see proposed changes to COB A5.9.1(d) and A6.7.1(2)(g) in Appendix 2.

9. The DFSA's Client Money and Safe Custody rules allow some discretion to firms in terms of where and how assets are held. Amongst other elements of discretion, it is possible to hold such assets in a jurisdiction outside the DIFC.

10. Where firms take this option, they are required to disclose to clients that assets are held in another jurisdiction, and that the market practices, insolvency and legal regime in that jurisdiction may differ from that in the DIFC (see COB A5.9.1(d) and A6.7.1(2)(g)).

11. The intention of these rules is not for clients to be told simply that there may be differences in regime. There should also be an explanation of any actual differences between the regimes applicable in the DIFC and other jurisdiction, together with an

indication of the possible consequences for the client of these differences.

12. Requiring such an explanation does not increase the burden on firms. Under COB A5.6.1, for Client Money, and COB A6.5.1 and 6.5.1A, for Safe Custody, firms are already obliged to carry out due diligence in relation to use of third-party agents, including looking at the relevant insolvency regime. The obligation on firms to provide disclosure, under COB A5.9.1(d) and A6.7.1(2)(g), is simply a matter of disclosing pertinent elements of the due diligence carried out, or the conclusions of that due diligence.

13. A consideration of any potential consequences arising from any differences of regime should also not be onerous. Under A5.6.1(2) and A6.5.1(3), the firm should already have reached a conclusion on whether the arrangements with a third-party, including where that third-party is in a jurisdiction other than the DIFC, provide equivalent protections.

14. The information provided by firms to clients, in the circumstances set out in COB A5.9.1(d) and A6.7.1(2)(g), must be communicated in a way that is clear, fair and not misleading, in line with the requirements of Principle 6 (GEN 4.2.6).

15. We propose to amend the relevant rules in COB to clarify the intention of these rules, as discussed above.

Please see proposed changes to the Guidance in COB A5.12 in Appendix 2.

Client Money Auditor's Report

16. GEN Rule 8.6.1(c) requires an Authorised Person, where they are permitted to hold or control Client Money, to require its Auditor to produce a Client Money Auditor's Report in accordance with the Rules in AUD App2.

17. The Guidance in COB A5.12 indicates that – in accordance with GEN 8 - an Authorised Firm that holds Client Money, for Segregated Clients, must arrange for the production on an annual basis of a Client Money Auditor's Report.

18. Some firms have argued that the Guidance in COB A5.12 means that they do not, under GEN Rule 8.6.1(c), need to arrange for a Client Money Auditor's Report if they control, but do not hold, Client Money.

19. This is not the intention of the provisions and, of course, Guidance cannot override a provision set out in a Rule. Nonetheless, we propose to amend the Guidance in COB A5.12 so that it is in line with GEN Rule 8.6.1(c).

3. Calculation and reporting of the Maturity Mismatch Ratio (MMR)

Please see proposed changes to PIB 9.3.10, A9.3.1 and A9.3.2 in Appendix 3.

20. We are proposing to revise our EPRS reporting Form B80 "liquidity schedule - Maturity Mismatch" to be more granular in terms of the items collected and time buckets. This is in line with the international standards on monitoring tools outlined in the Basel Committee on Banking Supervision's (BCBS) paper "Basel III: Liquidity Coverage Ratio and liquidity risk monitoring tools".

21. The revised reporting form is needed:

    (a) to facilitate reporting and monitoring of different business models in the DIFC, such as retail funding, and the increased reliance on collateralised funding, both not captured by the current reporting form;

    (b) to collect granular data that allows the DFSA to perform liquidity stress testing and provide better insight into the liquidity profile of individual firms; and

    (c) to adopt BCBS and International best practice when it comes to liquidity reporting standards and monitoring tools.

22. In addition to monitoring the cash flow mismatches, the existing Form B80 is used to calculate the MMR, outlined in PIB 9.3.10, PIB 9.3.11 and in PIB A9.3.2[2] Given the different granularity and classification of items proposed in the revised form, it will no longer be possible to perform the mismatch ratio calculation precisely as described in the current PIB rules. This leaves us with two options:

    (a) retain the existing form B80 for the MMR calculation and introduce a new form. This might be seen as creating undue burden on firms as the two forms will essentially collect similar information but at different levels of granularity; or

    (b) slightly modify the rules in PIB to allow the MMR calculation to be performed using the data from the revised form.

23. The proposed calculation of the MMR would use the same granularity of data as the Liquidity Coverage Ratio (LCR). This would also have the benefit of aligning the haircuts applied to liquid assets under the two measures of short-term liquidity we use, the LCR and the MMR, where the same asset is eligible to be included in both ratios. The change in MMR calculation would provide

[2] Supervisors use the Maturity Mismatch approach to assess the adequacy of a firm's liquidity position, by looking at the mismatch between inflows and outflows in different time bands. The MMR sets a maximum limit on the cumulative mismatch allowed in the sight to 8 days' time band.

supervisors with a more consistent set of short-term liquidity monitoring tools, which would be easier to understand and monitor.

24. We consider that the second option is preferable, as the reporting burden on firms is not increased unduly, while the change would provide a number of benefits to our liquidity regime, as discussed above.

25. The proposed changes would also clarify the treatment of Contingent Liabilities. Here, the consideration of the likelihood (i.e., whether it is more likely than not) of the liabilities being triggered only needs to cover the period for which the MMR is being calculated.

26. We propose, therefore, to introduce the new EPRS reporting form, and to make the necessary changes in the PIB rules to allow calculation of the MMR using the data from the new reporting form.

4. Fees applicable to Funds

Please see proposed changes to FER 2.1.1(2), 3.2.1(3) and 3.9.1 in Appendix 4.

27. The DFSA made a substantial number of changes to its fee rules in 2017, most of which took effect at the start of this year. When we made those changes we said that we would aim to limit further fee rule changes, in the short to medium term, so that firms could get used to the new fee model. However, we said we would make changes where it would simplify or improve the fee regime.

28. At present, we charge application and annual fees for managing funds (other than an umbrella fund), and separate application and annual fees for managing an umbrella fund and its sub-funds. After discussion, we have concluded that the imposition of separate fees for managing an umbrella fund and its sub-funds is an unnecessary complication in our fee rules. We propose, therefore, to remove these separate requirements.

29. The consequence of this is that the only factor that may differentiate the fees to be paid at application and on an annual basis is whether the fund is a Qualified Investor Fund.

30. FER 3.9 and 3.10 set out the fees to be paid per fund for initial and subsequent periods, respectively. Initial period fees for authorised firms are pro-rated, depending on the time of year when the firm is authorised, through the provisions in FER 3.1.1(2). We propose, again to simplify our fee regime, to amend FER 3.9 so that initial period fees for funds are, similarly, pro-rated based on the time of year when the fund is registered with, or notified to, the DFSA.

DFSA

31. The consequence of this change is that the initial period fee will be less for the majority of funds that are registered with, or notified to, the DFSA in future.

5. Other matters

Please refer to:

32. We have also identified a number of other matters that involve minor additions, clarifications or where cross-references need correcting. The proposed changes we are consulting on are:

Appendix 3

(a) PIB A9.3.2 – we propose to amend the 15% band in the table to correct an omission;

Appendix 5

(b) GEN 7.2.2(3) – changes previously made to GEN 7.2.2(1) mean that there is no difference between the provisions, so we propose to delete GEN 7.2.2(3); and

Appendix 6

(c) MKT 8.1.2(3)(a) – we have made changes to the term Related Party so that it can be used throughout the Rulebook. In making those changes, we deleted most instances of the term Affected Party. This particular instance, in MKT 8.1.2(3)(a), was missed, so we propose to delete it now.

Q1: Do you have any comments on, or concerns related to, the proposed rule changes? If so, what are they and how should they be addressed?