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**CONSULTATION PAPER NO. 97**

**15 SEPTEMBER 2014**

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**PROPOSED CHANGES TO THE CLIENT CLASSIFICATION  
REGIME**

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## CONSULTATION PAPER 97

### PROPOSED CHANGES TO THE CLIENT CLASSIFICATION REGIME

#### PART A: Introduction and Overview

##### Why are we issuing this paper?

1. The DFSA proposes to make substantial changes to the current client classification provisions in chapter 2 of the Conduct of Business (COB) module of its Rulebook (“the client classification regime”) to bring that regime in line with current developments and practices in the financial services industry. The client classification regime requires Authorised Firms, before providing financial services or products to clients, to classify such clients as “retail” or “non-retail”<sup>1</sup> clients, so that an appropriate level of protection can be provided to those clients given their level of knowledge, experience and resources.
2. The proposals in this paper stem from issues we have identified, as well as concerns expressed by some Authorised Firms that they face practical difficulties in complying with the current client classification regime because it does not cater to the wide ranging business structures and arrangements under which both firms and their clients operate. Accordingly, the proposals in this paper are designed to address the issues and concerns we have identified and concerns raised by firms whilst also remaining well aligned with international best practice as far as applicable.<sup>2</sup>

##### Overview of the proposals

3. While the proposals in this paper build upon the current client classification provisions, we propose significant enhancements and restructuring. The proposals include:
  - (a) expanding the categories of persons who can be classified as professional clients, without the firm having to undertake a detailed assessment of the assets or expertise of such persons, based upon proxies such as the institutional or wholesale nature of the client (‘deemed’ Professional Clients) or the nature of the particular financial services involved (‘service-based’ Professional Clients);
  - (b) expanding the instances in which the professional status of one person can be attributed to another person based either on the strength of an ownership-based or family relationship-based nexus between the two persons;

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<sup>1</sup> Non retail clients are professional clients and market counterparties.

<sup>2</sup> International standards are set by the Basel Committee of Banking Supervisors (BCBS) for the banking sector, the International Association of Insurance Supervisors (IAIS) for the insurance sector and the International Organization of Securities Commissions (IOSCO) for the securities sector. The classification of clients into retail and professional categories is a cornerstone of the IOSCO standards which apply to firms conducting investment business.

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- (c) providing flexibility for firms to rely on a client classification made by its head office or a Group member, provided risks associated with such reliance are effectively addressed; and
  - (d) providing greater scope for a firm, which is a member of a Group, to operate under an arrangement where a bundle of financial services is provided to one client by the firm in conjunction with other members of its Group.

#### **Who should read this paper?**

- 4. The proposals in this paper would be of interest to all Authorised Firms and applicants for licences, their professional advisers, and persons using or intending to use the financial services or financial products offered by regulated persons.

#### **Terminology in this paper**

- 5. In the remainder of this paper, 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) of the DFSA Rulebook. Unless the context otherwise requires, where capitalisation of the initial letter is not used, the expression has its natural meaning. All references to Rules in Appendix 1 are references to proposed Rules.

#### **How to provide comments?**

- 6. All comments should be in writing and sent to the address or email specified below. If sending your comments by email, please use the Consultation Paper number in the subject line. You may, if relevant, 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 addressed or emailed to:**

**Consultation Paper No. 97**  
**Policy and Legal Services**  
**DFSA**  
**PO Box 75850**  
**Dubai, UAE**

**Email: [consultation@dfsa.ae](mailto:consultation@dfsa.ae)**

**Tel: +971(0)4 3621500**

#### **What happens next?**

- 7. The deadline for providing comments on this consultation is **15 October 2014**. Once we receive your comments, we shall consider if any further refinements are required to these proposals. We shall then proceed to make the relevant changes to the DFSA's Rulebook. You should not act on these proposals until the relevant changes to the DFSA Rulebook are made. We shall issue a notice on our website telling you when this happens.

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## Structure of this paper

8. The proposals in this paper follow the order of the provisions in the proposed new client classification regime, i.e. the proposed COB chapter 2 set out in Appendix 1. Any reference to a COB Rule or Guidance is a reference to the Rules and Guidance in Appendix 1, unless otherwise stated.
9. Accordingly, the proposals in this paper are structured as follows:
  - (a) Part A: Introduction and Overview;
  - (b) Part B: Background;
  - (c) Part C: DFSA's risk-based approach to client classification;
  - (d) Part D: Types of Clients;
  - (e) Part E: Retail Clients;
  - (f) Part F: Professional Clients;
  - (g) Part G: Market Counterparties;
  - (h) Part H: Procedures relating to client classification;
  - (i) Part I: Reliance on client classifications made by its head office or member of the Group;
  - (j) Part J: Group Clients;
  - (k) Part K: Record Keeping;
  - (l) Part L: Restructure and some consequential changes;
  - (m) Annex A: Table of Key Proposals;
  - (o) Appendix 1: Draft amendments to chapter 2 of COB module, and chapter 3; and
  - (p) Appendix 2: Draft amendments to the GLO module.

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## **PART B: Background**

### **Scope of, and rationale for, the client classification regime**

10. As noted in paragraph 1, the client classification regime requires Authorised Firms to determine, before they carry on any financial services with or for any person, whether that person is a retail client or non-retail client to ensure that clients are given the right level of regulatory protection.
11. The categorisation of clients into retail and non-retail is a common feature in financial services regulatory regimes in most jurisdictions. International standards, particularly those set by IOSCO, require such differentiation for the purposes of providing a higher level of regulatory protection to retail clients than to those regarded as professional and institutional clients. This differentiation is based on considerations that professional and institutional clients, unlike retail clients, would generally have:
  - (a) more expertise and knowledge to be able to appreciate risks associated with relevant financial products and services; and
  - (b) sufficient resources to be able both to negotiate the terms upon which they obtain financial services or products and to pursue legal and other remedies available to them to enforce their rights.
12. The DFSA regime, whilst remaining true to IOSCO standards, has also drawn from other well-established regulatory regimes, particularly the UK. By doing so, our regime is designed to remain substantially aligned with the EU regime for investment business, for which the UK regime acts as a proxy. This is to facilitate firms conducting investment business in or from the Dubai International Financial Centre (“DIFC”) to be able to carry on their activities without impediments resulting from unwarranted differences between the requirements applicable in the DIFC and in the EU, particularly where the DIFC firm is either a Branch, or a member, of an EU based firm or Group.

### **Need for change**

13. The current client classification regime has remained unchanged since it was introduced in 2007. Some parts of the current regime have become unwieldy, as evidenced by a range of requests we have received from Authorised Firms for waivers and modifications of the current client classification regime to accommodate their market practices and structures (many of which have been granted on a case-by-case basis).
14. Further, as part of the DFSA’s on-going engagement with Authorised Firms, earlier this year we undertook a series of discussions with a cross-section of firms. This enabled us to identify a range of concerns relating to the current client classification regime, including some ambiguities as to how the provisions are intended to apply to Branch and Group operations.
15. The proposals in this paper are designed to address the practices and concerns noted above, whilst also remaining in line with international best practice as far as applicable. The table in Annex A provides a convenient overview of the types of clients and the proposals for client classification discussed in this paper.

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## Issues out of scope of this paper

16. Some issues we have identified, although having some connection to the client classification regime, cannot be conveniently dealt with as part of the proposals in this paper. These issues relate to the nature and scope of certain Financial Services, such as the activity of “Arranging Credit or Deals in Investments”, where the activity involves a person obtaining a financial service or financial product from a firm other than the one with which it has the first interaction (i.e. the firm undertaking ‘arranging’). As these are wider issues relating to particular Financial Services, they are not addressed in this paper.

## PART C: DFSA’s risk-based approach to client classification

### Application and overview provisions

17. A key consideration which underlies the proposed client classification regime is the DFSA’s risk-based approach to regulation.<sup>3</sup>
18. A risk-based approach encompasses a range of factors. First, the level of regulation needs to be aligned to the risks associated with the relevant financial services and products. The level of regulation is set not only by the nature and stringency (or otherwise) of the regulatory requirements, but also by the supervisory approach to monitoring and enforcing such requirements. To ensure the right level of regulation, a range of factors needs to be taken into account such as:
- (a) the nature and type of risks associated with particular financial services and products;
  - (b) the structures and arrangements under which financial services and products are offered by firms to their users, particularly end users; and
  - (c) the nature and circumstances of the users themselves.
19. The client classification regime provides an effective method for risks associated with financial services and products to be better calibrated to the types of clients (in terms of their levels of knowledge, expertise and resources). The proposals in this paper do so, for example, by:
- (a) classifying certain wholesale and institutional clients as ‘deemed’ Professional Clients without a detailed assessment, on the basis of their higher levels of expertise and resources;<sup>4</sup>
  - (b) classifying certain clients as ‘service-based’ Professional Clients taking into account who bears the risks associated with a particular type of Financial Service;<sup>5</sup>
  - (c) classifying certain clients as ‘service-based’ Professional Clients taking into account the type of persons to whom certain Financial

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<sup>3</sup> See Guidance No.2 under Section 2.2 ‘Overview’.

<sup>4</sup> See Rule 2.3.4.

<sup>5</sup> See Rule 2.3.5.

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Services are usually provided;<sup>6</sup>

- (d) providing flexibility for client classifications made by the head office or a Group member to be used, provided risks associated with such use are effectively addressed;<sup>7</sup>
  - (e) providing flexibility for provision of group-based Financial Services where risks associated with such services are effectively addressed when treating those as a composite service;<sup>8</sup> and
  - (f) providing flexibility for look-through arrangements where reliance can be placed on available knowledge, expertise and resources, such as at a holding company or controller level.<sup>9</sup>
20. While the amended client classification regime should provide greater flexibility for Authorised Firms, such flexibility brings with it scope for practices which may not necessarily be within the intended effect or spirit of the regulatory requirements. The DFSA expects firms to adopt an approach that is not merely consistent with the letter of the Rules, but also the intent of the client classification provisions, which is to ensure that clients get the right level of regulatory protection relating to Financial Services and financial products offered to them. More detailed Guidance relating to what is expected of Authorised Firms is included in the proposals.<sup>10</sup>

#### **Issues for consideration**

- Q1:** Do you have any concerns relating to the DFSA's overall approach to risk-based regulation as reflected in these proposals? If so, what are they, and how should they be addressed?
- Q2:** Is there scope for more Guidance to be included indicating the DFSA's expectations relating to compliance with the proposed client classification regime? If so, what are those areas, and what Guidance should be included?

#### **PART D: Types of clients**

21. We propose to retain the current regime of having three types of clients, namely:
- (a) Retail Clients;
  - (b) Professional Clients; and
  - (c) Market Counterparties.
22. While we propose no changes to the three types of clients, we propose some enhancements to the current categorisations to provide greater clarity and certainty, including:

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<sup>6</sup> See Rule 2.3.6.

<sup>7</sup> See Rule 2.4.4.

<sup>8</sup> See Rule 2.4.5.

<sup>9</sup> See Rule 2.3.8(2).

<sup>10</sup> See Guidance included under Rule 2.3.1 and Rule 2.3.5.

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- (a) a distinct provision which identifies the three types of clients;
  - (b) moving the current exclusion provided to Representative Offices (as they have no client relationship with persons to whom they market financial services or products) to the main application provision which contains similar exclusions. We also propose more Guidance as to how this exclusion operates;<sup>11</sup> and
  - (c) a clarification that a trustee of a trust, and not its beneficiaries, is treated as a client.<sup>12</sup>
23. We also propose a Rule which clearly provides flexibility for Authorised Firms to be able to provide different Financial Services or financial products to a Client under different classifications.<sup>13</sup>

**Issue for consideration**

**Q3:** Do you have any concerns or comments about the changes proposed under paragraphs 22 or 23? If so, what are they and how should they be addressed?

**PART E: Retail Clients**

24. Under the existing regime, where a Person cannot be classified as a Professional Client or a Market Counterparty, an Authorised Firm must classify that Person as a Retail Client. As a result, the more extensive conduct requirements in COB for Retail Clients would apply to the firm.
25. We propose a number of refinements to the current definition of a Retail Client to provide greater clarity and to remove some unintended effects. For example, we propose to:
- (a) place the Retail Client definition as the first, instead of the last, of the three types of client definitions;
  - (b) remove the reference to “he” in the current Retail Client definition, which could imply that only an individual could be classified as a Retail Client;<sup>14</sup> and
  - (c) provide detailed Guidance as to when the client classification process should be undertaken.<sup>15</sup>

**Issues for consideration**

**Q4:** Do you have any concerns about the refinements we propose to make, with regard to Retail Clients, set out in paragraph 25? If so, what are they and how

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<sup>11</sup> See Rule 2.1.1 and associated Guidance.

<sup>12</sup> See Rule 2.3.1(4). This is also the UK approach.

<sup>13</sup> See Rule 2.3.1(2).

<sup>14</sup> See Rule 2.3.2. A small Undertaking can also be a Retail Client where it does not meet the relevant net asset and expertise criteria.

<sup>15</sup> See Rule 2.3.1.

should they be addressed?

**Q5:** Are there any other issues or concerns relating to Retail Client definition, and associated provisions, which have not been addressed in the proposals? If so, what are they and why, and how, should they be addressed?

## **PART F: Professional Clients**

26. Most enhancements in these proposals relate to classification as Professional Clients, including having three distinct categories of Professional Client, reflecting the different routes through which persons may qualify. These are:
- (a) 'Deemed' Professional Clients – wholesale or institutional clients with sufficient expertise/resources available to them in managing significant assets,<sup>16</sup> who would be deemed as Professional Clients without the need for any further detailed assessment of their net assets or expertise;<sup>17</sup>
  - (b) 'Service-based' Professional Clients – who would be considered Professional Clients based on the nature of the Financial Services involved and the risks associated with such services (i.e. credit provided for business purposes and corporate advisory and arranging activities);<sup>18</sup> and
  - (c) 'Assessed' Professional Clients – clients to whom Professional Client status can be granted following an assessment whether they meet the prescribed two-pronged net asset and knowledge and experience test.<sup>19</sup>
27. The first and the third categories above are existing categories of Professional Clients, but contain proposed enhancements to provide greater flexibility and clarity and also to remove some unintended effects. The second category is completely new, introduced consistent with the DFSA's risk-based approach to regulation. Each is examined more closely below.

### **(a) 'Deemed' Professional Clients**

28. We propose to make certain enhancements in relation to 'deemed' Professional Clients. First proposal is to change the partial deeming of Professional Client status under existing COB Rule 2.3.2(2). Under that provision, an Authorised Firm may treat certain specified persons (such as regulated firms, pension funds, central banks, governments and semi-governmental agencies, listed companies and similar institutional investors) as Professional Clients on the basis that they:

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<sup>16</sup> Most wholesale or institutional investors included under the deemed category of Professional Clients would have both their own assets (for example, to meet the capital requirements applicable to regulated firms) and, also, significant assets of others which are under their control or management (for example, a trustee of a Trust or a manager of a Pension Fund or Collective Investment Fund).

<sup>17</sup> See Rule 2.3.4.

<sup>18</sup> See Rules 2.3.5 and 2.3.6.

<sup>19</sup> See Rules 2.3.7 and 2.3.8.

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- (a) possess the necessary degree of experience and understanding relating to financial markets, products and transactions; and
- (b) meet the prescribed net asset test.
29. Given that these are wholesale or institutional clients possessing significant assets in their own right or under their control, it is considered that the net asset test<sup>20</sup> is a redundant requirement causing unnecessary work for firms. We propose to remove this requirement, giving those in this category a 'deemed' Professional Client status without any assessment of their expertise or net assets.<sup>21</sup>
30. Secondly, and in line with the EU directive on Markets in Financial Instruments ("MiFID"), we propose to expand the current list of institutional and wholesale clients in existing COB Rule 2.3.2(2) by including "Large Undertakings".<sup>22</sup> To qualify as a Large Undertaking, an entity must meet, as at the time of their most recent balance sheet, at least two out of three of:
- (a) a balance sheet total of US\$ 20 million;
- (b) a net annual turnover of at least US\$ 40 million; or
- (c) own funds or called up capital of at least US\$ 2 million.
31. Under our proposals, 'deemed' Professional Clients, unlike 'service-based' or 'assessed' Professional Clients (discussed below), would not have the right to opt-in as Retail Clients under Rule 2.4.1. We consider this restriction is appropriate in light of their higher expertise and resources and because, under these proposals, they are the only category of Professional Client that may be classified as a Market Counterparty.<sup>23</sup>
32. We also propose to include in the list of Persons who are to be 'deemed' Professional Clients a holder of a licence under the SFO Regulations<sup>24</sup> on the basis that such licensees possess sufficient expertise and resources when carrying out their licensed activities.<sup>25</sup>

#### Issues for consideration

- Q6:** Do you have any concerns relating to the proposed removal of the current net asset assessment required for 'deemed' Professional Clients? If so, what are they and how should they be addressed?
- Q7:** Do you have any concerns relating to the proposed inclusion of a Large Undertaking as a 'deemed' Professional Client, or the test proposed for qualifying as a Large Undertaking? If so, what are they and how should they

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<sup>20</sup> Currently set at US\$ 500,000 for both individuals and Undertakings but, going forward, proposed to be changed to US\$ 1,000,000 (see paragraphs 44 and 48).

<sup>21</sup> See Rule 2.3.4.

<sup>22</sup> See Rule 2.3.4(2).

<sup>23</sup> See Rule 2.4.1, Guidance No.1 under Rule 2.3.4, and Guidance No.1 under Rule 2.4.1.

<sup>24</sup> Single Family Office Regulations made under the DIFC Companies Law Act, 2009.

<sup>25</sup> See Rule 2.3.4(1)(k).

be addressed?

- Q8:** Do you have any concerns relating to the proposed inclusion of a holder of a licence under the SFO Regulations as a 'deemed' Professional Client? If so, what are they, and how should they be addressed?
- Q9:** Do you agree with our proposal not to allow 'deemed' Professional Clients a right to opt-in as a Retail Client under proposed Rule 2.4.1? If not, why not?
- Q10:** Are there any other issues or concerns relating to 'deemed' Professional Clients? If so what are they and how should they be addressed?

**(b) 'Service-based' Professional Clients**

33. As noted above, this is a proposed new category of Professional Client, where an Authorised Firm could treat certain persons as professional without having to undertake any detailed assessment of their net assets and expertise, in contrast to 'assessed' Professional Clients.
34. The proposal is based on considerations that certain types of Financial Services are, by their very nature, provided to certain types of clients who do not require the benefit of the additional regulatory protection given to Retail Clients. We have identified two such categories of Financial Services, one relating to Providing Credit and the other relating to corporate advisory and arranging services.

Providing Credit to Undertakings for business purposes

35. We propose to provide Professional Client status to a client of an Authorised Firm where three conditions are met:<sup>26</sup>
- (a) the relevant Financial Service is Providing Credit;
  - (b) the client is an Undertaking; and
  - (c) credit is provided to the Undertaking for use in the business activities of the Undertaking, or a related party<sup>27</sup> of that Undertaking.
36. The DFSA has previously granted a series of waivers and modifications to permit Authorised Firms to treat as Professional Clients those to whom they provide credit for business purposes. This is on the basis that the lending firm, rather than the borrower, is mostly at risk, thereby providing such a firm a strong incentive to assess the risks associated with lending, including the borrower's capacity to repay when due.<sup>28</sup>
37. We propose to confine the 'service-based' Professional Client treatment to an Undertaking which obtains credit for use in their businesses, and not extend

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<sup>26</sup> See Rule 2.3.5.

<sup>27</sup> Also for use in the businesses of the related parties of the Undertaking, such as a Controller or members of its own Group – see paragraph 38 for details.

<sup>28</sup> This category covers a wider group of Undertakings than is included in "Large Undertakings", discussed in paragraph 30.

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similar treatment for non-commercial credit (i.e. consumer credit), for two reasons:

- (a) firstly, the DFSA does not have, and does not propose to assume, the role of a consumer credit regulator, which would entail additional consumer protection safeguards in the regulatory regime to protect retail clients obtaining credit for consumer purposes; and
  - (b) secondly, and more importantly, to minimise the risk that lending activities undertaken by Authorised Firms may impinge on the Federal Law prohibition against dealing in the U.A.E Dirham. For this purpose, current COB Rule 4.3.1 prohibits firms from Providing Credit to a person, unless the person can be classified as a Professional Client (following an assessment) or, if the person does not meet the Professional Client criteria and so is a Retail Client, the person is an Undertaking and the credit is provided for a business purpose. This Rule prevents consumer credit being provided to Retail Clients.
38. We also propose to extend the scope of the proposed Professional Client status for an Undertaking where credit is obtained not only for its business use, but also where credit is to be used in the businesses of a Controller of the Undertaking or a member of the Group to which the Undertaking belongs, as well as a joint venture of the Undertaking or its Controller or a member of its Group.<sup>29</sup> This extension reflects the current practices of corporate clients, where they often use Undertakings for borrowing purposes. It also takes into account a number of waivers and modifications previously granted by the DFSA.

Advisory and arranging services for corporate structuring and financing

39. The second proposed category of 'service-based' Professional Client relates to those clients to whom an Authorised Firm provides either or both of the Financial Services of 'Advising on Financial Products or Credit' or 'Arranging Credit or Deals in Investments' for the purposes of corporate structuring and financing. These services are typically provided to persons who have sufficient expertise and resources, so rendering a further assessment of their net assets and expertise redundant.<sup>30</sup>
40. While 'service-based' professional status is warranted for clients obtaining corporate structuring and financing related advice and arranging, we do not consider a similar status is warranted for individuals who obtain similar services for their private wealth management purposes. Advice or arranging is generally given to such individuals for the purposes of managing their Investments or portfolios and may often include risk management strategies and lending arrangements. Under the proposals, such individuals can only be treated as Professional Clients if they qualify as such after an assessment of their net worth and expertise.<sup>31</sup>

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<sup>29</sup> See Rule 2.3.5(c).

<sup>30</sup> See Rule 2.3.6.

<sup>31</sup> See Rule 2.3.6(2)(b) and associated Guidance No.3, and Rules 2.3.7 and 2.3.8.

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Considerations relevant to both types of 'service-based' Professional Clients

41. In the case of both types of 'service-based' Professional Clients discussed above, an Authorised Firm is not required to undertake any detailed assessment of their expertise or net assets for them to be classified as professional. However, a firm must have a reasonable basis for classifying a person as falling within the proposed categories. For example, a firm may need to have some documentation to verify and demonstrate to the DFSA that the borrower is an Undertaking and, if credit is obtained for use by its Controller or a member of its Group, the relevant relationship. For this purpose, a firm may rely on documents such as certificates of incorporation and shareholdings.<sup>32</sup>

**Issues for consideration**

- Q11:** Do you agree with our proposal to classify Undertakings to whom credit is provided for business purposes as Professional Clients on the basis that the lending firm, rather than the Undertaking, is primarily at risk? If not, why not?
- Q12:** Do you agree with our proposal to classify as Professional Clients those persons to whom advisory and arranging services are provided for corporate structuring and financing purposes, on the basis that such services are usually given to Professional Clients? If not, why not?
- Q13:** Do you have any concerns relating to our proposal not to treat an individual who is a wealth management client as Professional Clients without any assessment of his net assets and expertise? If so, what are those concerns and how should they be addressed?
- Q14:** Are there any other categories of Financial Services where the persons obtaining such services can be classified as Professional Clients, either based on the nature of the service, or the type of clients who generally require such services? If so, what are they, and why should they be treated as such?
- Q15:** Are there any other concerns relating to our proposals? If so, what are they, and how should they be addressed?

**(c) 'Assessed' Professional Clients**

42. In relation to 'assessed' Professional Clients, we propose a number of enhancements to the current provisions. The current test contains two components, one based on a net asset threshold of at least US\$ 500,000 and the other based on expertise (i.e. sufficient experience and knowledge about financial products and markets, and their associated risks).<sup>33</sup>
43. Under the current regime, no distinction is drawn with regard to the criteria applicable for assessing individuals (i.e. natural persons) and Undertakings (i.e. corporates) as Professional Clients. We propose to make such a

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<sup>32</sup> See Guidance No.5 under Rules 2.3.5.

<sup>33</sup> See the current COB Rule 2.3.2(1) and (2), read in conjunction with current Rules 2.4.1 and 2.5.1.

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distinction, which will enable us to tailor the applicable asset-based and expertise-based criteria better to individuals, in contrast to Undertakings. Further, the type of “look-through” arrangements<sup>34</sup> under which one person’s Professional Client status can be attributed to another person, so that the latter may also be considered a Professional Client, are significantly different in the case of individuals, in contrast to Undertakings. Set out below are the proposed enhancements, as well as a number of issues that we have considered.

### Individuals

44. We propose a number of enhancements. The first relates to the net asset threshold applicable to both individuals and to Undertakings (see paragraph 48), which is set as a minimum of US\$ 500,000.<sup>35</sup> Due to inflation and other considerations, we are of the view that this threshold has become inadequate as a quantitative asset base. Therefore, we propose to increase it from US\$ 500,000 to US\$ 1,000,000, but do so only in about a year’s time. This would provide sufficient advance notice of our intention to firms so that they could consider what impact such an increase would have on their existing client base and what, if any, transitional arrangements are needed in order to address the position of any existing clients who may not be able to meet the proposed increase to the net asset threshold.
45. We also propose enhancements to the current alternative available to individuals for meeting the minimum net assets test of US\$ 500,000, which is ‘being in the previous two years an Employee of the relevant Authorised Firm, or being an Employee in a professional position in another Authorised Firm’,<sup>36</sup> as follows:
- (a) firstly, we propose to move this from its current location as an alternative to having net assets of at least US\$ 500,000, to a new location to act as a proxy for the experience and knowledge-based component of the test applicable to an individual; and
  - (b) secondly, we propose to remove the current potential anomaly where an Authorised Firm providing Financial Services to its own Employees is not subject to a requirement that such individuals be ‘Employees in a professional position’, whereas such a requirement applies where the client is an Employee of another Authorised Firm.<sup>37</sup>
46. The next proposed enhancements relate to the assessment of individuals as Professional Clients on a look-through basis (i.e. where one individual’s

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<sup>34</sup> Look-through arrangements permit assets and/or experience and knowledge held by one person to be attributed to another person for the purposes of assessing whether that other person meets the applicable asset-based and experience and knowledge based tests to qualify as a Professional Client.

<sup>35</sup> See Rule 2.3.7(1)(a).

<sup>36</sup> Own Employees of an Authorised Firm and Employees engaged in a professional capacity in other Authorised Firms where they have been so employed within the previous two years do not need to meet the net asset test. See current COB Rule 2.3.2(1)(a)(ii).

<sup>37</sup> Such a distinction is drawn between own Employees of an Authorised Firm, on the one hand (see current COB Rule 2.3.2(1)(a)(ii)(A)), and Employees of another Authorised Firm, on the other hand (see current COB Rule 2.3.2(1)(a)(ii)(B)).

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professional status is permitted to be attributed to another person). Currently, there is one type of permitted look-through arrangement, which we propose to retain.<sup>38</sup> This allows a personal investment vehicle (such as a trust or foundation) of an individual who qualifies as a Professional Client to be also treated as a Professional Client where the vehicle is set up solely for managing the relevant client's investment portfolio.<sup>39</sup>

47. We propose a second category of look-through arrangement relating to joint accounts operated by Family Members. Authorised Firms often have to deal with individuals who are Professional Clients operating joint accounts for Family Members who are not necessarily individuals who meet Professional Client criteria. To address this in a risk-based manner, we propose that Family Members of a Professional Client be allowed to be classified as Professional Clients where two conditions are met:<sup>40</sup>

- (a) the primary account holder meets the Professional Client criteria; and
- (b) the other joint account holders confirm in writing that the primary account holder is authorised to make investment decisions relating to the account.

#### Undertakings

48. We propose to increase the net asset threshold applicable to Undertakings from the current threshold of US\$ 500,000 to a minimum of own funds or called up capital of at least US\$ 1,000,000 in about a year's time for the reasons set out in paragraph 44.<sup>41</sup>
49. We also propose an enhancement relating to the permitted look-through arrangements for Undertakings. Where an Undertaking has a Controller, Holding Company, Subsidiary or joint venture partner who meets the Professional Client criteria, the Undertaking itself can be classified as a Professional Client.<sup>42</sup> A number of waivers and modifications have been previously granted by the DFSA to permit such look-through arrangements and the proposals aim to formalise the current DFSA policy.
50. We have encountered issues where Authorised Firms have requested that they be allowed to accord Professional Client status to an Undertaking set up by a person (sponsor) who meets the Professional Client criteria but where that Undertaking itself has no legal relationship to the sponsor and, therefore, in a true legal sense, is an 'orphan'. For example, an off-balance sheet arrangement where an Undertaking is set up by a Professional Client for the purposes of securitisation of its assets, or for the purposes of an intended capital raising, where the Undertaking is a stand-alone entity with no legal relationship to the Professional Client who sponsored the setting up of the

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<sup>38</sup> See current COB Rule 2.3.2(3).

<sup>39</sup> See Rule 2.3.7(2).

<sup>40</sup> See Rule 2.3.7(3).

<sup>41</sup> See Rule 2.3.8(1)(a). If the proposal to increase the asset base for Undertakings is to be implemented, transitional arrangements would be needed to address the position of existing clients not meeting the higher threshold.

<sup>42</sup> See Rule 2.3.8(2).

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Undertaking (such as being its Controller, its Holding Company or Subsidiary, or a member of its Group).

51. We are of the view that where there is no legal relationship between the Undertaking and its sponsor, generally, it is hard to impute the Professional Client status of the sponsor to the Undertaking. This does not necessarily mean that in certain circumstances the sponsor's Professional Client status cannot justifiably be imputed to the Undertaking; for example, if an Undertaking is only unable to meet the Professional Client criteria on a temporary basis. Such a situation may arise where a securitisation or capital raising vehicle set up by a sponsor remains unfunded at the initial stages pending the transfer to it of the securitisation assets by the sponsor, or the completion of its capital raising activities. It may be warranted to grant such a vehicle Professional Client status on the strength of its sponsor's Professional Client status during the interim period pending funding.
52. Given that the type of commercial arrangements that result in the creation of "orphaned" Undertakings can be highly variable, we are of the view that a case-by-case assessment would need to be undertaken to determine whether the Professional Client status of a sponsor could be attributed to the Undertaking, where it is a stand-alone entity which is legally unrelated to the sponsor. We do not propose to deal with such situations through specific Rules, but instead expect to deal with such situations through our waiver and modification powers on a case-by-case basis.

**Issues for consideration**

- Q16:** Do you agree with our proposals to separate individuals from Undertakings for the purposes of the tests applicable to them in assessing whether they are Professional Clients? If not, why not?
- Q17:** Do you have any concerns about our proposal to increase the net asset threshold from US\$ 500,000 to US\$ 1,000,000 in about a year's time? What type of transitional arrangements would be appropriate to address the position of any existing clients who may not be able to meet such an increase in the net asset test? Are there any other issues or concerns that arise in this context?
- Q18:** Do you agree with our proposals to place the criterion based on professional expertise gained by being 'an employee of a regulated firm in a professional capacity for two years' as part of the expertise test, instead of being an alternative to having at least US\$ 500,000? If not, why not?
- Q19:** Do you have any concerns relating to the proposed treatment of Family Members of a Professional Client as Professional Clients themselves in the circumstances specified in paragraph 47? If so, what are they, and how should they be addressed?
- Q20:** Do you agree with our proposed approach that would allow an Undertaking to be treated as a Professional Client where it has a Controller, Holding Company, Subsidiary or a joint venture partner who meets the Professional Client criteria? If not, why not?

- Q21:** Do you agree with the Guidance we have provided indicating when an Undertaking set up for the purposes of a joint venture can be treated as a Professional Client, based on one joint-venture partner's Professional Client status? If not, why not?
- Q22:** Do you agree with our proposal not to treat Undertakings as Professional Clients on the strength of the Professional Client status of an unrelated sponsor? If not, why not?
- Q23:** Are there any other concerns relating to the proposals relating to Assessed Professional Clients? If so, what are they, and how should they be addressed?

## **PART G: Market Counterparties**

53. We do not propose to make substantial changes to the current Market Counterparty provisions. Persons who are deemed to be Professional Clients can be classified as Market Counterparties provided the Authorised Firm has complied with the notice procedures.<sup>43</sup>
54. We do however propose some minor enhancements. These include no longer requiring an Authorised Firm to make a separate assessment of whether a Market Counterparty meets the asset based component of the Professional Client criteria. This results from the proposed removal of that requirement so far as it applies to 'deemed' Professional Clients (which is relevant because, to be a Market Counterparty, a person must first be a 'deemed' Professional Client). There are two issues to highlight.

### Distinction between procedures applicable to certain Market Counterparties

55. The first issue is the current distinction drawn with respect to the preliminary procedures relevant to classification of a 'deemed' Professional Client as a Market Counterparty. Under these procedures:
- (a) a limited number of 'deemed' Professional Clients (such as public authorities, Large Undertakings, listed companies and professional institutional investors) require not only a written notification, but also their written agreement, before being classified as a Market Counterparty; and<sup>44</sup>
  - (b) in contrast, a firm must notify most Professional Clients prior to classification as a Market Counterparty. If no objection is received within a specified period, such a person can be classified as a Market

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<sup>43</sup> See Rules 2.3.4 and 2.3.9. Note that when an Authorised Firm carries on Financial Services with a Market Counterparty, only a limited number of conduct requirements in the DFSA Rulebook apply to such Firms. This is because Authorised Firms transact with Market Counterparties on an equal footing and so most of the client protections in the Rulebook are not needed to protect such parties.

<sup>44</sup> See Rule 2.3.9(2)(b).

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Counterparty.<sup>45</sup>

56. While we have retained the current distinction where a limited number of 'deemed' Professional Clients require not only a written notification, but also their written agreement, to be classified as Market Counterparties, we seek public comment on the issue of whether such a written confirmation serves any useful purpose. The presumption behind the differentiation is that these 'deemed' Professional Clients warrant greater protection than the other types of 'deemed' Professional Clients who can be treated as Market Counterparties with only a written notice subject to their no-objection within the specified period.

Classification of reinsurance, asset management and custody services

57. Prompted by some concerns raised by Authorised Firms, we considered whether there is a need for another category of 'service-based' Professional Client for Financial Services activities such as reinsurance, asset management and custody services.
58. We did not see the need for this. Those types of Financial Services are usually provided by an Authorised Firm to another Authorised Firm, Regulated Financial Institution or other entity included in the proposed category of 'deemed' Professional Clients. Further, by virtue of being a 'deemed' Professional Client, such services could also be provided on a Market Counterparty basis to a regulated entity where the notice procedures are met. However, we propose to include Guidance to provide greater clarity.<sup>46</sup>

**Issues for consideration**

- Q24:** Do you think that it is appropriate to retain the current distinction referred to in paragraph 56 with regard to the procedures applicable to certain types of 'deemed' Professional Clients before they could be classified as Market Counterparties? If not, what are your reasons?
- Q25:** Do you have any concerns relating to our proposal not to create a bespoke category of 'service-based' Professional Clients where reinsurance, asset management and custody services are provided? If not, why not?
- Q26:** Do you have any other concerns relating to the Market Counterparty provisions in proposed Rule 2.3.9? If so, what are they, and how should they be addressed?

**PART H: Procedures relating to client classification**

59. There are three main types of procedures applicable for client classification purposes:
- (a) procedures for a Professional Client to opt-in as a Retail Client;

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<sup>45</sup> See Rule 2.3.9(2)(a).

<sup>46</sup> See generally Rule 2.3.4(1) and Rule 2.3.9 and associated Guidance.

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- (b) procedures for assessing the net assets of an individual; and
  - (c) procedures for assessing knowledge and experience of an individual or Undertaking.

**(a) Option for a Professional Client to be classified as a Retail Client**

- 60. We propose to retain the current procedures that enable Professional Clients to opt-in as Retail Clients, subject to one significant change. The change we propose is that only ‘service-based’ and ‘assessed’ Professional Clients, and not ‘deemed’ Professional Clients, would have the right to opt-in as Retail Clients.<sup>47</sup>
- 61. We consider that a right to ‘opt-in’ as a Retail Client is not appropriate for ‘deemed’ Professional Clients because they possess sufficient resources, experience and knowledge, and accordingly are in a position to negotiate the terms of the Financial Services they obtain.

**(b) Assessing net assets of an individual<sup>48</sup>**

- 62. We propose to retain the current “net asset” assessment process for individuals, where the primary residence of the individual is excluded from the assets that are taken into account to meet the US\$ 500,000 threshold, and both direct and indirectly held assets are counted.
- 63. Through our supervisory experience, we have seen various practices among Authorised Firms when calculating the net assets of an individual which, though within the letter, may not necessarily be within the spirit of the client classification regime. We propose further Guidance to clarify issues which we have encountered, such as whether an expatriate client who owns a primary residence in his home jurisdiction could count it as an asset, and whether the value of an asset should be discounted to the extent that it is subject to a mortgage.<sup>49</sup>
- 64. We have considered as an option whether the net asset test for individuals should be replaced with a “portfolio of investments” test, as the latter is used under MiFID for investment business. However, we propose to retain the current ‘net asset’ based threshold (subject to the proposed increase of it from US\$ 500,000 to US\$ 1,000,000 in a year’s time) as it has so far not caused any concerns (except the ambiguities noted in paragraph 63).

**(c) Assessing knowledge and experience**

- 65. Our supervisory experience has not identified any difficulties associated with the current “analysis”<sup>50</sup> process relating to knowledge and experience of individuals or Undertakings. Therefore, we do not propose any changes except for some minor enhancements:

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<sup>47</sup> See the provisions in Rules 2.3.4 to 2.3.8.

<sup>48</sup> We have not included any procedures for assessing the assets of Undertakings as the test is straightforward (i.e. own assets or called up capital of US\$ 500,000).

<sup>49</sup> See Rule 2.4.2.

<sup>50</sup> See current COB Rule 2.5.1.

- (a) we propose to remove the reference to financial advice provided by 'financial institutions' in existing COB Rule 2.5.1(1)(b), as it is an unintended restriction when assessing a relevant client's knowledge and experience, particularly as financial advice can be, and often is, provided by professionals other than financial institutions;<sup>51</sup> and
- (b) we propose to remove the existing Guidance under COB Rule 2.4.3 so far as it relates to the expertise of Employees who have worked in the financial services industry for at least one year in a professional capacity, as this Guidance is inconsistent with the requirement to have at least two years of employment in a professional capacity.<sup>52</sup>

#### Issues for consideration

**Q27:** Do you agree with our proposal not to allow a 'deemed' Professional Client the right to opt-in as a Retail Client? If not, why not?

**Q28:** Do you have any other concerns relating to the client classification procedures proposed? If so, what are they, and how should they be addressed?

#### **PART I: Reliance on client classifications made elsewhere**

- 66. The existing provisions do not confer an ability to rely on client classifications made elsewhere. We propose to introduce new provisions to allow Authorised Firms to rely on client classifications made elsewhere, i.e. in the case of a Branch, by its head office or another branch of the same legal entity and, in the case of a Group member, by another member of its Group. Note that we already have outsourcing-related requirements, but those requirements do not necessarily address issues that arise where a firm relies on client classifications made by its head office or another branch, or by another member of its Group.<sup>53</sup>
- 67. Some Authorised Firms have found practical difficulties in applying the current client classification regime to more complex group-wide arrangements. Through our supervisory experience, we also identified various practices which are not necessarily consistent with the letter and spirit of the current client classification regime.
- 68. Under the proposals, an Authorised Firm would be able to rely on a client classification made by its head office or another branch of the same legal entity, or by another member within its Group, where certain pre-conditions are met:

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<sup>51</sup> See Rule 2.4.3(1)(d).

<sup>52</sup> See Rule 2.3.7(1)(b)(i), discussed in paragraph 44.

<sup>53</sup> Where an Authorised Firm outsources the client classification task to an external service provider, the classification would be undertaken for and on behalf of the firm, and in accordance with the client classification provisions that are applicable to the firm. The requirements in GEN Rules 5.3.21 and 5.3.22 apply to such outsourcing arrangements, which include proper supervision by the firm of the outsourced activity, and the firm's primary accountability for such activities.

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- (a) the firm must have reasonable grounds to believe that the client classification is substantively similar to the client classification required under the Rules. For this purpose, a firm is expected to carry out a gap analysis between the relevant client classification requirements applicable to it, and the other entity which carries out the client classification;
  - (b) if any gaps are identified, the firm must effectively address them; and
  - (c) the firm must also be able to demonstrate to the satisfaction of the DFSA that the reliance on such a client classification is reasonable and appropriate.
69. The above proposals are outcome-based, rather than prescriptive, and provide Authorised Firms more flexibility to adopt procedures that are suited to their own business structures, provided the stated outcomes are effectively achieved. For example, a firm relying on a client classification carried out in respect of a client by its head office in accordance with MiFID requirements would, generally, be able to demonstrate that the classification is substantially similar to the client classification requirements under COB. However, documentation relating to the relevant client classification must be available to the firm and, most importantly, the firm must be able to produce or provide access to such documents to the DFSA, to enable the firm to demonstrate that a classification was in fact carried out for the particular client in accordance with the MiFID requirements (see paragraphs 76 and 77 relating to record keeping requirements).<sup>54</sup>

#### **Issues for consideration**

- Q29:** Do the proposed outcome-based requirements adequately address issues that arise where an Authorised Firm seeks to rely on a client classification made elsewhere, such as by its head office or a member of its Group? If not, what are those issues and how should they be addressed?
- Q30:** Are there other issues which are not addressed? What are they and why, and how, should they be addressed?

#### **PART J: Group clients**

70. Authorised Firms have also found practical difficulties where they, together with other firms within their Group, provide multiple financial services or products (i.e. a bundle of services) to the same client in a seamless manner.
71. We recognise that Groups have different arrangements to provide bundled financial services to their clients, depending on the nature of the Group, where the members of the Group are located, the needs of the clients, and the financial service or products involved. As a result, risks associated with

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<sup>54</sup> Authorised Firms should be aware that, while the MiFID requirements apply to Investment Business carried out by EU based firms, the client classification regime under COB has a wider application, as the latter applies to Financial Services such as insurance intermediation and providing credit.

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such arrangements could also differ widely. To be able to cater to such diversity, we propose to adopt an outcome-based approach, rather than detailing prescriptive requirements. Our proposals are designed to provide a greater degree of flexibility for firms in their processes and documentation, in a manner that does not unnecessarily reduce the level of protection provided to a client.

72. Accordingly, we propose that an Authorised Firm may provide one or more Financial Services as part of a bundle of financial services provided to a client by the Group, where:<sup>55</sup>
- (a) the client classification adopted by the Authorised Firm remains consistent with the legal requirements applicable to the firm, and is appropriate for the overall financial services provided to the client;
  - (b) the client has a clear understanding of the arrangement; and
  - (c) any risks arising from the arrangement are identified and appropriately and effectively addressed.
73. We also propose to provide Guidance addressing risks such as conflicting legal requirements applicable in the jurisdictions in which members of the Group are located, difficulties in identifying the entity providing the service, and the resulting greater exposure to legal risk by members of the Group. We also propose Guidance on systems and controls.<sup>56</sup>
74. We do not propose expressly to extend these requirements to a Branch, as a Branch is not a separate legal entity from its head office and, hence, would generally have greater flexibility to provide a Financial Service to a client in conjunction with its head office or any other part of the same legal entity. However, to the extent a Branch conducts its activities as a stand-alone entity, it may use the same outcome-based approach.<sup>57</sup>
75. We have also considered whether these provisions should apply to Professional Clients only, on the basis that Retail Clients may be less likely to be able to understand the complexities of such arrangements. However, we felt that such a restriction was unnecessary because:
- (a) generally, the type of clients who would require services of this nature would be Professional Clients; and
  - (b) the proposed outcome-based requirement that the client is able to clearly understand the arrangement would also act as a barrier against such a service being provided to a Retail Client.

#### **Issues for consideration**

**Q31:** Do the proposed outcome-based requirements adequately address issues that arise where Authorised Firms operating within a Group provide a composite package of financial services to the same client? If not, what are

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<sup>55</sup> See Rule 2.4.5.

<sup>56</sup> See Guidance under Rule 2.4.5.

<sup>57</sup> See Guidance No.6 to Rule 2.4.5.

those issues and how should they be addressed?

**Q32:** Do you agree with our view in paragraph 75 that it is not necessary to have an express exclusion for Group services under proposed Rule 2.4.5 being provided to a Retail Client? If not, why not?

**Q33:** Do you have any concerns relating to our proposal not to cater expressly to Branch operations? If so, what are they and how should they be addressed?

## **PART K: Record keeping**

76. We do not propose to make changes to the existing record keeping requirements except in relation to the proposals to provide greater flexibility to accommodate different practices which Authorised Firms may adopt to cater to business structures within which they operate (such as Branch or Group operations where Authorised Firms rely on the proposed outcome-based requirements discussed above). In this context, we expect Authorised Firms to be able to demonstrate to the satisfaction of the DFSA that they are fully complying with the Rules by achieving the relevant outcomes.

77. Accordingly, we propose an express requirement that Authorised Firms ensure that the DFSA has unrestricted access to all records required for the firm to be able to demonstrate to the DFSA its compliance, including any records where they are maintained by its head office or any member of its Group. These proposed requirements complement the existing record keeping requirements in GEN Rules 5.3.24 to 5.3.27.<sup>58</sup>

### **Issues for consideration**

**Q34:** Do you have any concerns about the proposed record keeping requirements? If so, what are they and how should they be addressed?

**Q35:** Are there other issues or concerns relating to record keeping which are not addressed? What are they and why, and how, should they be addressed?

## **PART L: Restructure and consequential changes**

### Proposed restructure of the client classification regime

78. In order to provide greater clarity, and to accommodate the changes proposed above, we propose to restructure the client classification regime into four main sections:

- (a) the first to contain the application provisions and exclusions, together with a comprehensive overview of the provisions;<sup>59</sup>
- (b) the second to prescribe the types of clients and the relevant definitions

<sup>58</sup> See Rules 2.4.4 and 2.4.5.

<sup>59</sup> See section 2.1.

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- and sub-categories of Professional Clients,<sup>60</sup>
- (c) the third to contain substantially all the procedures applicable to client classification;<sup>61</sup> and
  - (d) the fourth to contain record keeping requirements.<sup>62</sup>
79. We also propose a range of (mostly minor) changes to provide greater clarity and cohesion to the regime. A few of the more notable are:
- (a) moving to Rule level the Guidance under current COB Rule 2.3.2, which provides that “where an Authorised Firm becomes aware that a Professional Client no longer fulfils the condition which made him eligible to be classified as a Professional Client, the Authorised Firm should take appropriate action”, as this is more in the nature of a mandatory requirement;<sup>63</sup> and
  - (b) replacing existing references to ‘treating’ persons as a particular type of client with references to ‘classifying’ persons.

#### Consequential changes to the Client Agreement provisions

80. The Client Agreement provisions in COB chapter 3, section 3.3 are closely associated with the client classification requirements, and both sets of requirements must be met before a Financial Service can be provided to a client. Client classification can impact on whether a Client Agreement is needed, as Financial Services carried on with a Market Counterparty do not require a Client Agreement.<sup>64</sup> The level of information in a Client Agreement also depends on whether the client is classified as a Professional Client or a Retail Client, where more details are required for the latter.<sup>65</sup>
81. Our supervisory experience indicates that some Authorised Firms seek to rely on a Client Agreement made by or at its head office or a member of its Group. We believe that there is limited scope for an Authorised Firm to be able to legitimately rely on such a Client Agreement for a number of reasons. For example, the Client Agreement may not be legally binding on the Authorised Firm and, as a result, the client may not be able to enforce its rights against the firm (which may not be the case if it is a Branch relying on its head office Client Agreement, as they are the same legal entity). Also, the client may not be able to clearly identify what services are being provided by the firm. Also, if the Client Agreement is executed outside the DIFC, records may not be readily accessible to the DFSA.
82. To address these concerns, we propose to restrict the ability for an Authorised Firm to rely on a Client Agreement made by another entity except

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<sup>60</sup> See section 2.3.

<sup>61</sup> See section 2.4.

<sup>62</sup> See section 2.5.

<sup>63</sup> See Rule 2.3.3(2).

<sup>64</sup> See current COB Rule 3.3.1(a). It is also noted that certain types of financial Services, such as Accepting Deposits and Providing Credit do require Client Agreements.

<sup>65</sup> See current COB Appendix 2, which prescribes the information required to be included in a Client Agreement.

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in two specific instances.<sup>66</sup>

- (a) firstly, where the Authorised Firm is a Branch, and the Client Agreement is made by its head office or any other branch of the same legal entity. In order to be able to rely on such an agreement, the Client Agreement must clearly cover the Financial Services provided by the Branch and the firm must ensure that the Client Agreement, including any amendments to it, is available to the DFSA on request; and
- (b) secondly, where the Authorised Firm provides a Financial Service as part of a bundle of financial services under proposed Rule 2.4.5. If the firm is relying on a Client Agreement executed by a member of its Group, the agreement must clearly identify the Financial Services provided by the firm and state that the client's rights under the contract in respect of such services are enforceable against the Authorised Firm. The firm must also ensure that the Client Agreement, including any amendments to it, is available to the DFSA on request.

**Issues for consideration**

**Q36:** Do you have any concerns relating to the proposed restructure of the client classification regime? If so, what are they and how should they be addressed?

**Q37:** Do you agree with our proposals in paragraph 82 relating to Client Agreements? If not, why not?

**Q38:** Are there other unintended effects or anomalies that need to be addressed? What are they and why, and how, should they be addressed?

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<sup>66</sup> See Rule 3.3.4.

## ANNEX A

### Table of Key Proposals

Requirement	Type of Client				
	Retail Client ("RC")	Professional Client ("PC")			Market Counterparty ("MC")
		'Deemed' PC	'Service-based' PC	'Assessed' PC	
<b>Classify a person as a RC, PC or MC</b>	✓ Rule 2.3.1(1)	✓ Rule 2.3.1(1)	✓ Rule 2.3.1(1)	✓ Rule 2.3.1(1)	✓ Rule 2.3.1(1)
<b>Process for client classification</b>	A person must be classified as a RC if that person: <ul style="list-style-type: none"> <li>cannot be classified as a PC or MC; or</li> <li>opts-in to be a RC.</li> </ul> See Rule 2.3.2 & Rule 2.4.1.	Verify whether the person is a type of specified institutional/wholesale client. See Rule 2.3.4.	Verify whether the Financial Service provided to the person meets the requirements for: <ul style="list-style-type: none"> <li>'credit for business purposes'; or</li> <li>'corporate structuring and financing'.</li> </ul> See Rule 2.3.5 & Rule 2.3.6.	Undertake assessment (using Rules 2.4.2 & 2.4.3) if the person is an: <ul style="list-style-type: none"> <li>'individual' – meets the asset and expertise requirements;</li> <li>Undertaking – meets the asset and expertise requirements.</li> </ul> See Rule 2.3.7 & Rule 2.3.8.	Verify whether the person is a 'deemed' PC and give to the person notification and a right to object, or seek written consent. See Rule 2.3.9.
<b>Right to opt-in as a RC</b>	Not applicable	✗	✓	✓	Not applicable
<b>Option to be classified as a MC</b>	Not applicable	✓	✗	✗	Not applicable