

Appendix 1

The text in this appendix is all new and has not been underlined and struck through in the usual manner to show amendments.

The DFSA Sourcebook



Regulatory Policy and Process (RPP Sourcebook)

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1 INTRODUCTION

1-1 PURPOSE

1-1-1 The purpose of the Regulatory Policy and Process (RPP) Sourcebook is to provide readers with an understanding of how the Dubai Financial Services Authority (DFSA) functions and operates and what we expect from the regulated community.

1-1-2 The RPP contains:

- (a) statements of DFSA's regulatory policy;
- (b) descriptions of the regulatory processes that we follow when exercising our statutory powers;
- (c) information as to DFSA's risk based approach to authorisation, supervision and enforcement; and
- (d) information on matters which the DFSA may assess when considering to exercise specific discretionary powers. For example, this would include those matters which the DFSA may take into consideration when making an assessment of whether an Authorised Person or Authorised Individual is fit and proper.

1-1-3 RPP is therefore relevant to a Person who is:

- (a) seeking to be authorised or registered by the DFSA;
- (b) already subject to applicable Laws, Rules and policies administered by the DFSA such as Authorised Persons (i.e. Authorised Firms or Authorised Market Institutions), Ancillary Service Providers, Registered Auditors, Authorised Individuals, Principal Representatives and any other Persons subject to the DFSA's regulatory oversight; and
- (c) otherwise subject to the jurisdiction of the DFSA such as by reason of the DFSA's authority under delegated powers.

1-1-4 RPP also concerns Persons who have made or intend to make:

- (a) an Offer of Securities; or
- (b) a Financial Promotion;

in or from the DIFC.

1-1-5 The types of Person mentioned above to whom RPP is relevant are not intended to be exhaustive.

1-2 STATUS

1-2-1 The information in RPP is issued under Article 116(2) of the Regulatory Law 2004. RPP is for information purposes only and forms one of the DFSA's Sourcebook modules. RPP contains policy and process information which is indicative and non-binding.

1-2-2 RPP is not an exhaustive source of the DFSA's policy on the exercise of its statutory powers and discretion. To the extent that it sets out how the DFSA may act in certain circumstances, the information in RPP does not bind the DFSA and nor does it necessarily create a legitimate expectation for Persons who might reasonably seek to rely upon it. RPP should not be relied upon as a safe harbour by any Person.

1-2-3 Anyone reading RPP should also refer to the:

- (a) DIFC Laws, including DFSA administered Laws ("Laws");
- (b) DFSA Rulebook ("Rules"); and
- (c) other parts of the DFSA Sourcebook ("Sourcebook");

that may impact on them.

1-2-4 The Laws and Rules set out the precise scope and effect of any particular provision referred to in RPP. If you have any doubt about a legal or other provision or your responsibilities under the Law, Rules or other relevant requirements, you should seek appropriate legal advice.

1-2-5 The Sourcebook comprises a number of modules such as the Prudential Returns (PRU) module and the Application, Forms and Notices (AFN) module.

1-3 UPDATING THE RPP

1-3-1 We shall take reasonable steps to review the RPP to ensure that it remains current. We shall also make amendments where there are changes in our policy or processes in light of our regulatory experience and to reflect legal and market developments in the DIFC or in the relevant standards and practices set by international regulatory bodies. This may result in new chapters being added or existing chapters being amended or merged or deleted, as is necessary.

1-4 DEFINED TERMS

1-4-1 In order to be consistent and accurate when referring to terms that have specific meaning elsewhere, defined terms are identified throughout RPP by the capitalisation of the initial letter of a word or each word of a phrase and are defined in the Glossary module (GLO) of the DFSA's Rulebook. Unless the context otherwise requires, where capitalisation of the initial letter is not used, an expression has its natural meaning.

1-5 DFSA'S REGULATORY MANDATE

1-5-1 The DFSA is the independent regulator of financial and ancillary services conducted in or from the Dubai International Financial Centre (DIFC), a purpose-built financial free-zone in Dubai.

1-5-2 The DFSA's regulatory oversight includes asset management, banking and credit services, securities, collective investment funds, custody and trust services, commodities futures trading, Islamic finance, insurance, an international equities and derivatives exchange and an international commodities derivatives exchange.

1-5-3 The DFSA's mandate is to ensure that the DIFC is one of the best regulated international financial centres in the world, a centre based on principles of integrity, transparency and efficiency.

1-5-4 The international standards adopted and applied by the DFSA in the DIFC are those set by leading international organisations such as IOSCO (International Organisation of Securities Commissions), BCBS (Basel Committee on Banking Supervision), IAIS (International Association of Insurance Supervisors) and FATF (Financial Action Task Force).

1-6 DFSA'S OBJECTIVES AND GUIDING PRINCIPLES

1-6-1 In discharging its regulatory mandate, the DFSA has a statutory obligation under Article 8(3) of the Regulatory Law 2004 to pursue the following objectives:

- (a) to foster and maintain fairness, transparency and efficiency in the financial services industry (namely, the financial services and related activities carried on) in the DIFC;
- (b) to foster and maintain confidence in the financial services industry in the DIFC;
- (c) to foster and maintain the financial stability of the financial services industry in the DIFC, including the reduction of systemic risk;
- (d) to prevent, detect and restrain conduct that causes or may cause damage to the reputation of the DIFC or the financial services industry in the DIFC, through appropriate means, including the imposition of sanctions;
- (e) to protect direct and indirect users and prospective users of the financial services industry in the DIFC;
- (f) to promote public understanding of the regulation of the financial services industry in the DIFC; and
- (g) to pursue any other objectives as the Ruler of Dubai may from time to time set under DIFC Law.

1-6-2 In exercising its powers and performing its functions, the DFSA has regard to the following guiding principles as set out in Article 8(4) of the Regulatory Law 2004, being the desirability of:

- (a) pursuing the objectives of the DIFC as set out under Dubai Law in so far as it is appropriate and proper for the DFSA to do so;
- (b) fostering the development of the DIFC as an internationally respected financial centre;
- (c) co-operating with and providing assistance to regulatory authorities in the United Arab Emirates and other jurisdictions;
- (d) minimising the adverse effects of the activities of the DFSA on competition in the financial services industry;
- (e) using its resources in the most efficient way;
- (f) ensuring the cost of regulation is proportionate to its benefit;
- (g) exercising its powers and performing its functions in a transparent manner; and
- (h) complying with relevant generally accepted principles of good governance.

1-7 DFSA'S REGULATORY STRUCTURE

1-7-1 The DFSA is structured into a number of divisions and departments. For the purpose of this Sourcebook, the most relevant are as follows:

Supervision

- (a) The Supervision Division authorises firms and individuals to conduct Financial Services in or from the DIFC. This Division also registers Ancillary Service Providers and Registered Auditors (see Chapter 2).
- (b) This Division also conducts supervisory oversight on all Authorised Firms, Ancillary Service Providers and Registered Auditors, including by conducting risk assessments. The scope and frequency of such assessments are dictated by the nature of the firm's activities and its perceived risks. From time to time, Supervision carries out thematic reviews inspired by topical events which have both local and international relevance (see Chapter 3).

Markets

- (c) The Markets Division licenses and supervises Authorised Market Institutions in the DIFC (see Chapters 2 and 3).
- (d) The Division also recognises those financial markets who operate an exchange or clearing house outside the DIFC without having a physical presence in the DIFC but make their services available to Persons in the

DIFC. Trading and Clearing members of an Authorised Market Institution who operate in a jurisdiction other than the DIFC and do not have a physical presence in the DIFC are also recognised by the Division.

- (e) The Division is also responsible for regulating Offers of Securities in or from the DIFC, and supervises Reporting Entities by monitoring their ongoing market disclosures and compliance with Rules.

Enforcement

- (f) The primary function of the Enforcement Division is to prevent, detect and restrain conduct that causes or may cause damage to the reputation of the DIFC or the financial services industry in the DIFC. Consequently, the Enforcement Division is responsible for:
 - (i) liaising and co-operating with international regulatory and enforcement agencies pursuant to a relevant multilateral memorandum of understanding or bi-lateral arrangement in relation to investigation and enforcement matters;
 - (ii) conducting investigations commenced pursuant to Article 78 of the Regulatory Law 2004 in respect of contraventions of DFSA administered Laws and Rules; and
 - (iii) the taking of enforcement action in circumstances where contraventions of DFSA administered Laws and Rules pose an unacceptable risk to the DIFC.
- (g) The DFSA has a range of remedies to enforce the legislation that we administer.

Policy and Legal

- (h) The Policy and Legal Services Division is responsible for developing DFSA administered Laws, Rules and policies, as approved by the DFSA Board of Directors. The Division also assists in the drafting of certain DIFC Laws. This Division is also responsible for providing regulatory legal advice and managing the business of the Regulatory Policy Committee and the Rules and Waivers Committee and advises on the disclosure of confidential regulatory information.

2 AUTHORISATION - BECOMING REGULATED

2-1 DFSA'S APPROACH TO AUTHORISATION

Introduction

2-1-1 This chapter outlines the DFSA's approach to assessing an applicant to become:

- (a) an Authorised Person, that is, an Authorised Market Institution or an Authorised Firm (an Authorised Firm includes a Representative Office);
- (b) an Authorised Individual;
- (c) a Principal Representative;
- (d) an Ancillary Service Provider; or
- (e) a Registered Auditor.

2-1-2 Prior to submitting an application to the DFSA, the relevant applicant should contact the DFSA Enquiries Team on +971 (0)4 362 1500 or via e-mail info@dfsa.ae. In preparing an application, this chapter should be read in conjunction with the forms and notes in the AFN Sourcebook, and relevant Laws and Rules.

2-1-3 In assessing whether a relevant applicant is and remains fit and proper, the DFSA may also consider the degree to which an applicant is ready, willing and able to conduct the relevant activities in accordance with the Laws and Rules and other legislation applicable in the DIFC.

2-1-4 An applicant must not provide information to the DFSA which is false, misleading or deceptive, or conceal information where the concealment of such information is likely to mislead or deceive the DFSA (see Article 66 of the Regulatory Law 2004).

2-1-5 If an applicant becomes aware of a material change in circumstances that is reasonably likely to be relevant to an application which is under consideration by the DFSA, then it must inform the DFSA of the change, in writing, without delay (see Article 46 of the Regulatory Law 2004).

2-2 ASSESSING THE FITNESS AND PROPRIETY OF AUTHORISED PERSONS

Introduction

2-2-1 This section sets out matters which the DFSA takes into consideration when assessing the fitness and propriety of an Authorised Person (including applicants). There are some matters in this section which apply to all Authorised Persons and some which are specific to either an Authorised Firm or an Authorised Market Institution. Such matters should be read in conjunction with those requirements relating to Authorised Firms (see chapter 7 of the GEN module) and Authorised Market Institutions (see chapters 2 and 7 of the AMI module).

2-2-2 The DFSA may have regard to all relevant matters, whether arising in the DIFC or elsewhere. The DFSA may determine the materiality of any information for the purposes of considering whether an Authorised Person has demonstrated, or continues to demonstrate, that it is fit and proper.

2-2-3 The DFSA may request or require any information which it considers relevant to its consideration of an application by an Authorised Person.

2-2-4 In considering any specific matters, the DFSA may request reviews by an appropriately skilled third party on any aspect of the Authorised Person's proposed or actual activities or the environment in which the applicant predominantly operates. The DFSA will normally agree to the scope of any reviews performed. Such reviews will ordinarily be at the applicant's sole expense.

Background and history

2-2-5 In respect of the background and history of an Authorised Person, the DFSA may have regard to any matters including, but not limited to, the following:

- (a) any matter affecting the propriety of the Authorised Person's conduct, whether or not such conduct may have resulted in the commission of a criminal offence or the contravention of the law or the institution of legal or disciplinary proceedings of whatever nature;
- (b) whether an Authorised Person has ever been the subject of disciplinary procedures by a government body or agency or any self regulating organisation or other professional body;
- (c) a contravention of any provision of financial services legislation or of rules, regulations, statements of principle or codes of practice made under it or made by a recognised self regulatory organisation, Financial Services Regulator or regulated exchange or clearing house;
- (d) whether an Authorised Person has been refused, or had a restriction placed on, the right to carry on a trade, business or profession requiring a licence, registration or other permission;
- (e) an adverse finding or an agreed settlement in a civil action by any court or tribunal of competent jurisdiction resulting in an award against or payment by an Authorised Person in excess of \$10,000 or awards that total more than \$10,000;
- (f) whether an Authorised Person has been censured, disciplined, publicly criticised or the subject of a court order at the instigation of any regulatory authority, or any officially appointed inquiry, or any other Financial Services Regulator; and
- (g) whether an Authorised Person has been open and truthful in all its dealings with the DFSA.

Locations of offices

2-2-6 An Authorised Person should be able to satisfy the DFSA that it is in compliance with chapter 6 of the GEN module. In particular, section 6.5 of GEN module requires that if an Authorised Person is a Body Corporate constituted under the laws of the DIFC it should maintain its head office and registered office within the boundaries of the DIFC. In considering the location of an Authorised Person's head office, the DFSA may have regard to the location of its directors, partners, and senior management with respect to its strategic, operational and administrative arrangements. Where an Authorised Firm is a Partnership with its head office in the DIFC, it must carry on business in the DIFC.

Close Links

2-2-7 GEN section 6.6 concerns Close Links. The DFSA should be satisfied that the existence of Close Links do not prevent the effective supervision of the Authorised Person by the DFSA.

Legal status of Authorised Firms

2-2-8 The DFSA will only consider an application for authorisation where the legal status of the proposed entity meets the requirements set out in section 7.2 of the GEN module or chapter 7 of the AMI module.

2-2-9 In respect of Effecting Contracts of Insurance, Carrying Out Contracts of Insurance, Acting as the Trustee of a Fund, or Operating a Collective Investment Fund, an Authorised Firm has to be a Body Corporate in accordance with GEN Rules 7.2.2(2) and 7.2.2(4) respectively.

2-2-10 In respect of Accepting Deposits or seeking to Accept Deposits, an Authorised Firm has to be a Body Corporate or Partnership in accordance with GEN Rule 7.2.2(3).

Ownership and Group

2-2-11 In respect of the ownership and Group structure of an Authorised Person, the DFSA may have regard to:

- (a) the Authorised Person's position within its Group, including any other relationships that may exist between the Authorised Person's affiliates, Controllers, Associates or other Persons that may be considered a Close Link;
- (b) any information provided by other regulators or third parties in relation to the Authorised Person or any entity within its Group;
- (c) the background, history and principal activities of the Authorised Person's Controllers, including that of the Controller's Directors, Partners or other officers associated with the Group, and the degree of influence that they are, or may be, able to exert over the Authorised Person and/or its activities;
- (d) the reputation and experience of a Controller or any other Person who will exert significant management influence over the Authorised Person;

- (e) the financial strength of a Controller and other members of the Group and its implications for the Authorised Person; and
- (f) whether the Authorised Person or its Group is subject to any adverse effect or considerations arising from its country of incorporation or the country (or countries) of incorporation or other relevant jurisdiction of its Controllers. In considering such matters, the DFSA may also have regard to the type and level of regulatory oversight in the country or countries of incorporation or other relevant jurisdiction referred to above, the regulatory infrastructure and adherence to internationally held conventions and standards that the DFSA may have adopted in its Rules.

Resources, Systems and Controls

2-2-12 The DFSA may have regard to whether the Authorised Person has sufficient resources, including the appropriate systems and controls (including those set out in chapter 5 of the GEN module), such as:

- (a) the Authorised Person's financial resources and whether it complies, or will comply, with any applicable financial Rules, and whether the Authorised Person appears in a position to be able to continue to comply with such Rules;
- (b) the extent to which the Authorised Person is or may be able to secure additional capital in a form acceptable to the DFSA where this appears likely to be necessary at any stage in the future;
- (c) the availability of sufficient competent human resources to conduct and manage the Authorised Person's affairs, in addition to the availability of sufficient Authorised Individuals to conduct and manage the Authorised Person's Financial Services;
- (d) whether the Authorised Person has sufficient and appropriate systems and procedures in order to support, monitor and manage its affairs, resources and regulatory obligations in a sound and prudent manner;
- (e) whether the Authorised Person has appropriate anti money laundering procedures and systems designed to ensure full compliance with applicable money laundering and counter terrorism legislation, and relevant UN Security Council sanctions and resolutions, including arrangements to ensure that all relevant staff are aware of their obligations;
- (f) the impact of other members of the Authorised Person's Group on the adequacy of the Authorised Person's resources and in particular, though not exclusively, the extent to which the Authorised Person is or may be subject to consolidated prudential supervision by the DFSA or another Financial Services Regulator;
- (g) whether the Authorised Firm is able to provide sufficient evidence about the source of funds available to it, to the satisfaction of the DFSA. This is particularly relevant in the case of a start-up entity; and
- (h) the financial soundness of a Controller, in particular where such a Controller agrees to contribute any funds or other financial support such as a guarantee or a debt subordination agreement in favour of the Authorised Firm.

Authorised Firms - Collective suitability of individuals or other persons connected to the Authorised Firm

2-2-13 Notwithstanding that individuals performing Licensed Functions are required to be Authorised Individuals and that an Authorised Firm is required to appoint certain Authorised Individuals to certain functions as stated in chapter 7 of the GEN module, the DFSA may also consider:

- (a) the collective suitability of all of the Authorised Firm's staff taken together, and whether there is a sufficient range of individuals with appropriate knowledge, skills and experience to understand, operate and manage the Authorised Firm's affairs in a sound and prudent manner;
- (b) the composition of the Governing Body of the Authorised Firm, including the presence of non-executive members, taking into consideration the nature, size and complexity of the Authorised Firm's activities, the generally accepted standards of corporate governance applicable to the relevant industry, and the position of the Authorised Firm in any Group to which it belongs;
- (c) the individual or collective suitability of any Person or Persons connected with the Authorised Firm;
- (d) the extent to which the Authorised Firm has robust human resources policies designed to ensure high standards of conduct and integrity in the conduct of its activities; and
- (e) whether the Authorised Firm has appointed auditors, actuaries and advisers with sufficient experience and understanding in relation to the nature of the Authorised Firm's activities.

Authorised Market Institutions – Other Considerations

2-2-14 In determining whether an Authorised Market Institution has satisfied its Licensing Requirements set out in section 7.2.2 of the AMI module, the DFSA may, in addition to the matters raised in this chapter, consider:

- (a) its arrangements, policies and resources for fulfilling its obligations under the Licensing Requirements;
- (b) the extent to which its constitution and organisation provide for effective governance;
- (c) the arrangements made to ensure that the Governing Body has effective oversight of its Regulatory Functions;
- (d) the access the Key Individuals have to the Governing Body;
- (e) the size and composition of the Governing Body including:
 - (i) the number of independent Directors in the Governing Body;

- (ii) the number of members of the Governing Body who represent Members of the Authorised Market Institution or other persons and the types of persons whom they represent; and
 - (iii) the number and responsibilities of any members of the Governing Body with executive roles within the Authorised Market Institution.
- (f) the structure and organisation of its Governing Body, including any distribution of responsibilities among its members and committees;
 - (g) the integrity, qualifications and competence of its Governing Body and Key Individuals;
 - (h) its arrangements for ensuring that it employs individuals who are honest and demonstrate integrity; and
 - (i) the independence of its regulatory and listings departments from its commercial departments.

2-2-15 The DFSA will consider a Director to be “independent” if the Director is found, on the reasonable determination by the Governing Body, to:

- (a) be independent in character and judgement; and
- (b) have no relationships or circumstances which are likely to affect or could appear to affect the Director’s judgement in a manner other than in the best interests of the Authorised Market Institution.

2-2-16 In forming a determination the Governing Body should consider the length of time the Director has served as a member of the Governing Body and whether the relevant Director:

- (a) has been an employee of the Authorised Market Institution or group within the last five years;
- (b) has or has had, within the last three years, a material business relationship with the Authorised Market Institution, either directly or as a Partner, shareholder, Director or senior employee of a body that has such a relationship with the Authorised Market Institution;
- (c) receives or has received, in the last three years, additional remuneration or payments from the Authorised Market Institution apart from a Director’s fee, participates in the Authorised Market Institution’s share option, or a performance-related pay scheme, or is a member of the Authorised Market Institution’s pension scheme;
- (d) is or has been a Director, Partner or Employee of a firm which is the Authorised Market Institution’s auditor;
- (e) has close family ties with any of the Authorised Market Institution’s advisors, Directors or senior employees;

- (f) holds cross directorships or has significant links with other Directors through involvement in other bodies; or
- (g) represents a significant shareholder.

2-3 ASSESSING THE FITNESS AND PROPRIETY OF AUTHORISED INDIVIDUALS AND PRINCIPAL REPRESENTATIVES

Introduction

2-3-1 This section sets out the matters which the DFSA takes into consideration when assessing the fitness and propriety of an Authorised Individual or Principal Representative under section 7.6 of the GEN module and section 4.2 of the REP module, respectively.

2-3-2 In order to assess the fitness and propriety of a proposed Authorised Individual or Principal Representative, the DFSA may request an interview with the proposed individual.

2-3-3 In respect of Authorised Individuals, Article 53(2) of the Regulatory Law 2004 provides that applications for Authorised Individual status in respect of Licensed Function roles must be made by both the individual seeking to be authorised and the Authorised Firm for which that individual is to perform services.

2-3-4 Under Articles 55 & 56 of the Regulatory Law 2004, the DFSA may reject an application for Authorised Individual status or extension to such status or grant Authorised Individual status or extension to such status with or without conditions and restrictions.

Integrity

2-3-5 In determining whether an individual has satisfied the DFSA as to his integrity, the DFSA may have regard to matters including, but not limited to, the following:

- (a) the propriety of an individual's conduct whether or not such conduct may have resulted in the commission of a criminal offence, the contravention of a law or the institution of legal or disciplinary proceedings of whatever nature;
- (b) a conviction or finding of guilt in respect of any offence, other than a minor road traffic offence, by any court of competent jurisdiction;
- (c) whether the individual has ever been the subject of disciplinary proceedings by a government body or agency or any recognised self regulatory organisation or other professional body;
- (d) a contravention of any provision of financial services legislation or of rules, regulations, statements of principle or codes of practice made under or by a recognised self regulatory organisation, Authorised Market Institution, regulated exchange or regulated clearing house or Financial Services Regulator;
- (e) a refusal or restriction of the right to carry on a trade, business or profession requiring a licence, registration or other authority;
- (f) a dismissal or a request to resign from any office or employment;

- (g) whether an individual has been or is currently the subject of or has been concerned with the management of a Body Corporate which has been or is currently the subject of an investigation into an allegation of misconduct or malpractice;
- (h) an adverse finding in a civil proceeding by any court of competent jurisdiction of fraud, misfeasance or other misconduct, whether in connection with the formation or management of a corporation or otherwise;
- (i) an adverse finding or an agreed settlement in a civil action by any court or tribunal of competent jurisdiction resulting in an award against the individual in excess of \$10,000 or awards that total more than \$10,000;
- (j) an order of disqualification as a director or to act in the management or conduct of the affairs of a corporation by a court of competent jurisdiction or regulator;
- (k) whether the individual has been a director, or concerned in the management of, a body corporate which has gone into liquidation or administration whilst that person was connected with that body corporate or within one year of such a connection;
- (l) whether the individual has been a partner or concerned in the management of a partnership where one or more partners have been made bankrupt whilst that person was connected with that partnership or within a year of such a connection;
- (m) whether the individual has been the subject of a complaint in connection with a financial service, which relates to his integrity, competence or financial soundness;
- (n) whether the individual has been censured, disciplined, publicly criticised by, or has been the subject of a court order at the instigation of, the DFSA, or any officially appointed inquiry, or Financial Services Regulator; and
- (o) whether the individual has been candid and truthful in all his dealings with the DFSA.

Competence and capability

2-3-6 In determining the competence and capability of an individual, the DFSA may have regard to any factors, whether in the U.A.E. or elsewhere including, whether an individual is capable of performing functions which his Authorised Firm employs or intends to employ him to perform.

Financial soundness

2-3-7 In determining the financial soundness of an individual, the DFSA may have regard to any factors including, but not limited to, the following:

- (a) whether an individual is able to meet his debts as they fall due; and
- (b) whether an individual has been adjudged bankrupt, had a receiver or an administrator appointed, had a bankruptcy petition served on him, had his estate sequestered, entered into a deed of arrangement (or any contract in relation to a failure to pay due debts) in favour of his creditors or, within the last 10 years, has

failed to satisfy a judgement debt under a court order, whether in the U.A.E. or elsewhere.

2-4 WAIVERS DURING AUTHORISATION

2-4-1 An applicant for authorisation may request a waiver whilst its application for authorisation is being processed. In some circumstances, the applicant may need to work with the DFSA in developing the waiver and may not be required to use the formal application process. However, the written consent to the waiver by the Authorised Person will then be required once the applicant is authorised.

2-5 START-UP ENTITIES IN THE DIFC

General

2-5-1 This section replaces DFSA Policy Statement 2/2005 on Start Up Entities in the DIFC — as amended on 16 February 2006.

What are "Start up Entities"?

2-5-2 Start up entities are, either:

- (a) new financial services businesses; or
- (b) existing financial services businesses which have never been subject to financial services regulation, for whatever reason.

2-5-3 This section is designed to serve as a guide to assist start up entities which are interested in applying for authorisation by the DFSA to conduct Financial Services in or from the DIFC. This section sets out the information required to support an application and indicates the criteria that the DFSA may apply in the authorisation process. Start ups, as with any other applicants, will be required to satisfy all relevant aspects of the DFSA's rules and authorisation process prior to being granted a licence.

2-5-4 Considering the restriction in Article 4(1) (a) of the Federal Law No 8 of 2004, the DFSA may not authorise a new entity proposing to form in the DIFC to carry out banking activities, unless it is a branch or a wholly owned subsidiary of an existing bank or a joint venture between parties, in which each party must be an existing bank. In formulating this policy the DFSA recognises that it is not practical to provide information on the application of the policy to every possible scenario. Therefore, interested parties are invited to contact the DFSA if they have questions about the application of the policy to their particular circumstances.

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

2-5-5 Any consideration of an application for authorisation received by the DFSA is likely to involve an assessment of the risks posed to the objectives of the DFSA by the proposed activities of the applicant. Whilst the broad categories of risks for all applicants will be the same, the nature of those risks within start up entities will be unique, as start ups do not have a regulatory track record upon which the DFSA may place reliance. In the case of a new business, even where senior management has substantial experience and relevant

competence in the business sector, this does not necessarily imply an ability to create and sustain an adequate management control environment and compliance culture, particularly when faced with all the other issues of establishing a new business.

2-5-6 In the case of an existing, but previously unregulated business, any existing control environment and compliance culture may not have been subject to external independent regulatory scrutiny and the additional regulatory reporting requirements which apply to an authorised firm.

2-5-7 The broad categories of risk and some of the unique elements of those risk categories that apply to start up entities include financial risk, governance risk, business/operational risk and compliance risk.

Financial Risk

2-5-8 All applicants are required to demonstrate a sound initial capital base and funding and to meet the relevant prudential requirements of the DFSA rulebook, on an ongoing basis. This may include holding sufficient capital to cover expenses on a zero revenue basis. Inevitably, start up entities face greater financial risks as they seek to establish and grow a new business.

2-5-9 In addition to the risks associated with the financial viability of the start up entity, particular attention may be focussed on the clarity and the verifiable source of the initial capital funding. Start up entities may be required to disclose the source of their funds and the history of those funds for at least the previous 12 months.

Governance Risk

2-5-10 All applicants are required to demonstrate robust governance arrangements together with the fitness and integrity of all controllers, directors and senior management. The DFSA is aware that management control, in smaller start ups especially, may lie with one or two dominant individuals who may also be amongst the owners of the firm. In such circumstances, the DFSA would expect the key business and control functions (i.e. risk management, compliance and internal audit) to be subject to appropriate oversight arrangements which reflect the size and complexity of the business. Applicants can assist the DFSA by describing in detail the ownership structure, high level controls and clear reporting lines which demonstrate an adequate segregation of duties.

2-5-11 The DFSA may request details of the background, history and ownership of the start up entity and, where applicable, its Group. Similar details relating to the background, history and other interests of the directors of the start up entity may also be required. Where it considers it necessary to do so, the DFSA may undertake independent background checks on such material. A higher degree of due diligence will apply to individuals involved in start up entities and there would be an expectation that the entity itself will have conducted detailed background checks, which may then be verified by the DFSA.

Business/Operational Risk

2-5-12 All applicants are required to establish appropriate systems and control environment to demonstrate that the affairs of the firm are managed and controlled effectively. The nature of the systems and controls may depend on the nature, size and complexity of the business. Start up entities may wish to consider which additional systems and controls may be

appropriate in the initial period of operation following launch, such as increased risk or compliance monitoring. Due to the unproven track record of start up entities, the DFSA may impose restrictions on the business activities of the entity or a greater degree and intensity of supervision until such a track record is established.

Compliance Risk

2-5-13 The Senior Executive Officer within all Authorised Firms is expected to take full responsibility for ensuring compliance with the DFSA rules by establishing a strong compliance culture which is fully embedded within the organisation. To this end, a start up entity will be required to appoint a UAE resident Compliance Officer and Money Laundering Reporting Officer (MLRO) with the requisite skills and relevant experience in compliance and anti money laundering duties. The individuals fulfilling these roles within start up entities may be expected to demonstrate to the DFSA their competence to perform the proposed role and adequate knowledge of the relevant sections of the DFSA rulebook and, in the case of the MLRO, the wider anti-money laundering legislation and related provisions.

Main Information Requirements

2-5-14 The main information requirements are the same for all applicants, including start ups, and each application will be assessed on its own merits. It may help if start up applicants consider the risk categories set out above and how they will address the particular risks raised by their start up proposition.

2-5-15 A key document will be the regulatory business plan submitted in support of the application. It will facilitate the application process if applicants cover the following areas within this submission:

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

2-5-16 Start up applicants may find it useful to include diagrams illustrating corporate structures, and, where applicable, group relationships, governance arrangements, organisational design, clear reporting lines, business process flows and systems environments.

2-5-17 Comprehensively addressing these areas and detailing how the key risks will be identified, monitored and controlled may significantly assist the DFSA in determining applications from start up entities.

2-6 APPLICATION FOR A RETAIL ENDORSEMENT

2-6-1 Section 7.3 of the GEN module provides that an applicant intending to carry on a Financial Service with a Retail Client requires an endorsement on its Licence.

2-6-2 When assessing an application for a Retail Endorsement, the DFSA may consider, among other things, the following:

- (a) the adequacy of an applicant's systems and controls for carrying on Financial Services with a Retail Client;
- (b) whether the applicant is able to demonstrate that its systems and controls (including policies and procedures) adequately provide for, among other things, compliance with the requirements specifically dealing with Retail Clients in the COB module, in particular:
 - (i) marketing materials intended for Retail Clients;
 - (ii) the content requirements for Client Agreements for Retail Clients;
 - (iii) the suitability assessment for recommending a financial product for a Retail Client;
 - (iv) the disclosure of fees and commissions, and any inducements, to a Retail Client; and
 - (v) the segregation of Client Money and/or Client Investments, where relevant;
- (c) whether the applicant has adequate systems and controls to ensure, on an ongoing basis, that its Employees remain competent and capable to perform the functions which are assigned to them, including any additional factors that may be relevant if their functions involve interfacing with Retail Clients; and
- (d) the adequacy of the applicant's Complaints handling policies and procedures. An applicant's policies and procedures must provide for fair, consistent and prompt handling of complaints. In addition to the matters set out in Chapter 9 of the GEN module, the policies and procedures should explicitly deal with how the applicant ensures that:
 - (i) Employees dealing with Complaints have adequate training and competencies to handle Complaints, as well as impartiality and sufficient authority (see GEN Rules 5.3.19, 9.2.7 and 9.2.8);
 - (ii) a Retail Client is made aware of the firm's Complaints handling policies and procedures before obtaining its services (see COB Rule A2.1.2(1)(h)); and
 - (iii) the applicant's Complaints handling policies and procedures are freely available to any Retail Client upon request (see COB Rule 9.2.11).

2-7 APPLICATION FOR AN ISLAMIC ENDORSEMENT

2-7-1 Pursuant to Article 9 of the Law Regulating Islamic Financial Business 2004, in order to conduct Islamic Financial Business, an Authorised Person must have an endorsed Licence authorising it to conduct business either as an Islamic Financial Institution or as an Islamic Window. Conducting Islamic Financial Business means carrying on one or more Financial Services in accordance with Shari'a.

2-7-2 An Authorised Person who is granted an endorsement to operate an Islamic Window may conduct some of its Financial Service activities in a conventional manner while conducting its Islamic Financial Business through the Islamic Window.

2-7-3 The DFSA may grant an Islamic Endorsement only if it is satisfied that the applicant has demonstrated that it has the systems and controls in place to undertake Islamic Financial Business. In deliberating over the granting of an Islamic Endorsement, the DFSA may consider, among other things, those matters set out in the IFR Module of DFSA's Rulebook.

2-8 APPLICATION TO BE A REPRESENTATIVE OFFICE

2-8-1 An applicant seeking to become a Representative Office will need to comply with requirements including those set out in the REP module and take note of any applicable matters set out in section 2.2 of the RPP.

2-8-2 In assessing an application for a Representative Office, the DFSA is likely to assess matters including whether:

- (a) the proposed activities to be undertaken by the applicant are consistent with the Financial Service activity of Operating a Representative Office as described in section 2.26 of the GEN module; and
- (b) the applicant is incorporated and regulated by a Financial Services Regulator in a jurisdiction other than the DIFC.

2-8-3 Further general information in relation to the DFSA's Representative Office regime can be located in a Question and Answer document accessible on:

<http://www.dfsa.ae/Pages/DFSALibrary/DFSAPublications/Publications.aspx>

2-9 APPLICATION TO BE AN ANCILLARY SERVICE PROVIDER

2-9-1 An applicant seeking to become an Ancillary Service Provider will need to comply with requirements including those set out in the ASP module.

2-9-2 In respect of Ancillary Service Providers, Article 44(1) of the Regulatory Law 2004 prohibits a Person from carrying on an Ancillary Service in or from the DIFC unless the Person is registered as an Ancillary Service Provider.

2-9-3 Chapter 4 of the ASP module outlines some of the matters required to be addressed when making an application to carry on Ancillary Services. The activities which constitute

Ancillary Services are defined in the ASP module as Providing Legal Services and Providing Accountancy Services.

2-9-4 ASP Rule 4.2.2 provides that applications for registration as an Ancillary Service Provider may be submitted only by a Body Corporate or Partnership.

2-9-5 The DFSA will have particular regard to whether the firm, or anyone in a position of influence in or over it, has criminal convictions or been the subject of adverse findings by courts or regulatory authorities in the UAE or elsewhere, or is known to have engaged in dishonest or improper business practices.

2-10 APPLICATION TO BE A REGISTERED AUDITOR

2-10-1 An applicant seeking to become a Registered Auditor will need to comply with requirements including those set out in chapter 8 of the GEN module and Part 8 of the Regulatory Law 2004.

2-10-2 Authorised Firms and Authorised Market Institutions that are Domestic Firms and Operators of Domestic Funds are required to appoint and retain Auditors who are registered for the duration of the audit. A Person intending to audit Authorised Firms or Authorised Market Institutions (that are Domestic Firms), or Domestic Funds, must apply to the DFSA for registration in accordance with the GEN module.

2-10-3 An applicant for registration should be able to demonstrate to the DFSA's satisfaction that:

- (a) it has professional indemnity insurance as required in section 8.17 of the GEN module;
- (b) it has adequate systems, procedures and controls to ensure due compliance with:
 - (i) the International Standards on Auditing;
 - (ii) the International Standards on Quality Control; and
 - (ii) the Code of Ethics for Professional Accountants;
- (c) where applicable, it has adequate systems, procedures and controls to ensure due compliance with:
 - (i) the Islamic Accounting and Auditing Standards; and
 - (ii) the Code of Ethics for Accountants and Audit Firms of Islamic Financial Institutions;
- (d) it is controlled by Persons each of whom holds a Recognised Professional Qualification from a Recognised Professional Body; and
- (e) it has complied with any other requirement as specified by the DFSA.

3 SUPERVISION - BEING REGULATED

3-1 DFSA'S APPROACH TO SUPERVISION

Introduction

3-1-1 Chapter 3 focuses on the DFSA's risk-based approach to supervision and the ongoing relationship between the DFSA and an Authorised Person, Ancillary Service Provider or Registered Auditor (collectively referred to as firms in this Chapter unless otherwise stated).

3-1-2 Whilst section 3.1 outlines the DFSA's general approach to risk based supervision, the remaining sections (3.2 to 3.6) provide additional information in relation to the DFSA's approach to the supervision of a particular type of firm.

3-1-3 The appropriate use of the DFSA's supervisory powers plays an important part in ensuring that the DFSA achieves its statutory objectives and has regard to its guiding principles which are set out in chapter 1.

Supervision philosophy

3-1-4 The DFSA has adopted a risk-based approach to the regulation and supervision of a firm in order to concentrate its resources on the mitigation of risks to its objectives. The DFSA will work with an entity to identify, assess, mitigate and control these risks where appropriate.

3-1-5 The DFSA's supervisory approach is based upon:

- (a) developing a strong relationship with a firm and its senior management, as set out in paragraphs 3-1-7 to 3-1-9;
- (b) where applicable, considering any lead or consolidated supervision which a firm or its Group may be subject to in other jurisdictions, taking into account the DFSA's relationship with other regulators, set out in paragraphs 3-1-10 to 3-1-11;
- (c) utilising its risk-based approach to supervision, including the risk assessment and classification of a firm, as part of the DFSA's continuous risk management cycle, set out in paragraphs 3-1-12 to 3-1-19; and
- (d) using appropriate supervisory tools, set out in paragraphs 3-1-20 to 3-1-40 and further set out in sections 3.2 to 3.6. In relation to these supervisory tools, paragraphs 3-1-30 to 3-1-42 only apply to Authorised Persons

3-1-6 The DFSA's risk-based approach to the supervision of a firm may vary depending upon the size, scale, nature and circumstances of each individual firm and the specific risks it poses to the DFSA's objectives.

DFSA's Relationship with firms

3-1-7 In order to meet its objectives, the DFSA requires an open, transparent and co-operative relationship between itself and a firm. The DFSA expects to establish and

maintain an ongoing dialogue with the firm's senior management in order to develop and sustain a thorough understanding of the firm's business, systems and controls and, through this relationship, to be aware of all areas of risk to its objectives.

3-1-8 The DFSA seeks to maintain an up-to-date knowledge of a firm's business. However, a firm is also required to keep the DFSA informed of significant events, or anything related to the firm of which the DFSA would reasonably expect to be notified.

3-1-9 The nature and intensity of the DFSA's relationship with a firm may depend on a number of factors. The DFSA's level of supervision will be proportionate to the risks which the firm poses to the DFSA's objectives and will emphasise the responsibilities of the firm's senior management in identifying, assessing, mitigating and controlling its risks. The greater the impact and probability of the firm's perceived risks, the more intensive the supervisory relationship may be.

Co-operation with other regulators

3-1-10 The DFSA views co-operation with other regulators as an important component of its supervisory activities. Effective co-operation arrangements with other regulators will provide for prompt exchange of information in relation to supervision, investigation and enforcement matters. Usually, co-operation arrangements will be in the form of memoranda of understanding or other arrangements. The information exchange may enhance, for example, the DFSA's understanding of the operations of an Authorised Firm's Group and the effect on the firm.

3-1-11 The DFSA may exercise its powers for the purposes of assisting other regulators or agencies (see Article 39 of the Regulatory Law 2004). The DFSA may also delegate functions and power to representatives of other regulators or agencies (see Article 40 of the Regulatory Law 2004).

Risk management cycle

3-1-12 The DFSA has adopted a continuous risk management cycle. This comprises the identification, assessment, prioritisation and mitigation of risks. This is determined by the use of a risk matrix which covers two factors: Impact and Probability.

Impact and Probability

3-1-13 The Impact Rating is an assessment of the potential adverse consequences that could follow from the failure of, or significant misconduct by, a firm. The potential adverse consequences of failure and misconduct encompass not only the direct financial impact on such firm's customers and stakeholders, but also the potential for damage to the reputation and objectives of the DFSA.

3-1-14 The Probability Rating covers four broad risk groups:

- (a) Corporate Governance, Strategy and Business Model Risks;
- (b) Financial and Operational Risks;
- (c) Conduct of Business Risks to Clients and Markets; and

(d) AML/CTF and Financial Crime.

3-1-15 Within these risk groups are risk elements which the DFSA may review, according to the type of firm, to identify risks that could inhibit the achievement of its objectives.

Risk prioritisation and mitigation

3-1-16 A risk assessment enables the DFSA to allocate its resources in such a way that its supervisory tools are targeted towards those firms and activities which pose a higher risk to the DFSA's objectives.

3-1-17 Whenever appropriate, the DFSA may inform the firm of the steps the firm needs to take in relation to specific risks. Subsequently, the DFSA expects the firm to demonstrate that it has taken appropriate steps to mitigate the risks it poses to the DFSA's objectives.

3-1-18 Where necessary, risk mitigation programmes may be developed with a firm in order to mitigate or remove identified areas of risk.

3-1-19 Whilst the DFSA may discuss certain information with a firm, in particular the specific risks that lead it to assign an overall risk classification to the firm and any necessary remedial actions, it will not usually disclose the final risk classification.

Supervisory Tools

3-1-20 For the purpose of supervision, the DFSA will select those supervisory tools which are most suitable and effective to identify and address particular risks in a specific situation.

3-1-21 Some of the supervisory tools are discussed further below, whilst others are discussed in varying detail in sections 3.2 to 3.6.

Information and documents

3-1-22 In order to supervise the conduct and activities of a firm, the DFSA needs to have access to a broad range of information about a firm's business.

3-1-23 The supervisory power for the DFSA to obtain information and require a firm to produce information and documents is provided under Article 73 of the Regulatory Law 2004.

3-1-24 The DFSA will provide a firm with written notice of the documents and information that are required.

3-1-25 The DFSA may make a request for information and documents from a firm wherever that firm may be located (see Article 73(3) of the Regulatory Law 2004). For example, this allows the DFSA access to the head office of a Branch or Subsidiary and the provision of documents from its head office.

3-1-26 Article 73(4) of the Regulatory Law 2004 allows the DFSA, on application to the Court, to exercise these rights outside the jurisdiction of the DIFC in relation to a Person other than an Authorised Person or Ancillary Service Provider and require such a Person to comply with the requirement or permit the exercise of the DFSA's rights.

Access to premises

3-1-27 The DFSA may enter the premises of a firm during normal business hours or at any other time as may be agreed, for the purpose of inspecting and copying information or documents (at the firm's expense) stored in any form on such premises, as it considers necessary or desirable to meet the objectives of the DFSA (see Article 73(2) of the Regulatory Law 2004).

3-1-28 The DFSA expects to be able to give reasonable notice to a firm when it seeks information, documents, meetings or access to premises. On rare occasions however, the DFSA may seek access to premises without notice, where it is necessary for the DFSA to meet its objectives and the delay is likely to be prejudicial to the interests of the DIFC.

3-1-29 The DFSA is conscious that the decision to exercise these access powers might have a significant impact on a firm and accordingly will do so only when necessary.

Requirement to Provide a Report

3-1-30 Article 74 of the Regulatory Law 2004 provides that the DFSA may require an Authorised Person to provide it with a report on any matter about which the DFSA has required or could require the giving of information or production of documents under Article 73 of the Regulatory Law 2004.

3-1-31 The person appointed to make a report, must be a person nominated or approved by the DFSA. This person is referred to as an independent expert in GEN section 11.12.

3-1-32 Where such a requirement has been made of an Authorised Person, it must take all reasonable steps to ensure that any person who is providing or has provided services to the Authorised Person, gives such assistance as the independent expert may reasonably require.

3-1-33 As outlined in Article 74 of the Regulatory Law 2004, information given or a document produced is admissible in evidence in administrative and civil proceedings, provided that any such information or document also complies with any requirements relating to the admissibility of evidence in such proceedings.

3-1-34 An Authorised Person may appeal to the Regulatory Appeals Committee in respect of the requirement to provide a report (see Article 27(2)(h) of the Regulatory Law 2004).

Procedure to restrict an Authorised Person's business or property

3-1-35 The DFSA has a power to impose restrictions on an Authorised Person's business. This includes prohibiting an Authorised Person from entering into specific or certain types of transactions, from soliciting business from specific or certain types of person or from carrying on business in a specific manner. The DFSA may also require an Authorised Person to carry on business in, and only in, a specified manner (see Article 75 of the Regulatory Law 2004).

3-1-36 Article 76 of the Regulatory Law 2004 provides the DFSA with the power to prohibit or require an Authorised Person to deal with any relevant property in a certain manner.

3-1-37 The DFSA may exercise its powers to impose a prohibition or requirement in circumstances prescribed in GEN Rule 11.13.1. The DFSA is conscious that the decision to exercise these powers may have a significant impact on the Authorised Person and accordingly will only do so where it is necessary for the DFSA to meet its objectives and the delay is likely to be prejudicial to the interests of the DIFC.

3-1-38 Where possible an Authorised Person will receive an opportunity to make representations prior to the DFSA imposing a restriction on its business or property unless the DFSA concludes that any delay likely to arise as a result of such requirement is prejudicial to the interests of the DIFC. When making a representation the process in Appendix 3 to the ENF module should be followed.

3-1-39 An Authorised Person may appeal to the Regulatory Appeals Committee in respect of a restriction imposed on its business or property (see Article 27(2)(h) of the Regulatory Law 2004).

3-1-40 When the DFSA imposes a restriction it will do so in writing setting out matters including:

- (a) the restriction on the business or property;
- (b) the date and time when the restriction takes effect;
- (c) where applicable, the duration of the restriction; and
- (d) the fact that the Authorised Person may appeal to the Regulatory Appeals Committee.

Notifications to the DFSA

3-1-41 Section 11.10 of the GEN module sets out Rules on specified events, changes or circumstances that require notification to the DFSA by an Authorised Person (other than a Representative Office). The list of notifications outlined in section 11.10 is not exhaustive and other areas of the Rulebook may also specify additional notification requirements.

3-1-42 An Authorised Firm and Authorised Market Institution is required to comply with the high level principles in GEN Rule 4.2.10 and AMI Rule 10.2.1 respectively. These Rules require an Authorised Person to deal with the DFSA in an open and co-operative manner and keep the DFSA promptly informed of significant events or anything else relating to such person of which the DFSA would reasonably expect to be notified.

3-2 SUPERVISION OF AUTHORISED FIRMS

Introduction

3-2-1 Section 3.2 provides additional information in relation to DFSA's approach to the supervision of an Authorised Firm. Where relevant, some of these requirements may apply to a Representative Office.

3-2-2 In supervising an Authorised Firm, the DFSA expects an Authorised Firm to comply with a number of high level principles in relation to its activities.

3-2-3 An Authorised Firm, other than a Representative Office, must comply with the eleven principles set out in section 4.2 of the GEN module. In brief, these are:

- (a) Principle 1 – Integrity;
- (b) Principle 2 – Due skill, care and diligence;
- (c) Principle 3 – Management, systems and controls;
- (d) Principle 4 – Resources;
- (e) Principle 5 – Market Conduct;
- (f) Principle 6 – Information and Interests;
- (g) Principle 7 – Conflicts of Interest;
- (h) Principle 8 – Suitability;
- (i) Principle 9 – Customer assets and money;
- (j) Principle 10 – Relations with regulators; and
- (k) Principle 11 – Compliance with high standards of corporate governance.

3-2-4 A Representative Office must comply with the four principles set out in section 3.2 of the REP module. In brief, these are:

- (a) Principle 1 – Integrity;
- (b) Principle 2 – Due skill, care and diligence;
- (c) Principle 3 – Resources; and
- (d) Principle 4 – Relations with regulators

Group supervision

3-2-5 When the DFSA licenses an Authorised Firm, it takes into consideration the relationship with any wider Group to which the firm may belong or with other Persons closely linked to it. The DFSA may also take into account lead or consolidated supervision to which an Authorised Firm or its Group may be subject in another jurisdiction.

3-2-6 An Authorised Firm is expected to provide information as required or reasonably requested under legislation applicable in the DIFC relating to the Authorised Firm and, where applicable, its consolidated or lead regulatory arrangements. This information may include prudential information, reports on systems and controls relating to an Authorised Firm's Group, internal and external audit reports, details of disciplinary proceedings or any matters which may have financial consequences, reputational impact or pose any significant risk to the DIFC or to the Authorised Firm. This information may initially be taken into account as part of DFSA's fit and proper test as set out in AUT and may subsequently be

utilised in the supervision of the Authorised Firm. Further Rules and Guidance with regard to obtaining information from an Authorised Firm's lead regulator are set out in GEN Rule 11.1.6.

3-2-7 The DFSA has an interest in the relationship of an Authorised Firm with other regulators, particularly in order to determine the level of reliance the DFSA may place on a regulator in another jurisdiction concerning any lead supervision arrangements. Depending on the legal structure of an Authorised Firm and the relationship of the DFSA with the regulator in question, the DFSA may place appropriate reliance on the supervision undertaken by this regulator.

Domestic firm's group with DIFC head office

3-2-8 The DFSA will usually be the lead and consolidated regulator of any Group headed by a Domestic Firm. Members of the Group, that is any of the Authorised Firm's Subsidiaries or branches, will be either subject to DFSA's exclusive supervision or, where members of the Group are located in a jurisdiction outside the DIFC, generally subject to lead or consolidated supervision by the DFSA in co-operation with another regulator.

Subsidiary of a non-DIFC firm

3-2-9 The DFSA will routinely be the lead regulator for the purpose of prudential supervision of an Authorised Firm which is a DIFC incorporated Subsidiary of a non-DIFC firm.

3-2-10 Where the Authorised Firm is a Subsidiary of a regulated non-DIFC parent company, the DFSA may have regard to any consolidated prudential supervision arrangements to which the Subsidiary is subject and will liaise with other regulators as necessary to ensure that these are adequately carried out, taking into account the Subsidiary's activities. The DFSA may place appropriate reliance on the Subsidiary's consolidated regulator in another jurisdiction if it is satisfied that it meets appropriate regulatory criteria and standards.

3-2-11 An Authorised Firm carrying on Financial Services as a Subsidiary of an unregulated non-DIFC parent company may be subject to DFSA's consolidated prudential supervision, taking into account the parent's activities.

Branch of a non-DIFC firm

3-2-12 An Authorised Firm carrying on Financial Services through a Branch will be subject to supervision by both the DFSA and the regulator in its head office jurisdiction.

3-2-13 The DFSA will have regard to any lead or consolidated prudential supervision arrangements to which a Branch is subject. The DFSA may place appropriate reliance on a Branch's lead regulator in another jurisdiction and, where appropriate, its consolidated prudential regulator if it is satisfied that it meets appropriate regulatory criteria and standards. Where an Authorised Firm is subject to lead regulation arrangements with a foreign regulator, the DFSA will usually not seek to impose consolidated prudential supervision on the Authorised Firm's Group.

3-2-14 During the authorisation process the DFSA will take into account the nature and scope of the regulation and supervision to which the applicant is subject in its head office jurisdiction. Notwithstanding that an Authorised Firm may be subject to lead or consolidated

regulatory arrangements, the DFSA requires it to remain fit and proper in respect of its Group and Controllers. Certain changes or events will require notification to, or prior approval from, the DFSA.

3-2-15 The DFSA will determine the level of regulatory and supervisory oversight which is subsequently required for a specific Branch. As part of DFSA's risk assessment process, during the authorisation process the DFSA undertakes a two-tier approach to the risks to its objectives posed by the Branch, thereby taking into account the characteristics of the applicant and its head office. The first part of this assessment includes a judgement on the degree of home country supervision and considers the strength of support, both financial and managerial, which the head office is capable of providing to the Branch, taking into account the Branch's activities. The second part of the assessment considers the risk and control mechanisms within the Branch itself.

3-2-16 As a result of the assessment, the DFSA may consider granting a waiver or modification notice in respect of specific prudential or other regulatory requirements relating to a Branch.

Prudential returns for Authorised Firms

3-2-17 An Authorised Firm is required to submit periodic prudential returns. In addition, an Authorised Firm may be required to submit copies of its Group's annual interim and audited accounts. The DFSA may also require an Authorised Firm to provide copies of Group returns which are sent to any other regulator.

Ongoing risk analysis

3-2-18 The DFSA conducts an ongoing analysis of risks relating to each Authorised Firm, although the information required may vary from firm to firm. Authorised Firms with a higher risk classification may be subject to closer regulatory attention and would typically be subject to supervisory reviews specifically designed to address particular causes of risk.

3-2-19 All Authorised Firms will be subject to an individual on-site risk assessment, except where more than one Authorised Firm belongs to the same Group, in which case the DFSA may decide to carry out a Group risk assessment.

3-2-20 The risk assessment process is ongoing and it is expected that the risks of each Authorised Firm may be reviewed on at least an annual basis. Notifications, reporting of information, an on-going dialogue with senior management and visits to the Authorised Firm will ensure that the DFSA has current information on key risk areas of the Authorised Firm.

3-2-21 There are also a number of trigger events which may affect the frequency of a risk assessment and the Authorised Firm's overall risk classification. Examples include:

- (a) a notification from a non-DIFC regulator or other authority of an issue concerning the Authorised Firm or its Group;
- (b) a material change in an Authorised Firm's business and new business activities;
- (c) a change in the Authorised Firm's Controllers;
- (d) an Authorised Firm's development of high risk products or business lines;

- (e) an Authorised Firm's development of business areas with characteristics such as unusual profitability;
- (f) an Authorised Firm's appointment of new personnel in key business areas;
- (g) an Authorised Firm's acquisition of new or revised information systems or new technology;
- (h) a rapid growth in specific areas of activity of an Authorised Firm;
- (i) an Authorised Firm's corporate restructuring, merger or acquisitions;
- (j) an Authorised Firm's expansion or acquisition of non-DIFC operations including the impact of changes in related economic and regulatory environments; or
- (k) the DFSA's response to industry-wide concerns or themes.

Review of risk management systems

3-2-22 Pursuant to GEN Rule 5.3.4, an Authorised Firm must ensure that its risk management systems provide the Authorised Firm with the means to identify, assess, mitigate and control its risks. In addition to undertaking its own assessment of the Authorised Firm, the DFSA may review the results of the Authorised Firm's internal risk assessment and determine the extent to which each of the Authorised Firm's risks impacts on DFSA's objectives, the likelihood of the risk occurring and then will consider the controls and mitigation programmes the firm has in place.

Desk based reviews

3-2-23 The DFSA may undertake desk based reviews in order to review compliance with legislation applicable in the DIFC. They assist the DFSA's understanding of an Authorised Firm's operations. For example, monitoring its financial position and detecting emerging problems or concerns to be explored in greater detail through prudential meetings, examinations, or otherwise. A desk based review may involve analysing information provided by the firm through supervisory returns, internal management information or published financial information.

3-2-24 The DFSA may, from time to time, issue a Controls questionnaire to Authorised Firms who will be asked to complete and return this to the DFSA. A Controls questionnaire focuses on key areas of risk identified by the DFSA at that time. An Authorised Firm must evaluate itself against each of the risk areas and score itself in terms of its own arrangements and the systems and controls it has in place for mitigating the particular risks.

On-site visits

3-2-25 On-site visits provide the DFSA with an overview of the Authorised Firm's operations and enable it to form a first hand view of the personnel, systems and controls and compliance culture within the Authorised Firm as well as identifying and evaluating the risks to the DFSA's objectives, taking into account any mitigation by the Authorised Firm. They enable the DFSA to test the soundness of the Authorised Firm's systems and controls and the extent to which the DFSA can continue to rely on them and the Authorised Firm's senior

management to prevent or mitigate risks to the DFSA's objectives. On-site visits will also assist the DFSA to assess the extent of supervision and the use of other supervisory tools required to address certain key risk areas.

3-2-26 There are various types of on-site visits by the DFSA to an Authorised Firm which differ in their objective and frequency:

- (a) Periodic visits are undertaken at frequencies determined by the DFSA and focus on the main risk areas within an Authorised Firm as well as providing the DFSA with a thorough understanding of the Authorised Firm, its business and any major changes that have taken place within the Authorised Firm since a previous visit or risk assessment and their probable effects;
- (b) Theme visits are designed to address a current or topical risk or issue either within a particular type of Authorised Firm or the market place in general. They tend to be short in duration and are focused in their approach. Examples of theme visits are anti money laundering, client assets and conflict management;
- (c) Follow-up visits are often required to assess the implementation of any action that may have been agreed as part of a risk mitigation programme or to satisfy the DFSA that the Authorised Firm has taken appropriate action arising from a previous visit or communication;
- (d) Special visits are unique to a particular Authorised Firm and are generally scheduled following a particular event or notification from an Authorised Firm. They are generally short, focused visits usually targeted to a particular area of an Authorised Firm. These visits allow the DFSA to review certain high risk areas of an Authorised Firm's business in isolation. Occasionally, special visits may be unannounced. These assist in keeping firms alert to the need to maintain a continuously high quality of compliance; and
- (e) The DFSA may, from time to time, hold high level meetings with an Authorised Firm's senior management. Such meetings enable the DFSA to assess issues including any prudential concerns arising from desk based reviews or elsewhere.

Periodic Communications

3-2-27 The DFSA is committed to open and transparent communication with Authorised Firms. From time to time, the DFSA may issue letters to Senior Executive Officers or equivalent persons across the DIFC (commonly referred to as 'Dear SEO Letters'). Frequently, these letters will be issued as a means of communicating findings arising from completed thematic visits. However, they may also be issued in response to other major events or changes. For example, such a letter may include an update from relevant United Nations Security Council Sanctions or Resolutions or the Financial Action Task Force, in relation to the prevention of money laundering and combating the financing of terrorism.

3-2-28 In addition to the Senior Executive Officer letters, the DFSA may issue alerts and warnings in response to particular matters of concern. An example of this could be in relation to matters concerning fraudulent activity that the DFSA has become aware of.

3-2-29 The DFSA holds outreach sessions from time to time, to interact with firms operating in the DIFC. These sessions are held to discuss regulatory matters in an open manner.

3-2-30 From time to time, the DFSA may consider a particular item of communication to an Authorised Firm to be of key regulatory importance. For this reason, the DFSA may consider it necessary to issue such communications directly to a senior member of staff at the Board level of the DIFC entity copied (where appropriate) to the group's home state regulator. For entities established as a Branch in the DIFC, these communications will likely be delivered to the Chairman of the Board at the DIFC Branch entity's head or Parent office. For DIFC incorporated entities, communications will likely be delivered directly to the Chairman of the firm's Board or head office. These communications may include, for example, the results of DFSA's risk assessment visits where a risk mitigation plan has been sent that contains significant matters of concern to DFSA's objectives.

External auditor reports, statements and tripartite meetings

3-2-31 The DFSA requires an Authorised Firm's registered external auditor to co-operate with the DFSA in a number of ways, including the submission of specific audit reports and statements. As part of an audit, the DFSA would expect an auditor to review any relevant correspondence between the DFSA and the Authorised Firm. Further, tripartite meetings between the Authorised Firm's senior management, the auditor, and the DFSA may be requested at the DFSA's initiative. Finally, an auditor is required to disclose to the DFSA those matters outlined in Article 104(3) of the Regulatory Law 2004.

Requiring information and documents

3-2-32 Apart from reports such as regular prudential returns, the DFSA may from time to time also request from an Authorised Firm additional supplementary information and documents, including non-financial information such as an Authorised Firm's internal policies on particular areas of risk or its organisational chart.

Application for a Change in Control

3-2-33 Article 64 of the Regulatory Law 2004 and section 11.8 of the GEN Module govern DFSA's requirements relating to a change in control.

3-2-34 Where the DFSA requires further information in relation to a notification made in accordance with GEN Rule 11.8.5, it may seek to request such information within a reasonable period of time of receipt of the original notification.

3-2-35 The DFSA will endeavour to act on an application for prior approval made in accordance with GEN Rule 11.8.6 within 28 days of receipt of all the required information being submitted, or such shorter time as may be agreed in exceptional circumstances.

3-2-36 The DFSA may require further information relating to an application for approval within 28 days of receipt of the application where such additional information is required in order to determine the fitness and propriety of the Authorised Firm in light of the changes referred to in the application or notification.

Application for a Change of Scope of Licence

3-2-37 Where an Authorised Firm applies to change the scope of its Licence, it should provide the following information:

- (a) a revised business plan as appropriate, describing the basis of, and rationale for, the proposed change;
- (b) details of the extent to which existing documentation, procedures, systems and controls will be amended to take into account any additional activities, and how the Authorised Firm will be able to comply with any additional regulatory requirements; and
- (c) descriptions of the Authorised Firm's senior management responsibilities (see GEN chapter 5) where these have changed from those previously disclosed, including any up-dated staff organisation charts and internal and external reporting lines.
- (d) details of any transitional arrangements where the Authorised Firm is reducing its activities and where it has existing customers who may be affected by the cessation of a Financial Service;
- (e) the appropriate financial reporting statement where the variation may result in a change to the Authorised Firm's prudential category or the application of additional or different financial rules. If a capital increase is required in order to demonstrate compliance with additional financial rules but such capital is not paid up or available at the time of application, proposed or forecast figures may be used;
- (f) details of the effect of the proposed variation on the Authorised Individuals including, where applicable, submitting any application forms for individuals to perform additional or new Licensed Functions, or to remove existing Licensed Functions; and
- (g) revised pro forma financial statements.

3-2-38 An Insurer which wishes to vary its Licence to remove the Financial Service of Effecting Contracts of Insurance or to reduce the classes of insurance should refer to the run-off provisions in PIN chapter 9.

3-2-39 In considering whether an Authorised Firm is fit and proper with respect to a change in the scope of its Licence, the DFSA may take into account those matters in Chapter 2 of the RPP Sourcebook, which provides Guidance on fitness and propriety for Authorised Firms.

3-2-40 When considering a change to the scope of a Licence, the DFSA may also consider one or more of the matters outlined in paragraphs 3-2-41 to 3-2-46 below relating to the withdrawal of a Licence.

Application for a Withdrawal of Licence

3-2-41 In considering requests under GEN Rule 11.4.1, an Authorised Firm will need to satisfy the DFSA that it has made appropriate arrangements with respect to its existing customers, including the receipt of any customers' consent where required and, in particular:

- (a) whether there may be a long period in which the business will be run-off or transferred;
- (b) whether deposits must be returned to customers;

- (c) whether money and other assets belonging to customers must be returned to them; and
- (d) whether there is any other matter which the DFSA would reasonably expect to be resolved before granting a request for the withdrawal of a Licence.

3-2-42 In determining a request for the withdrawal of a Licence, the DFSA may require additional procedures or information as appropriate including evidence that the Authorised Firm has ceased to carry on Financial Services.

3-2-43 An Authorised Firm should submit detailed plans where there may be an extensive period of wind-down. It may not be appropriate for an Authorised Firm to immediately request a withdrawal of its Licence in all circumstances, although it may wish to consider reducing the scope of its Licence during this period. Authorised Firms should discuss these arrangements with the DFSA.

3-2-44 The DFSA may refuse a request for the withdrawal of a Licence where it appears that customers may be exposed to adverse effect.

3-2-45 The DFSA may also refuse a request for the withdrawal of a Licence where:

- (a) the Authorised Firm has failed to settle its debts to the DFSA; or
- (b) it is in the interests of a current or pending investigation by the DFSA, or by another regulatory body or Financial Services Regulator.

3-2-46 Some other matters which an Authorised Firm should be mindful of in relation to the withdrawal of its Licence include:

- (a) Under Article 63 of the Regulatory Law 2004 where the DFSA grants a request for the withdrawal of a Licence, the DFSA may continue to exercise any power under the Regulatory Law 2004 or Rules in relation to an Authorised Firm or Authorised Individual for two years from the date on which the Licence was withdrawn;
- (b) Article 43(2) of the Regulatory Law 2004 states that Licensed Functions of an Authorised Firm shall be carried out by its Authorised Individuals. Accordingly, where an Authorised Firm's Licence is withdrawn, the authorised status of its Authorised Individuals will also be withdrawn from the same date. However, this does not remove the obligation on an Authorised Firm to provide a statement under GEN Rule 11.7.3 where an Authorised Individual has been dismissed or requested to resign; and
- (c) Where a Fund Manager or the Trustee makes a request under GEN Rule 11.4.1, the Fund Manager or the Trustee will need to satisfy the DFSA that it has made appropriate arrangements in accordance with the requirements under the Collective Investment Law 2010 and the CIR module with respect to the continuing management of the Fund for which it is the Fund Manager or the Trustee, as the case may be.

Notification to the DFSA relating to a Major Acquisition

3-2-47 GEN Rule 11.10.8 provides that an Authorised Firm which makes or proposes to make a Major Acquisition as defined must comply with either GEN Rule 11.10.9 or 11.10.10, depending on whether it is a Domestic Firm.

3-2-48 An Authorised Firm should provide to the DFSA information that would enable the DFSA to consider factors noted in GEN Rule 11.10.9(3). Although the DFSA does not prescribe the form in which such information is to be provided to the DFSA, Authorised Firms should consider any relevant industry and international practices when providing information to the DFSA for similar purposes.

3-2-49 The 45 day notice period referred to in GEN Rule 11.10.9(1) commences to run from the first business day after the date on which the DFSA receives the notification. However, if any critical information that the DFSA requires in order to assess the notification has not been provided to the DFSA at the time of the notification, the relevant notice period for considering that notification will only commence to run after the Authorised Firm has provided to the DFSA that information upon a request made by the DFSA under its powers in GEN Rule 11.10.11(1).

3-2-50 Upon the request of an Authorised Firm, the DFSA may, at its sole discretion, agree to consider a notification within a shorter period than the 45 days referred to above. The onus is on an Authorised Firm which wishes to obtain a DFSA decision under this Rule within a shorter period to make a request to that effect to the DFSA and provide all the information that the DFSA requires to enable the DFSA to process the notification within a shorter timeframe.

3-2-51 Where the DFSA exercises its powers under this provision to object to a proposed Major Acquisition or impose any conditions relating to such a Major Acquisition, a Person affected by such a decision may make an appeal relating to that decision to the DFSA's Regulatory Appeals Committee. Appeal provisions are in GEN Rule 11.10.12.

3-2-52 Where the DFSA receives a notification under GEN Rule 11.10.10(1)(b), it will to the extent necessary, liaise with the home regulator in taking any appropriate action relating to the proposed Major Acquisition.

Outsourcing

3-2-53 An Authorised Firm must comply with those requirements in GEN Rules 5.3.21 and 5.3.22 when outsourcing functions or activities. In relation to Funds, there are additional outsourcing and delegation requirements applicable for Fund Managers and Trustees in section 8.12 of the CIR module.

3-2-54 The DFSA requires an Authorised Firm to notify it of any material outsourcing arrangements. An outsourcing arrangement would be considered to be material if it is a service of such importance that weakness or failure of the service would cast serious doubt on the Authorised Firm's continuing ability to remain fit and proper or comply with applicable Laws and Rules.

3-2-55 The outsourcing of functions or activities does not absolve management or Governing Body of responsibility and accountability for ensuring proper administration and execution of these functions or activities.

3-3 SUPERVISION OF REPRESENTATIVE OFFICES

3-3-1 The DFSA expects to undertake periodic visits to Representative Offices as part of its risk based approach to supervising firms. The DFSA may also include Representative Offices in thematic visits.

3-3-2 Onsite visits to Representative Offices are likely to focus on issues including:

- (a) confirming that activities undertaken by the Representative office are allowed under its licence;
- (b) reviewing the adequacy of its systems and controls to comply with its AML responsibilities;
- (c) any solvency concerns with the head office or Group; and
- (d) the firm's disclosure of its regulated status.

3-3-3 The onsite visit is likely to include interviews with the Principal Representative and a review of relevant records.

3-4 SUPERVISION OF ANCILLARY SERVICE PROVIDERS

3-4-1 The DFSA expects to undertake periodic visits of Ancillary Service Providers as part of its risk based approach to supervising firms. The DFSA may also include Ancillary Service Providers in thematic visits.

3-4-2 Onsite visits to Ancillary Service Providers are likely to focus on their compliance with relevant AML/CTF Laws and Rules. This may include the DFSA testing the firm's systems and controls for conducting a money laundering risk assessment, customer due diligence and complying with relevant United Nations Security Council Sanctions and Resolutions.

3-4-3 The onsite visit is likely to include interviews with senior management and a review of relevant records. Depending on the outcome of the visit, the DFSA may provide a letter to the firm to discuss its findings.

3-4-4 The DFSA also expects to receive a copy of the annual Anti Money Laundering Officer ("AMLO") report from Ancillary Service Providers (see ASP Rule 6.4.5(2)).

3-5 SUPERVISION OF REGISTERED AUDITORS

3-5-1 The DFSA expects to undertake periodic visits of Registered Auditors as part of its risk based approach to supervising firms. The DFSA may include Registered Auditors in some thematic visits.

3-5-2 The DFSA is likely to request an annual information report from all Registered Auditors. The information report will request details such as:

- (a) outcome of a fit and proper assessment undertaken by the Registered Auditor;

- (b) any professional indemnity insurance obtained by the Registered Auditor;
- (c) names of the Authorised Firms audited;
- (d) continuing professional development undertaken by relevant employees of the Registered Auditor;
- (e) any other activities undertaken by the Registered Auditor; and
- (f) complaints received by the Registered Auditor.

3-5-3 The DFSA is likely to undertake a desk based review of the content of the annual information report it receives from a Registered Auditor. Prior to scheduling an onsite visit, the DFSA is likely to make a request for further information from the Registered Auditor.

3-5-4 The onsite visit is likely to include interviews with senior management and a review of files/documentation.

3-6 SUPERVISION OF AUTHORISED MARKET INSTITUTIONS

Introduction

3-6-1 The Regulatory Law 2004 establishes a principles-based framework for the licensing and supervision of Authorised Market Institutions and for taking regulatory action against those licensed institutions. This framework is supplemented by supervisory powers and other requirements in the Markets Law 2004.

3-6-2 The Markets Law 2004 establishes a framework in relation to how an Authorised Market Institution administers and operates an Official List of Securities and stipulates some specific Rule requirements in respect of this.

Official list of securities

3-6-3 Where an Exchange administers and operates an Official List of Securities, the risk-based approach to supervision also applies to the carrying on of this activity.

Group supervision

3-6-4 When the DFSA licenses an Authorised Market Institution, it takes into consideration the relationship with any wider Group to which the Authorised Market Institution may belong or with other Persons closely linked to it. The DFSA will also take into account lead or consolidated supervision to which an Authorised Market Institution or its Group may be subject in another jurisdiction. This may lead to the DFSA placing some reliance on the supervisory arrangements in another jurisdiction or creating and participating in special arrangements for the supervision of the Authorised Market Institution and its Group. The Authorised Market Institution is expected to provide information required or reasonably requested in relation to these consolidated or lead supervisory arrangements before final supervisory arrangements are established.

3-6-5 Each relationship will be considered on a case by case basis and according to the risks posed by the Authorised Market Institution's activities identified during supervisory

arrangements. Such supervisory arrangements may include a process to be agreed by the DFSA, the Authorised Market Institution itself and other relevant regulators.

3-6-6 Effective co-operation with regulators will provide for prompt exchange of information and co-operation in relation to supervision and enforcement between jurisdictions. This will include exchanges of information and co-operation in respect of activity conducted by an Authorised Market Institution. Usually co-operation arrangements will be in the form of memoranda of understanding. The information exchange will enhance the DFSA's understanding of the operations of a Group and the effect on the Authorised Market Institution.

Application for a Change in Control

3-6-7 The AMI module sets out requirements relating to a change in control. These requirements are similar to those for an Authorised Firm which are set out at paragraphs 3-2-33 to 3-2-41 and 3-2-54 to 3-2-56 of this chapter.

Directions Power

3-6-8 Article 9 of the Markets Law empowers the DFSA to give an Authorised Market Institution certain directions in relation to the Authorised Market Institution's duties under DFSA-administered laws. It also gives the DFSA a power to direct an Authorised Market Institution to do specified things including closing the market, suspending transactions and prohibiting trading in Investments. Article 9 also empowers the DFSA to exercise the powers contained in the Authorised Market Institution's Rules for participants as though it was the Authorised Market Institution where it considers that the Authorised Market Institution has not exercised the powers under those Rules.

3-6-9 In considering whether to exercise such powers, the DFSA may take into account factors including:

- (a) what steps the Authorised Market Institution has taken or is taking in respect of the issue being addressed in the planned direction;
- (b) the impact on the DFSA's objectives if a direction were not issued; or
- (c) whether it is in the interests of the DIFC.

3-6-10 The written notice given by the DFSA will specify what an Authorised Market Institution is required to do under the exercise of such powers. Though the DFSA is not required to do so under the Markets Law 2004, in most cases the DFSA will contact the Authorised Market Institution prior to issuing such a direction.

3-6-11 Article 19(1) of the Markets Law 2004 allows the DFSA to direct an Authorised Market Institution to suspend or delist Securities from its Official List of Securities. Such directions may take effect immediately or from a date and time as may be specified in the direction. Chapter 7 of the OSR contains details in respect of this.