CONSULTATION PAPER NO. 46

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PROPOSALS TO IMPLEMENT AN ELECTRONIC PRUDENTIAL REPORTING SYSTEM

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Purpose of the paper

1. This paper seeks public comment on the DFSA's proposals to implement an electronic prudential reporting system, along with some minor revisions to the current reporting requirements. The intention behind implementing an electronic prudential reporting system and the revised reporting requirements is to enhance the effectiveness of the DFSA's risk-based supervisory approach, to improve efficiency for Authorised Firms and the DFSA, and improve the availability of aggregate data on the activity levels of Firms in the DIFC.

Who should read this paper?

2. The proposals in this paper would be of interest to Authorised Firms which have obligations to submit prudential returns pursuant to the provisions of the Prudential – Investment, Insurance Intermediation and Banking Business Module ("PIB") or the Prudential – Insurance Business Module ("PIN") of the DFSA Rulebook.

How is this paper structured?

3. In this paper, we set out:
   (a) defined terms in paragraphs 6 to 7;
   (b) background in paragraphs 8 to 11;
   (c) current requirements for submission of prudential returns in paragraphs 12 to 14;
   (d) proposed EPRS and revised reporting requirements in paragraphs 15 to 31 and Annexes A to C;
   (e) consequential changes to the DFSA Rulebook, in paragraphs 32 to 36 and Annexes D to H;
   (f) costs and benefits associated with implementation of the EPRS in paragraphs 37 to 43;
   (g) handling of information collected in the EPRS in paragraphs 44 to 45;
   (h) technological considerations and solutions in paragraphs 46 to 49; and
   (i) implementation in paragraphs 50 to 52.

How to provide comments?

4. All comments should be provided to the person specified below. You may, if relevant, identify the organisation you represent in providing your comments. The DFSA reserves the right to publish, including on its website, any comments you provide, unless you expressly request otherwise at the time of making comments.

What happens next?

5. **The deadline for providing comments on these proposals is 24th June 2007**. Once we receive your comments, we will consider if any further changes are required to these proposals. We will then proceed to make the necessary changes to the DFSA's Rulebook covering all amendments resulting from this paper. However as the changes recommended in this paper are still proposals, you should not act on them until the relevant changes to the DFSA Rulebook are made. We will issue a notice on our website telling you when this happens.

Comments to be addressed to:
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Defined terms

6. Generally, capitalised terms used are defined terms in the Glossary (GLO) Module of the DFSA Rulebook. For example:
   (a) "Annual Regulatory Returns" means an annual regulatory return of the type specified in PIN Rule A10.3.1;
   (b) "Authorised Firm" means a Person, other than an Authorised Market Institution, who holds a Licence;
   (c) "PIB" means the Prudential – Investment, Insurance Intermediation and Banking Business Module of the Rulebook;
   (d) "PIN" means the Prudential – Insurance Business Module of the Rulebook;
   (e) "PRU" means the Prudential Returns Module of the Rulebook;
   (f) "Quarterly Regulatory Return" means a quarterly return of the type specified in PIN Rule A10.3.2; and
   (g) "Return" includes both Quarterly Regulatory Returns and Annual Regulatory Returns.
7. The following terms are regularly used in this paper and have the following meanings:
   (a) "DIFCA" means the Dubai International Financial Centre Authority;
   (b) "EPRS" means the proposed DFSA electronic prudential reporting system;
   (c) "Firm" means an Authorised Firm; and
   (d) "return" and/or "prudential return" includes both a return specified in PIB and a Return specified in PIN.

Background

8. Regulated banks and other financial institutions across the world are required to provide accounting and prudential information to their regulators on a periodic basis. This requirement is usually met by way of a set of prudential returns and accounting reports that regulated firms are mandated to submit to their regulator at specified intervals.
9. Such reporting arrangements are seen as an essential regulatory tool to enable regulators to assess, monitor and control the risk profile of regulated firms individually and collectively on a systemic basis. The submission of prudential returns also enables regulators to effectively carry out off-site supervisory tasks, which are an integral part of any effective risk-based supervisory approach.
10. International best practice standards on prudential regulation, such as the Core Principles for Effective Banking Supervision developed by the Basel Committee on Banking Supervision, stipulate that regulators must establish and implement a system of prudential returns to ensure effective off-site supervision and to achieve a good understanding of the firm-specific as well as systemic risk levels.
11. Consistent with such standards, Firms operating in the DIFC are currently required to prepare and submit prudential returns in accordance with the rules and guidance prescribed in PIB, PIN and in PRU. These rules prescribe the

applicable returns to be submitted by Firms in different prudential categories, applicable frequency of reporting, reporting deadlines and required level of authentication on the returns.

Current requirements for submission of prudential returns

12. The prudential returns forms, along with detailed guidelines for completion, are contained in PRU. Currently, Firms are required to submit the applicable prudential returns in paper with a formal signed declaration by appropriate officers of the Firm.

13. The PIB forms contained in PRU, focus on the primary financial accounting statements, information on risk exposures and calculation of capital adequacy position of Firms. These returns also require specific reports on liquidity risk position, large exposures to monitor concentration risk and non-performing loans and provisions for credit losses. The current PIB returns do not require the submission of adequate information to assess and monitor risk levels in some aspects such as, geographic concentration of credit and counterparty risk, currency and transfer risks.

14. Overall, the PIN forms contained in PRU require the submission of adequate information to assess and monitor risk levels. However, further submissions in relation to net earned premiums and claims incurred are required to enable a more comprehensive risk assessment.

Proposed electronic prudential reporting system and revised reporting requirements

15. The DFSA proposes to establish and implement a more comprehensive system for regulatory reporting by Firms. This system will provide an electronic medium for submission of reports along with a revised set of reporting requirements.

16. The DFSA believes that making use of appropriate technology will assist Firms in the provision of reporting data and allow the DFSA to manage, process and analyse that data more efficiently.

17. After the implementation of the new system, Firms will still be required to submit the forms currently specified in PIB, PIN and PRU (albeit electronically) with relatively minor change. However, there will be some additional reporting requirements in respect of the activity levels of the Firm.

Revisions to Existing Forms

18. Annex A includes a copy of all current PIB forms with any revised reporting requirements highlighted on the forms. The changes primarily affect PIB Forms 1, 2 and 9.

19. The revised reporting requirements in relation to these forms will facilitate reporting in accordance with the International Financial Reporting Standards and will also reduce the number of data items required to be reported as part of the calculation of risk weights for credit risk exposures in the non-trading book. This reduction in data items will be made possible partly because of the efficiencies and flexibility derived from the use of an electronic reporting system.

20. Annex B includes a copy of all current PIN forms with any revised reporting requirements highlighted on the forms. The changes are minor and primarily

affect PIN forms 1, 4 and 5. The additional information required in PIN form 1 will allow the DFSA to assess Firm liquidity. Additional tables will be inserted in PIN forms 4 and 5 to capture information regarding net earned premiums and net incurred claims. The submission by Firms of this information will allow the DFSA to understand the loss experience that an Insurer may sustain by Class of Business.

21. There will be no change to the category of Firms required to submit the existing forms. The requirement to submit these forms will continue to be as currently set out in PIB, PIN and PRU.

22. The amendments to the forms set out in Annexes A and B are provided for illustrative purposes only. The format of the forms and the proposed amendments may change prior to the implementation of the EPRS.

23. The PIN forms included in Annex B indicate the changes being proposed as part of the implementation of the EPRS. Further changes to PIN forms were proposed as part of Consultation Paper 44 ("Proposals Relating to Direct Long-Term Insurance, Credit Insurance and Group Supervision"), consultation on which closed on 3 May 2007. To gain a full picture of the proposed future reporting requirements for Insurers, the forms in Annex B should be read in conjunction with Consultation Paper 44 ("Proposals Relating to Direct Long-Term Insurance, Credit Insurance and Group Supervision"). The two sets of proposals are, however, independent of each other. If, after consultation, both sets of changes are approved, they will be integrated without conflict.

New Forms

24. Annex C contains a copy of the proposed new forms required to be submitted by Firms. All new forms are PIB forms. The forms a Firm is required to submit will be determined based on the financial service(s) for which a Firm is authorised.

25. The new forms will capture information regarding the activity levels of Firms covering matters such as, product volumes, trading volumes, amount of investments being arranged on behalf of clients, number of client accounts or portfolios being managed, amount of assets under management in portfolio management schemes and number of funds being sold in or from the DIFC.

26. The new forms will also capture data on credit activity such as details of credit disbursals and credit outstanding for any reporting period, including composition of credit activity in terms of type of borrower, by product category, by geographic and sector distribution of borrower, by maturity and by currency of denomination.

27. Most of the information captured on the new forms is essential for effective off-site prudential risk assessment. Much of the new information submitted to the DFSA by Firms will enable the DFSA to assess and monitor risk and activity levels on a Firm-specific basis as well as on a system-wide basis.

28. In addition to enabling the DFSA to assess and monitor risk and activity levels of Firms, the new information will also assist in the following ways:

(a) information on geographic distribution and currency of credit will assist in assessing the impact of activities in the DIFC on the macroeconomic position of the UAE and the GCC; and

(b) information on credit by product category will allow analysis of the size and growth of the market in the DIFC for various product segments; and

(c) information on geographic distribution of credit and currency-wide distribution of credit will assist in the assessment of systemic risk in the DIFC.

29. The forms contained in Annex C are provided for illustrative purposes only. The format of the forms and the content may change prior to the implementation of the EPRS.

Signed declaration

30. PIB Rule 1.6 requires officers of Firms to sign returns. Similarly PIN Rule 6 requires returns to include a Statement of Directors. The requirement for appropriate sign-off of returns in writing by officers and or directors of Firms will continue after the implementation of the EPRS.

31. Although sign-off in writing will still be required, it is not the DFSA's intention to compel Firms to submit these sign-offs at the time of electronic submission of returns. Rather, the DFSA is proposing to implement a process whereby Firms will be required to complete the appropriate sign-offs at the time of the submission of returns and maintain a copy of such sign-off on file for the DFSA to view on demand or at the next on-site supervisory meeting.

Consequential changes to the GEN, PIB and PIN Modules of the DFSA Rulebook

32. Consequential changes to GEN, PIB and PIN are set out in Annexes D to H.

33. These consequential changes arise mainly on account of the new mandatory obligation on Firms to submit returns required pursuant to PIB and PIN using EPRS.

34. The DFSA Board recently resolved to de-couple PRU from the Rulebook and make it a Sourcebook and a repository of all prudential forms and instructional guidelines. The only provisions in PRU that needed to be maintained as Rules were those provisions relating to PIN forms contained in old PRU Chapter 3. These provisions (old PRU Rules 3.1 to 3.4 and 3.15) have been moved to PIN Appendix 10. The information relating to completion of forms in old PRU Chapter 3 (old PRU Rules 3.5 to 3.14 and 3.16) have been reformatted and maintained in PRU as new PIN form 11: Instruction Guidelines.

35. It is envisaged that forms and information contained in PRU will mirror the forms and information in EPRS.

36. Consultation Papers 42 ("Proposed Enhancements to the DFSA Rulebook to Meet International Best Practice Standards"), 44 ("Proposals Relating to Direct Long-Term Insurance, Credit Insurance and Group Supervision") and 45 ("Proposals to Refine the Definitions of Related Parties") set out a series of amendments to PRU, PIB and PIN that are currently being considered.

Costs and benefits of the proposed EPRS

37. The desire to design and implement the proposed EPRS as a simple framework without excessive complications has been the foremost principle guiding the DFSA's efforts in developing the EPRS.

38. The DFSA's approach seeks to balance the need for a robust technological solution that is fit for purpose with the desire to minimise operational costs and burden for the DFSA and Firms. The DFSA is mindful of not over-engineering the solution and ensuring that the costs and implications remain proportionate to the benefits.

39. The primary benefits of implementing the EPRS for Firms and the DFSA include:

- removing the need for paper-based preparation, submission and manual processing, validation and analysis of data;
- providing greater certainty for Firms reporting via on-screen validation checks and automated receipt of submitted returns; and
- supporting the DFSA's objectives of producing and publishing accurate, consistent and timely aggregated data on the activities carried out within the DIFC.

40. The costs of implementing the EPRS include the:

- direct implementation costs associated with the EPRS design, build and roll out;
- ongoing costs associated with the operation of the EPRS; and
- development and implementation of additional internal systems for collection of required data by Firms.

41. The direct implementation costs will result in an increase to the overall operational costs of the DFSA in 2007. It is the DFSA's intention to absorb this cost rather than pass this cost on to Firms directly.

42. The ongoing costs of maintaining the EPRS will form part of the DFSA's operational costs. By way of example, the cost of licensing the EPRS, estimated to be US$1,500 to US$2,000 per Firm, will be met by the DFSA. A proportion of these costs will be recovered from Firms by way of the DFSA's normal fee provision.

43. The proposed EPRS will result in varying levels of incremental reporting obligations for Firms dependent on the financial service(s) for which a Firm is authorised. The incremental regulatory reporting requirements for Firms arising out of the proposed EPRS are illustrated in the table below. The financial services not included in the table do not require the preparation or submission of any new forms.

Financial Services Activity	**Number of new forms**
Accepting Deposits	3
Providing Credit	3
Dealing in Investments as Principal	1
Arranging Credit or Deals in Investments and Advising on Financial Products or Credit (mainly in relation to Wealth Management business)	1
Managing Assets	1

Operating a Collective Investment Fund	1
Dealing in investments as agent (mainly in relation to Brokerage business)	1
Providing Custody	1
Providing Trust Services	1
Providing Fund Administration	1
Acting as the Trustee of a Fund	1
Other forms Applicable to all Firms - Related party transactions	1

Handling of information collected as part of EPRS

44. The proposed EPRS includes a database to collect and store the data being reported by Firms and a software application to analyse the data collected for the purposes of assessing and monitoring prudential risk levels, both on a Firm-specific and systemic basis.

45. The application for analysis of data collected will also be designed to provide analytical reports to the DFSA that may be used (subject to the DFSA's obligations for protection, use and disclosure of information set out in Regulatory Law No 1 of 2004) in preparing and providing information on an aggregate basis to external stakeholders such as, the UAE Central Bank, DIFCA, relevant Government Ministries within Dubai and the UAE, and general public dissemination via appropriate means. It is the DFSA's intention that the provision of such information will only be on an aggregate level.

Technological considerations and solution

46. The DFSA has considered both off-the-shelf and custom made financial reporting and analysis solutions. Based on its review, it has concluded that adequate off-the-shelf solutions are available and, that the development of a custom made solution would present an unacceptable level of risk, in terms of quality, cost and timeliness.

47. Whilst undertaking its review the following matters were of primary importance to the DFSA:

- the complexity of the underlying technology;
- the resulting need for hardware and software for both the DFSA and the Firms;
- submission options (online via web, offline via downloadable forms or vendor software package or uploading of information via XML files or vendor software package);
- security; and
- the direct and indirect costs for Firms and the DFSA associated with implementing and maintaining the system.

48. The DFSA has identified a number of potential vendors of off-the-shelf solutions and is currently in the process of finalising its selection. Irrespective of the vendor selected, the system implemented will contain at a minimum the following functionality:

- online submission via web forms (the DFSA considers this submission method the most cost effective as it will not require Firms to invest in hardware or software) ;
- no specific hardware needs to be installed by Firms;
- the ability to complete forms in multiple sittings;
- automated confirmation upon receipt of forms by the DFSA;
- where appropriate, on line validation checks and reconciliation between data items contained in the forms;
- the ability to print a version of the forms submitted to the DFSA.

49. Security of the system will be ensured via two levels. Firstly, access to the relevant web page will be via SSL connection thereby ensuring any data transferred will be encrypted, and secondly entry to the EPRS only available upon username and password authentication.

Implementation of the electronic prudential reporting system

50. Use of the EPRS will be mandatory for all Firms.

51. The DFSA is aiming to have the EPRS implemented and available for Firms to use by the end of the fourth quarter of 2007. If the EPRS is implemented by the end of the fourth quarter 2007, Firms will be required to submit forms electronically in 2008 commencing with the reporting period ending December 31 2007.

52. New proposed PIB Rule 1.6 (contained in Annex E) and new proposed PIN Rule 6.5.1 (contained in Annex G) contain the provisions relating to submission of returns. Pursuant to these Rules the DFSA will issue a notice announcing when the EPRS is in operation, after which time Authorised Firms will be required to submit returns using the EPRS in accordance with any instructions set out in the notice and any instructions provided in the EPRS and the Rules.