CONSULTATION PAPER NO. 57

29 July 2008

MISCELLANEOUS AMENDMENTS TO THE RULEBOOK

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Why are we issuing this paper?

1. This Consultation Paper seeks public comment on the DFSA's proposals to make a wide variety of amendments to a number of modules of the DFSA Rulebook.

Who should read this paper?

2. The proposals in this Paper would be of interest to all Authorised Persons, Ancillary Service Providers and Recognised Persons.

How to provide comments

3. 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?

4. The deadline for providing comments on this proposal is 1 October 2008. Once we receive your comments, we will consider if any further refinements are required to these proposals. We will then proceed to enact the changes to the DFSA's Rulebook. Because these 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 advising you when this happens.

Comments to be addressed to:

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Defined Terms

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

Background

6. The DFSA has gathered together in one paper a number of miscellaneous amendments to the modules of the Rulebook. Each of the items listed below is a discrete amendment. Such amendments are grouped under the relevant module in the Appendices. The proposed amendments result from the DFSA's desire to simplify and clarify certain Rules but are also in response to the DFSA's experience of operating the Rules in practice, comments from market participants and also to ensure consistency with other jurisdictions where appropriate to do so.

Proposed amendments

Item 1. COB 6.7.1 – Recording of voice and electronic communications

The Rules relating to the recording of voice communications are proposed to be amended for clarity and to cover all electronic communications. These proposed Rules link with COB Rule 7.4.4 in regard to record keeping of orders and transactions. The period of time for keeping a record of electronic communication, including voice recordings, will be increased from 3 months to 6 months (in alignment with the period about to be introduced in 2009 under the UK regime).

Preventing, detecting and deterring market misconduct is one of the DFSA's key priorities. Good quality recordings of voice conversations and of electronic communications (taping) help firms and the DFSA to detect and deter inappropriate behaviour.

The term electronic communication has a wide application. It includes fax, email, Bloomberg mail, video conferencing, SMS, business to business devices, chat and instant messaging. But it is not limited to these as it captures any electronic communications involving receiving client orders and the agreeing and arranging of transactions.

The DFSA has provided an exemption in respect of recording general conversations and communications about market conditions.

These proposed amendments to the Rules are in Appendix 1.

Item 2. COB 7.2.2 – Direct insurance

The COB Rules currently prohibit an Insurer from Effecting or Carrying Out a Contract of Insurance in relation to a risk situated within the UAE (including the DIFC) unless it is a contract of reinsurance. This is more restrictive than the Financial Free Zones Law of 2004 which along with the UAE Ministerial Council Cabinet Resolution No.28 of 2007 permits an Authorised Firm to insure a DIFC risk directly. The DFSA proposes to change the rule accordingly.

The proposed Rule amendments to implement that approach are set out in Appendix 1.

Item 3. REC 7.2.2(a) – Authorisation and recognition

A significant number of Authorised Firms have sought and received relief from the effect of REC Rules 3.2.2 and 7.2.2 which prevent recognition being granted to an applicant which is also an Authorised Firm or Authorised Market Institution. The restriction was not intended to prevent Authorised Firms which have a principal place of business outside the DIFC and operate in the DIFC through a branch, from being recognised for the conduct of certain activities, i.e. trading on an AMI from their principal place of business. Therefore, the DFSA proposes changes to the relevant Rules to permit such recognition.

The proposed relevant Rules are in Appendix 2.

Item 4. CIR – Exclusion of certain companies and partnerships from constituting a fund

Whilst no issues arise from treating all open-ended Bodies Corporate (investment companies with variable capital) as collective investment funds, issues arise in regard to such treatment of closed-ended Bodies Corporate. Ordinary commercial companies can arguably fall within the definition in Article 15 of the Collective Investment Law 2006 and thereby be considered a fund unless exempted pursuant to Article 16 by the DFSA. There is an applicable exemption under the Rules at CIR Rule 2.3.5. Some uncertainties have arisen in regard to this Rule. To address this we have now included an amended exclusion and repositioned it under CIR Rule 2.3.2. An equivalent exclusion is proposed in relation to Partnerships.

The proposed exemption is set out in Appendix 3.

Issue for consideration

Do the draft Rules effectively exclude those closed-ended Bodies Corporate and Partnerships that are clearly not intended to be treated as collective investment arrangements and thereby regulated by the DFSA?
Are there any other characteristics which should also be included?

Item 5. CIR 2.3.9 - Certain Sukuk excluded from being a fund

Sukuk are often referred to as Islamic bonds. There are many ways in which sukuk can be structured. They commonly use a Special Purpose Vehicle whose contractual relationships with the originator may take a variety of forms. Some of these structures, though economically equivalent to debentures, have some legal similarities to collective investment funds. The DFSA therefore proposes introducing a new CIR Rule 2.3.9 to put beyond doubt that sukuk that are in essence economically equivalent to debentures should not be treated as funds for regulatory purposes.

The proposed Rules are in Appendix 3.

Issue for consideration

Does the draft Rule effectively exclude some sukuk which should not be at risk of being treated as collective investment funds? Are there further types of sukuk which should also be excluded, and how might an appropriate exclusion be drafted?

Item 6. CIR 2.3.10 and OSR 2.4.1 - Employee share scheme exclusion

A significant number of Authorised Firms offer the benefits of an employee share scheme to their employees and have sought and been granted relief from the marketing provisions relating to Funds in CIR and also the offer of securities provisions in OSR. Amendment is proposed to avoid the scheme being a Fund and thereby attracting the application of the CIR marketing Rules. Secondly, if the scheme is not a Fund, then the OSR prospectus offer Rules apply. Both sets of provisions are onerous in the circumstances of such employee reward arrangements.

The DFSA therefore proposes introducing appropriate exemptions in regard to such offering of Securities and Units. The proposed exemption in relation to CIR excludes certain employee share schemes from amounting to a Collective Investment Fund, whilst the proposed OSR provisions treat an offer of a Security in such a scheme as an Exempt Offer.

The proposed Rules are in Appendix 3 and Appendix 6.

Item 7. FER 3.9 and 3.10 - Fund net asset valuation date

In the Fees module (FER), the annual fee due for a Fund is calculated using the net asset value of the Fund. These amendments to FER 3.9 and 3.10 seek to remove any uncertainty by prescribing a date on which the net asset value is to be determined for the purpose of the fee calculation. If the Fund has not conducted a valuation on that date, then the most recent valuation will suffice for these purposes.

The proposed Rules are set out in Appendix 4.

Item 8. GLO definition – Islamic financial business

This proposed amendment aligns the definition of “Islamic Financial Business” in the Glossary (GLO) with the Law Regulating Islamic Financial Business 2004.

The proposed amendment is in Appendix 5.

Item 9. GLO definition - Foreign and domestic property funds

The DFSA proposes amendments to the definition of “Property Fund” and to insert a new definition for “Foreign Property Fund” to align more closely the definitions with the Domestic Property Funds under CIR Rule 13.5.4 and with Foreign Property Funds under CIR Rule 3.7.1.

The proposed amendment to the definition is in Appendix 3 and 5.

Item 10. OSR - Financial statements and annual reports

New Guidance has been inserted under OSR Rule A2.1.1(13). The purpose of the new Guidance is to clarify the difference between an annual report and a financial statement. Further, the new Guidance also clarifies that Reporting Entities may make different levels of disclosure for different types of instruments or investment products.

Appendix 6 contains the proposed amendments.

Item 11. AMI 7.2.3 and Art 17(1) Markets Law

Currently Article 17 of the Markets Law 2004 deals solely with Securities that an Authorised Market Institution ("AMI") may permit to trade on its facilities. This is inconsistent with the AMI module which also deals with the trading of Investments other than Securities, provided there is a proper market in respect of such Investments. The proposed amendments aim to align the Law with the Rules, thereby widening the scope of the Law to cover the trading of Investments other than Securities using the facilities of an AMI and to carry out consequential amendments for the purposes of Article 17(1)(b).

One minor amendment to the AMI module is also proposed, so that the reference to “Listing Rules” in AMI Rule 7.2.3 (2) (f) is changed to “listing rules” where applicable, as the proper market test only becomes relevant where Investments admitted to trading are either listed in other jurisdictions or otherwise than through inclusion in an Official List of Securities.

See Appendix 7 for the proposed changes to AMI Rules and Appendix 8 for the proposed changes to the Markets Law.

Item 12. Waivers and Markets Law

The DFSA proposes to ask the Ruler to amend Article 36(e) of the Regulatory Law 2004 to clarify that the Chief Executive exercises the power of the DFSA under Article 58 of the Markets Law.

Article 58(1) confers power on the DFSA to waive or modify the application of the Markets Law. This is the only instance in the laws administered by the DFSA of a power to waive or modify the application of law. However, the Regulatory Law and other laws administered by the DFSA do not clearly specify who within DFSA exercises this power. In this regard, under the Regulatory Law:

- the DFSA has a number of components, including the DFSA Board of Directors, and the Chief Executive and his staff (Article 9);
- neither the Board nor Chief Executive are given power to grant waivers or modifications in relation to law (see Articles 20 and 36);
- the Chief Executive has power to grant waivers and modifications to the Rules (Article 36(e)).

Article 36(a) of the Regulatory Law confers the DFSA's executive power on the Chief Executive. The DFSA considers that a power to waive or modify the application of Markets Law in relation to a person is inherently executive in character, and should therefore be exercised by the Chief Executive. .

The proposed changes to the Law are in Appendix 8.

Item 13. The making of guidance

The DFSA proposes to ask the Ruler to amend Articles 36(c) and (d) of the Regulatory Law 2004 to clarify that the Chief Executive "makes and issues" Guidance, excepting Guidance comprising a standard or code of practice.

"Guidance" is defined in Schedule 1 clause 2(f) of the Regulatory Law to comprise:

- guidance made and issued by the Chief Executive under the Law; and
- any standard or code of practice issued by the DFSA Board of Directors and which has not been incorporated into the Rules.

In relation to the power of the Board to incorporate a standard or code of practice into Rules, see Article 23(3) of the Regulatory Law.

The distinction between Guidance issued by the Chief Executive, and standards or codes of practice that are not incorporated into Rules, is recognised in Article 116 of the Regulatory Law.

The proposed amendments to Articles 36(c) and (d) are designed to address the following anomalies:

- the reference to preparation of "standards or codes of practice" in Article 36(c)(ii) overlaps with the reference to "Guidance" in Article 36(c)(iii) to the extent that the latter includes a standard or code that is not incorporated into Rules;

- Article 36(c) confers power on the Chief Executive to "prepare" Guidance but does not confer power to issue. Schedule 1 clause 2(f) of the Regulatory Law anticipates that Guidance is "made and issued" by the Chief Executive;

- Article 36(d) empowers the Chief Executive to "advise [the Board] of such Guidance". As "Guidance" includes a standard or code of practice issued by the Board but not incorporated into Rules, it is anomalous that the Chief Executive must advise the Board of this type of Guidance.

The proposed changes to the Law are in Appendix 8.