



CONSULTATION PAPER NO. 80

9 OCTOBER 2011

**PROPOSALS RELATING TO CONTROLLERS AND LEGAL
FORMS OF AUTHORISED PERSONS**

CONSULTATION PAPER NO 80

PROPOSALS RELATING TO CONTROLLERS AND LEGAL FORMS OF AUTHORISED PERSONS

Why are we issuing this paper?

1. This Consultation Paper seeks public comment on the DFSA's proposals to make certain changes to the DFSA's current regime governing Controllers of Authorised Persons (i.e. Authorised Market Institutions and Authorised Firms). These provisions are contained in the Regulatory Law 2004 and the GEN and Authorised Market Institutions (AMI) modules of the DFSA Rulebook and the RPP Sourcebook ("the DFSA Controller regime").
2. Controllers are legal or natural Persons who can exert influence over the prudential soundness or management of an Authorised Person. Such influence is generally acquired by Controllers through shareholdings or voting rights they or their Associates have in the Authorised Person or a Holding Company of such a firm. The proposals in this paper are designed to enable the DFSA to ensure that Controllers do not have any adverse impact on an Authorised Person's fitness and propriety or the ability to conduct its business prudently and soundly.
3. We also propose some changes to the legal forms Authorised Firms can take, and in some cases the Authorised Individuals they must have.

Who should read this paper?

4. The proposals in this paper would be of interest to:
 - (a) Authorised Persons;
 - (b) Persons proposing to become Authorised Persons; and
 - (c) Controllers or Persons intending to become Controllers of Authorised Persons.

How is this paper structured?

5. In this paper, we set out:
 - (a) background – paragraph 9;
 - (b) an overview of the DFSA's current Controller regime – paragraphs 10 – 13;
 - (c) benchmarking – paragraphs 14 and 15;
 - (d) addressing gaps – paragraphs 16 – 22;
 - (e) removing anomalies – paragraphs 23 and 24;

- (f) other enhancements relating to Controllers – paragraph 25; and
- (g) changes to permissible legal forms – paragraph 26.

How to provide comments?

- 6. All comments should be in writing and sent to the address or email specified below. If sending your comments by email, please use the Consultation Paper number in the subject line. You may, if relevant, identify the organisation you represent in providing your comments. The DFSA reserves the right to publish, including on its website, any comments you provide, unless you expressly request otherwise at the time of making comments.

Comments to be addressed to:

**Consultation Paper No. 80
Policy and Legal Services
Dubai Financial Services Authority
PO Box 75850
Dubai, UAE
TEL No. 04 362 1509**

or e-mailed to: consultation@dfsa.ae

What happens next?

- 7. The deadline for providing comments on the proposals is **8th December 2011**. Once we receive your comments, we will consider if any further refinements are required to these proposals. We will then proceed to recommend the changes to the Regulatory Law 2004 to the Ruler for enactment and we will proceed to enact the changes to the DFSA's Rulebook. You should not act on these proposals until the relevant changes to the Regulatory Law 2004 and the DFSA Rulebook are made. We will issue a notice on our website telling you when this happens.

Terminology in this paper

- 8. In this paper, defined terms are identified throughout by the capitalisation of the initial letter of a word or of each word in a phrase and are defined in GLO or in the proposed amendments. Unless the context otherwise requires, where capitalisation of the initial letter is not used, the expression has its natural meaning.

Background

- 9. During the course of previous years, the DFSA found that a number of Authorised Firms had significant shareholder/Controller disputes that were prejudicial to the sound and prudent management of those firms. In the process of addressing those issues, it was found that the powers the DFSA

currently has to deal with Controllers were somewhat limited. The benchmarking we undertook (see paragraphs 15 and 16 below) confirmed that the powers available to the DFSA to deal with Controllers of Authorised Persons are narrower than those available to comparable regulators, particularly under the UK regime on which the DFSA regime is substantially based. The proposals in this paper address those identified gaps by giving the DFSA powers to directly deal with the standing and rights of Controllers themselves, rather than with Authorised Persons with respect to their Controllers.

Overview of the current Controller provisions

10. Article 64 of the Regulatory Law 2004 contains the overarching provisions governing change of control. These include:
 - (a) the DFSA power to prescribe by Rules the circumstances in which a person becomes or ceases to be a Controller, when a change in control requires either approval by the DFSA or notification to the DFSA and the procedures relating to such approval and notification; and
 - (b) the DFSA power to revoke the Licence of an Authorised Person where:
 - (i) the DFSA has notified the firm that a Controller is unacceptable to the DFSA; and
 - (ii) the firm has failed to remove the unacceptable Controller or take any other action as required by the DFSA to the satisfaction of the DFSA.
11. Rules in GEN and AMI relating to Controllers flesh out in detail how the DFSA exercises the above powers. While GEN contains the approval and notification requirements relating to Controllers of Authorised Firms, AMI contains similar requirements so far as they apply to Authorised Market Institutions. The RPP Sourcebook contains the detailed guidance setting out matters that the DFSA takes into account in exercising the relevant powers.
12. The above provisions together require the DFSA to assess the impact a Controller would have on the fitness and propriety of the relevant Authorised Person and its ability to manage its business soundly and prudently. Such assessment takes place at the point of licensing of an Authorised Person and thereafter, whenever a new Controller emerges or an existing Controller proposes to increase its existing holdings beyond certain thresholds (30% or 50%).
13. Under the current Controller regime, the DFSA's powers relating to Controllers of Branches are not as extensive as those relating to Controllers of Domestic Firms. This is because in the case of Branches the DFSA places greater reliance on the adequacy of the home jurisdiction regulation. As a result, in relation to Branches, the DFSA requires only

notification of changes relating to Controllers instead of any prior approval of Controllers as required in the case of Domestic Firms.

Benchmarking

14. We benchmarked the DFSA's current Controller regime against the Controller regimes in the UK (as a proxy for the EU requirements under the Acquisitions Directive 2007/44/EC which introduced a cohesive single controller regime for financial institutions), Singapore and Australia.
15. That benchmarking highlighted the following:
 - (a) An assessment of controllers of banks, insurers, and to a varying degree, other financial institutions, is required in all jurisdictions. With the exception of the DFSA regime and the UK regime which covers controllers of all licensed Financial Service providers, Singapore only covers controllers of banks, insurers and holders of Capital Markets Services Licences (CMSL) and Australia covers only Deposit Taking Institutions (DTIs), insurers, Exchanges and clearing and settlement service providers (C&S) (referred to below as "regulated firms").
 - (b) The review of the suitability and prudential soundness of Controllers of regulated firms in all jurisdictions is undertaken as an integral part of the assessment of whether the regulated firm itself is, and remains, fit and proper and able to meet its prudential requirements. Accordingly, Controllers' suitability and prudential soundness are considered both at the point of licensing or authorisation and thereafter at various trigger points where changes of control occur (see (d) below).
 - (c) The definition of a Controller adopted in these jurisdictions contains two main limbs:
 - (i) the first limb which specifies the threshold level of shares or voting rights that a Person, alone or together with an associate, needs to have in the relevant regulated firm or a Holding Company of that firm to be considered a Controller. However, the threshold for becoming a Controller varies. In the UK regime, like in the DFSA regime, it is 10% but in Singapore it is 12% for banks and insurers and 20% for CMSLs. In Australia, it is 15% for DTIs, insurers, Exchanges and C&S; and
 - (ii) the second limb which is based on the concept of "significant influence" or indirect control which a Person has over the regulated firm, although slightly differently cast in each jurisdiction.
 - (d) The prior approval by the regulator (or the relevant Minister) is required for a proposed acquisition of control or an increase in the level of control of a regulated firm. The UK regime's triggers

for prior approval for increase in control are when the threshold of holdings of an existing Controller exceeds 20%, 30% or 50%, and the triggers under the DFSA regime are 30% and 50%.

- (e) An acquisition of control or an increase in the level of control of a regulated firm without prior approval is a criminal offence in the UK, Singapore and Australia, but there are no similar criminal sanctions attaching under the DFSA regime.
- (f) The regulators under the UK and Singapore regimes have the power to impose conditions where a new Controller or an increase in the holding by an existing Controller is approved. There are due process requirements for the exercise of the conditional approval power. The DFSA and Australian regimes do not contain such a conditional approval power of Controllers.
- (g) The UK and Singapore regulators have powers to object to a Person who has already become a Controller on a number of grounds. These grounds are where a Person becomes a Controller without prior approval, an existing Controller breaches a condition of approval and where an existing Controller becomes no longer acceptable to the regulator. The regulator in the UK and Singapore can, in such circumstances, direct such an unacceptable Controller to take specified actions (eg a direction that the Controller must dispose of his holdings, or refrain from exercising his powers in a specified manner). These powers must be exercised subject to due process requirements. The Australian regime requires the regulator to obtain court orders to give effect to such a direction. The DFSA regime contains no such powers, though there are powers enforceable against the Authorised Person;
- (h) The UK, Singapore and DFSA regimes contain a power exercisable against the regulated firm to require it to remove an existing Controller when that Controller was found to be unacceptable; and
- (i) A differentiation is found in the requirements applicable to Controllers of branches, as opposed to Controllers of domestic regulated firms. Generally, only notification of changes in control is required in the case of branches under the UK and DFSA regimes, as opposed to the prior approval requirements in the case of Controllers of domestic firms.

Addressing gaps – Analysis and proposals

16. The above benchmarking indicated that while the comparable regimes are cast somewhat differently, there are two significant gaps in the DFSA's Controller regime, particularly when viewed against the UK regime on which the DFSA regime is modelled. These gaps are:

- (a) the DFSA not having specific powers to intervene directly against a Controller where he is found to be no longer an acceptable Controller or where he has obtained control without prior approval of the regulator. The DFSA does not currently have the power to direct such a Controller to take specified actions (eg direct the Controller to dispose of his holdings in the firm or another firm, or to refrain from exercising his powers over the management of the firm), as found in the UK and Singapore regimes (see paragraph 14(g)); and
 - (b) the DFSA not having a conditional approval power, i.e. the power to impose conditions subject to which a new Controller or an existing Controller's increase in control is approved, as found in both the UK and Singapore regimes (see paragraph 14(f)).
- 17. The DFSA's supervisory experience also confirms that the objections power is an important power to have as it would be effective in dealing with existing Controllers where their circumstances or conduct have a negative impact on an Authorised Person's fitness and propriety or prudential soundness.
- 18. The power to impose conditions at the point of approval of a new Controller or of an increase in the level of control held by an existing Controller provides greater flexibility to the DFSA than the more blunt powers of approval or rejection of an application for approval. For example, where the DFSA has reservations that a proposed Controller may have a negative impact on the fitness and propriety of an Authorised Person only if he were to be involved in the management of the firm's business, instead of rejecting the application for approval, the DFSA would be able to impose a condition requiring that Person to refrain from participating directly or indirectly in the management of the firm. Similarly, a proposed acquisition can be made subject to the condition that the proposed Controller introduce additional capital to the Authorised Person (for example to ensure on-going commitment to the financial viability of the firm).
- 19. Both the exercise of the objections power and the conditional approval power are, under the UK and Singaporean regimes, subject to due administrative process requirements to prevent any abuse of these powers. The key aspects of those procedures include:
 - (a) the regulator being required to give prior notification to an existing Controller, a proposed new Controller or an existing Controller proposing to increase his existing holdings of the grounds of its objection;
 - (b) a right to make representation to the regulator by the person receiving a notification under (a); and
 - (c) a final decision to impose conditions on or object to a proposed Controller being subject to an administrative review process.

20. We propose that the identified gaps in the DFSA's powers to deal with unacceptable Controllers be augmented by incorporating specific powers that enable the DFSA to:
- (a) impose conditions subject to which Controllers are approved (See GEN Rule 11.8.13(2) and AMT Rule 6.2.10(2)); and
 - (b) require an existing Controller to dispose of its holdings or not exert management influence over the Authorised Person where such a Controller's circumstances or conduct are found to have an adverse impact on the fitness and propriety of the Authorised Person or its ability to conduct its business prudently and soundly (See GEN Rule 11.8.7 and AMI Rule 6.2.3).
21. We also propose that:
- (a) the additional powers proposed above are to be exercised by the DFSA subject to due process requirements along the lines specified in paragraph 19 above, both in order to promote certainty and fair procedures; and
 - (b) clear timelines be built into the DFSA process for dealing with applications for approvals to create certainty, for example, 90 days unless a longer period is required because the application is incomplete or additional clarifications are required.
22. To give effect to these proposals, we propose to:
- (a) seek amendments to Article 64 of the Regulatory Law 2004 so that it contains expanded overarching powers relating to the proposed conditional approval power and notification procedures (see Appendix 1);
 - (b) incorporate changes to:
 - (i) section 11 of GEN which contains the conditional approval power (see GEN Rule 11.8.5(2)(b) of Appendix 2) and the other powers to deal with unacceptable existing Controllers (see GEN Rule 11.8.13 of Appendix 2);
 - (ii) Section 6 of AMI which contains the conditional approval power (see AMI Rule 6.2.2(2)(b) of Appendix 3) and the other powers to deal with unacceptable existing Controllers (see AMI Rule 6.2.10 of Appendix 3); and
 - (iii) Sections 2.2.12, 2.2.13, 3.2.34 – 3.2.37 and 3.6.7 of the RPP Sourcebook containing procedural information relating to the exercise of the proposed powers (see Appendix 4).

Issues for consideration

1. Do you think the proposed DFSA powers to deal with unacceptable Controllers are adequate to ensure that Authorised Persons have acceptable Controllers? If not, what other powers are needed?
2. Do you agree with the proposed procedures for dealing with applications for approval of Controllers including timelines? If you think further enhancements are to be made, what are they and why should they be made?
3. Do you agree that the proposed powers ought to be available to the DFSA in respect of all categories of Authorised Persons? If not, what are your reasons.

Proposals to remove anomalies

23. We have also identified some ambiguities and anomalies in the DFSA's current Controllers regime. For example:
 - (a) where an Authorised Person has failed to comply with a request made by the DFSA pursuant to Article 64(2)(b) of the Regulatory Law 2004 to either remove an unacceptable Controller without undue delay or do some other specified act, there is ambiguity as to whether the DFSA can only revoke an Authorised Person's licence but not use its licence conditions power. This ambiguity has arisen because currently only the revocation power is specifically mentioned in Article 64(2), and not the licence conditions power, although Article 64(3) expressly states that the Article 64(2) powers do not affect powers and liabilities arising under other provisions in the law;
 - (b) Article 51 states that the DFSA may revoke the licence of an Authorised Person where such a Person fails to remove an unacceptable Controller upon a DFSA request made pursuant to Article 64(2)(b). However, it is silent on what the DFSA can do where an Authorised Person fails to comply with a request made by the DFSA to take a specified action other than the removal of the Controller pursuant to Article 64(2)(b); and
 - (c) there are no provisions in AMI which are similar to the disregarded holdings of a Controller under GEN, where such holdings are disregarded because they do not involve effective control (such as holdings resulting from firm placing or underwriting agreements where holdings are meant to be disposed of within a short period).
24. To address the above anomalies, we propose to seek amendments to Articles 64 and 51 of the Regulatory Law. See the revised drafting of Articles 64 and 51 of the Regulatory Law 2004 at Appendix 1 and Rule 6.1.3 of AMI at Appendix 3.

Issue for consideration

4. Are there any other anomalies that need to be addressed? If so, what are they?

Other enhancements relating to Controllers

25. We have undertaken a complete overhaul of the Controller regime, which has enabled us to make a range of other enhancements which include:
 - (a) distinguishing more clearly between the prior approval requirements applicable to Authorised Persons which are Domestic Firms and the mere notification requirements applicable to changes relating to Controllers of Branch operations. This is not a change from the current approach that draws such a distinction, but simply a clearer separation of the different requirements applying to firms incorporated in the DIFC (Domestic Firms) and Branches;
 - (b) a thematic re-arrangement of the Controller provisions in a more cohesive manner;
 - (c) rearranging the current considerations that are taken into account when assessing new applicants for licences under three distinct headings; adequate resources, fitness and propriety and compliance arrangements. See section 7.2 of GEN at Appendix 2; and
 - (d) incorporating into the RPP sourcebook additional material relating to the assessment of suitability and prudential soundness of Controllers in line with the changes made to the Controller provisions in the GEN and AMI modules. See Appendix 4.

Issues for consideration

5. Are there other enhancements that are needed to the DFSA's current controller regime? If so, what are they and why should they be made?

Changes to permissible legal forms

26. We have also taken the opportunity to make some limited changes to our position on the permissibility of particular legal forms for Authorised Firms. These include:
 - (a) Exclusion of unincorporated associations. The structure of an unincorporated association is problematic for prudential regulation as well as other aspects of legal responsibility. For example, it has no legal personality and cannot sue or be sued

in its own right. Accordingly, we believe the structure is not appropriate for Authorised Firms. See GEN Rule 7.2.2 at Appendix 2;

- (b) Guidance on unusual structures. We propose to include guidance in the Regulatory Policy and Process (RPP) Sourcebook about the DFSA's use of discretion when considering unusual structures for an Authorised Firm. See section 2-2-8 of the RPP sourcebook at Appendix 4;
- (c) Limited Partnerships. We will now only require general partners in Limited Partnership to register as Licensed Partners. This is because limited partners are specifically excluded from the management of the business and are prohibited from conducting transactions or executing documents for the Limited Partnership. The general partner will be primarily responsible for the governance of the Authorised Firm. See GEN Rule 7.5.5(2) at Appendix 2; and
- (d) Licensed Partners. In the case where the Partner of an Authorised Firm who would otherwise have to register as a Licensed Partner is not a natural person, we will require the Partner to nominate and register an individual as the Licensed Partner. The amendment will ensure Partners remain accountable. See GEN Rule 7.5.5 at Appendix 2.

Issues for consideration

- 6. Do you have any concerns relating to the proposed changes to permissible legal forms? If so, what are they and how should they be addressed?