



CONSULTATION PAPER NO. 87

16 DECEMBER 2012

**CHANGES PROPOSED TO THE AUTHORISED MARKET INSTITUTIONS
REGIME**

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CHANGES PROPOSED TO THE AUTHORISED MARKET INSTITUTIONS ("AMI") REGIME

Why are we issuing this paper?

1. The DFSA proposes to make substantial changes to its current regulatory regime applicable to Authorised Market Institutions ("AMI regime"). This paper sets out those proposals for public consultation.
2. The AMI regime contains the regulatory requirements that apply to Persons Operating Exchanges, Operating Clearing Houses and Operating Alternative Trading Systems. The facilities operated by such Persons can be collectively referred to as trading and clearing and settlement mechanisms to facilitate trading in Investments. Accordingly, the AMI regime can be described as the regime governing the activities of trading and clearing and settlement of transactions in Investments. These AMI provisions are substantially contained in the AMI module, with some relevant provisions contained in the GEN, COB and GLO modules of the DFSA Rulebook.
3. The proposals in this paper are designed to achieve four objectives:
 - (a) to meet international best practice as reflected in the standards of the International Organisation of Securities Commissions (IOSCO), in particular IOSCO Principles for Financial Markets Infrastructure (April 2012) ("IOSCO Principles"), as the DFSA's AMI regime will be assessed, under the Financial Sector Assessment Program (FSAP), against those standards;
 - (b) to align the proposed AMI regime to the EU model, consistent with the DFSA's recently adopted capital markets regime. The most tangible benefit of doing so is the potential that the European Securities and Markets Authority (ESMA) would recognise, where required by EU legislation to consider the question, elements of the DIFC regime as providing a substantially equivalent level of regulation to the EU regime for clearing houses. Such recognition would enable the DFSA regulated firms (for example Clearing Houses) to provide their services to exchanges, clearing houses, other trading facilities and Members located in the EU and similarly, enable EU based firms undertaking similar activities to establish in, or extend their operations to, the DIFC;
 - (c) to bring the current AMI regime in line with the other exchange and clearing house related developments which have occurred in recent years; and
 - (d) to develop an AMI regime which takes into account DIFC and regional specific characteristics, so that it remains effective and suited to the DIFC markets and their participants.

Who should read this paper?

4. The proposals in this paper would be of particular interest to:
- (a) Authorised Market Institutions Licensed to Operate Exchanges or to Operate Clearing Houses, and applicants for such a Licence;
 - (b) Authorised Firms Licensed to Operate Alternative Trading Systems, and applicants for such a Licence;
 - (c) applicants for a Licence to Provide Custody;
 - (d) Persons intending to act as a Trade Repository;
 - (e) Persons who are Members of Exchanges, Clearing Houses or ATS, and Persons intending to become Members;
 - (f) Authorised Firms acting as Financial Intermediaries in respect of transactions relating to Investments;
 - (g) Issuers of Securities who trade or clear their Securities on AMIs and Persons intending to do so;
 - (h) Persons who trade or clear Derivatives on an AMI and Persons intending to do so; and
 - (i) Financial Services Regulators.

How to provide comments?

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

Comments to be addressed or emailed to:

Consultation Paper No. 87
Policy and Legal Services
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Dubai, UAE

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What happens next?

6. The deadline for providing comments on the proposals is **14 February 2013**. Once we receive your comments, we shall consider if any further refinements are required to these proposals. We shall then proceed to enact the relevant changes to the DFSA's Rulebook. You should not act on these proposals until the relevant changes to the DFSA Rulebook are made. We shall issue a notice on our website telling you when this happens.

Background

7. The proposals in this paper are the result of the last of the major reviews undertaken by the DFSA as part of its rolling review of the Rulebook, which commenced in 2010.

Replacement of the current AMI module

8. As the proposals involve significant enhancements, including changes to many of the current provisions in the AMI module, and a thematic re-arrangement of those provisions, we intend to revoke and replace this module in its entirety with a new AMI module (see Appendix 1).
9. We also propose to amend provisions in other modules that are relevant to trading, clearing and settlement activities in Investments. These mainly comprise the relevant definitions of Financial Services in the GEN module (see Appendix 2), conduct requirements applicable to Authorised Firms operating ATS or Providing Custody in the COB module (see Appendix 3) and consequential changes to definitions in the GLO module (see Appendix 4).

Structure of the paper

10. The proposals in this paper are structured, for convenience, as follows:
 - (a) Part A: Proposals relating to the definitions and structure of the AMI regime – Paragraphs 12 – 50;
 - (b) Part B: Strengthening the governance of AMIs – Paragraphs 51 – 57;
 - (c) Part C: Enhance the regulatory regime applicable to AMIs – Paragraphs 58 – 70;
 - (d) Part D: Enhancements relating to Clearing Houses – Paragraphs 71 – 75;
 - (e) Part E: Enhancements relating to Alternative Trading Systems – Paragraphs 76 – 81; and
 - (f) Part F: Miscellaneous enhancements and transitional arrangements – Paragraphs 82 – 86.

Terminology in this paper

11. 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 in this paper. Unless the context otherwise requires, where capitalisation of the initial letter is not used, the expression has its natural meaning.

Part A: Proposals relating to the definitions and structure of the AMI regime

Financial Services definitions relevant to market operators

12. Under the current definitions of Financial Services in GEN module, there are three types of Financial Services which are relevant to market operators. These are the Financial Services of:

- (a) Operating an Exchange;
- (b) Operating a Clearing House; and
- (c) Operating an Alternative Trading System.

A Person needs a DFSA Licence to carry on the above Financial Services in or from the DIFC.

13. Of the three types of Financial Services referred to above, Operating an Exchange and Operating a Clearing House are Financial Services that can only be undertaken by a Person who is Licensed as an AMI. The other Financial Service of Operating an Alternative Trading System (ATS), although analogous to Operating an Exchange, can currently be undertaken only by an Authorised Firm.

14. We propose to retain the above three 'titles' of Financial Services without any change, as they are commonly recognisable titles with sufficiently wide scope to accommodate the specific changes we propose in this paper.

15. We also propose to retain the current divide between the Financial Services that can be undertaken by AMIs and those which can be undertaken by Authorised Firms. As a result, the two Financial Services of Operating an Exchange and Operating a Clearing House will remain AMI activities, whilst the Financial Service of Operating an ATS will remain an Authorised Firm's activity (with a degree of flexibility provided for an Exchange to undertake some ATS activities – see paragraph 43 below). See also GEN Rule 2.2.2(n), (o) and (s) in Appendix 2.

Issues for consideration

- 1. Do you have any concerns relating to our proposal to retain the current titles of the three main categories of Financial Services relevant to market operators (i.e. Operating an Exchange, Operating a Clearing House and Operating an ATS)? If so, what are those concerns and how should they be addressed?
- 2. Do you have any concerns relating to our proposals to continue to maintain the distinction between Financial Services assigned to AMIs and Financial Services assigned to Authorised Firm's? If so, what are those concerns and how should they be addressed?

Definitions of Operating an Exchange and Operating an ATS

16. We propose to replace the current definition of Operating an Exchange with a new definition, which provides as follows:¹
- “Operating an Exchange means operating a facility which functions regularly and brings together multiple third party buying and selling interests in Investments, in accordance with its non-discretionary rules, in a way that results in a contract in respect of Investments admitted to trading or traded on the facility.”* See GEN Rule 2.17.1(1) in Appendix 2.
17. Functionally, the above definition of Operating an Exchange is substantially similar to the proposed new definition of Operating a Multilateral Trading Facility (MTF), which is a sub-set of activities that may be undertaken by an Operator of an ATS (see the definition of MTF in paragraph 28 below). This is because the key elements of Operating an Exchange and Operating an MTF involve mostly the same key elements: i.e. operating a system which brings together multiple buyers’ and sellers’ interests in Investments in a manner that results in binding contracts relating to such Investments being made in accordance with the pre-determined non-discretionary rules of the operator of the Exchange or MTF.²
18. However, there are two key differences between Operating an Exchange and operating an MTF. The first and most fundamental difference is that, whilst an Exchange is generally a capital raising venue for Securities (where new Securities issues can be admitted to trading, attracting public interest regulation), an MTF is a system where Securities already admitted to trading on a regulated Exchange (and so subject to the initial and on-going disclosure applicable to publicly-traded Securities) can be traded. In that sense, an MTF is very much a secondary trading venue for Securities and does not attract public interest based regulation as an Exchange does.
19. The concept of “admission to trading”, and the resulting primary and secondary markets distinction between Exchanges and MTFs, is of little relevance when it comes to trading in Derivatives. This is because an MTF Operator will play a primary role in designing its own Derivative contracts for trading on its facility. Our proposed new definition of Exchange recognises this difference between Securities and Derivatives, by including the concept of “admission to trading” only in relation to Securities and not for Derivatives. See GEN Rule 2.17.1(2) in Appendix 2.
20. The second difference between an Exchange and an MTF is a construct of the current DFSA regime. An Exchange is permitted to obtain an endorsement on its Licence to maintain an Official List of Securities (although the function of maintaining an Official List is currently performed by the DFSA), whilst an MTF Operator will not be permitted to undertake that function under its Licence. This is because the function of maintaining an Official List remains within the domain of an AMI (which attracts public interest regulation) and lies outside the scope of Investment Business activities that can be undertaken by an Authorised Firm.

¹ The proposed definition of an Exchange is derived from MiFID I.

² An AMI’s rules are non-discretionary in that there is little scope for any arbitrary changes of such rules by the AMI. Similarly an OTF Operator has little scope for changing its rules in an arbitrary manner.

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21. We propose to adopt the new definition of Operating an Exchange as outlined above, with the main distinction between that definition and Operating an MTF being that Exchanges have an “admission” function relating to trading of Investments (which are Securities), whereas MTF Operators have no “admission” function relating to Investments which are Securities. As an adjunct, we continue to keep the function of Operating an Official List of Securities as a function that may be undertaken by an AMI and not an Authorised Firm.

Issues for consideration

3. Do you have any views relating to our proposal to amend the current definition of an Exchange as proposed above? If so, what are those views and how should they be accommodated within these proposals?
4. Do you consider that the “admission to trading” function relating to Securities, and the capacity to obtain an endorsement to maintain an Official List of Securities, provide sufficient grounds to distinguish the activities of Operating an Exchange and Operating an MTF? If not, what are your reasons and what changes to the proposed definitions are warranted to accommodate your views?

Functional sub-categorisation of activities under Operating a Clearing House

22. In line with the definitions adopted under the IOSCO Principles,³ we propose to introduce two sub-categories of activities under the Financial Service of Operating a Clearing House.
23. Under these proposals, a Person Operating a Clearing House may operate a clearing and settlement facility by either:
- (a) becoming a Central Counterparty (CCP) to every buy or sell contract cleared or settled on its facility; or
 - (b) Operating a “book-entry” Securities Settlement Service (SSS).
24. The proposals provide definitions of the terms CCP and SSS as follows:
- “a Person operates as a CCP where it:*
- (a) ensures the performance of open contracts relating to Investments, made on a facility for trading Investments; and*
 - (b) does so by interposing itself between counterparties to such contracts by becoming the buyer to every seller, and the seller to every buyer.*

“a Person operates an SSS where it operates a system which holds Investment accounts and which enables it to transfer or settle Investments held in such accounts by book entry and in accordance with its predetermined multilateral rules.”

³ The proposed definitions of CCPs and SSSs are based on the IOSCO Financial Market Infrastructure Principles – 2012. These are generally referred to as IOSCO Principles or standards.

25. The key difference between the two types of activities is that whilst a CCP incurs credit risk by becoming a counterparty to every buy/sell transaction cleared and settled on its facility, an SSS performs the clearing and settlement function through a book entry system. As a result, an SSS does not generally incur counterparty risks of the type to which a CCP is exposed, as it does not become a counterparty to transactions that are cleared on its facility. A CCP may however, mitigate its counterparty credit risk by obtaining guarantees against payment by the parties whose obligations it assumes, but such guarantees do not alter the primary accountability of a CCP under open contracts to counterparties, until the contracts are fully settled.
26. Both categories of activities attract, in most part, common regulatory requirements, as both involve clearing and settlement functions. However, a CCP warrants more detailed and stringent regulation than an SSS to address risks arising due to risk exposures it incurs in becoming a central counterparty. Accordingly, the proposed sub-categorisation enables us to provide bespoke regulation in line with the IOSCO Principles. (See also the additional tailored requirements proposed for Clearing Houses, particularly CCPs discussed below.)

See the amended definition of Operating a Clearing House in GEN Rule 2.18.1 in Appendix 2.

Issue for consideration

5. Do you have any concerns relating to the proposed sub-classification of the Financial Service of Operating a Clearing House into operating as a CCP and operating an SSS? If so, what are those concerns and how should they be addressed?
6. Are there other concerns relating to the proposed changes to the definition of a Clearing House? If so, what are they and how should they be addressed?

Functional sub-categorisation of activities under Operating an ATS

27. We propose to introduce two sub-categories of activities under the Financial Service of Operating an ATS. These are:
 - (a) Operating a Multilateral Trading Facility (MTF); and
 - (b) Operating an Organised Trading Facility (OTF).
28. The proposals provide definitions of the terms Operating an MTF and Operating an OTF as follows:

“a Person is an MTF Operator if that Person operates a system which brings together multiple third party buying and selling interests in Investments, in accordance with its non-discretionary rules, in a way that results in a contract in respect of such Investments.”

“a Person is an OTF Operator if that Person operates a system which brings together multiple third party buying and selling interests in Investments, in accordance with its discretionary rules, in a way that results in a contract in respect of such Investments.”

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29. Due to market convergence, the type of activities conducted by MTFs and OTFs are not substantially different, with the main distinction being that whilst MTF Operators must have non-discretionary rules in accordance with which they operate their facility, OTF Operators are allowed a greater degree of flexibility and discretion, with respect to the rules according to which their facility is operated.
30. We also note that the current definition of ATS accommodates both MTF and OTF operations. We have provided greater clarity between the two types of activities by adopting distinct definitions for these two types of activities, in line with the definitions adopted under the EU regime.⁴
31. However, as the separate regime of regulation proposed for OTFs under the EU regime is not yet finalised, we do not, at this stage, propose to introduce any OTF specific additional requirements. Instead, we propose to adopt the two definitions mentioned above in respect of MTFs and OTFs to distinguish between these two types of facilities because it:
- (a) is not a significant deviation from the current ATS definition, as that definition implicitly accommodates both types of facilities operated by Authorised Firms; and
 - (b) provides scope for recognising the substantial similarities between Operating an Exchange and Operating an MTF. This enables better alignment relating to regulation of both activities, including allowing an AMI the flexibility to operate an MTF via an endorsement on its Licence.
32. This approach also gives us the flexibility to augment OTF regulation without having to revisit the definitional and structural arrangements now proposed, should the EU proposals to regulate OTFs be implemented and we decide that additional regulation is warranted.
- See the amended definition of Operating an ATS in GEN Rule 2.22.1 in Appendix 2.
33. As Operating an ATS (i.e. an MTF or OTF) is a Financial Service conducted by an Authorised Firm (and hence is Investment Business), the conduct requirements in COB module apply to such activities (with the exception of the suitability, best execution and client order handing provisions in COB which are expressly dis-applied to MTF Operators). Further, as ATS operations are functionally similar to the Operation of an Exchange, we have enhanced the conduct requirements applying to ATS Operators to mirror, to the extent appropriate, the regulatory requirements applicable to Exchanges. This approach is consistent with the EU model, which applies substantially similar requirements when both investment firms and regulated exchanges operate MTFs.
- See the proposed COB requirements for ATS Operators in Chapter 9 of COB – Appendix 3.

⁴ These definitions are derived from MiFID 1 and MiFID II (proposed).

Issues for consideration

7. Do you have any concerns relating to the proposed sub-classification of the Financial Service of Operating an ATS into Operating an MTF and Operating an OTF? If so, what are those concerns and how should they be addressed?
8. Are there other concerns relating to the proposed conduct requirements for ATS Operators? If so, what are they and how should they be addressed?

Replacing the current “by way of business” carve-out with a more precise carve-out

34. We propose to replace the current “by way of business” exclusions (carve-outs) available to AMIs operating an Exchange or Clearing House in GEN Rule 2.3.4 with more functionally relevant and precise carve-outs.
35. Under the current carve-out, an AMI which is an Operator of an Exchange is permitted to carry out any Financial Service, other than Operating a Clearing House or ATS, provided that such activity is carried out as a ‘necessary part’ of its business of operating an Exchange. Similarly, an Operator of a Clearing House is permitted to carry out any Financial Service, other than Operating an Exchange or Operating an ATS, provided that such activities are carried out ‘for the purposes of or in connection with’ its clearing and settlement services.⁵
36. Due to the wide scope of the current “by-way-of-business” carve-outs, uncertainties have arisen relating to what other Financial Services an AMI should be able to carry out within the legitimate parameters of that carve-out.
37. To remove such uncertainties and to ensure adequate and appropriate regulation of AMI activities, we propose to replace the current carve-outs with more precise carve-outs. Under the proposals:
 - (a) an Operator of an Exchange would be allowed to carry on the Financial Services of Dealing in Investments as Agent, Arranging Credit or Deals in Investment or Arranging Custody where such services are carried out as an incidental and integral part of Operating an Exchange; and
 - (b) an Operator of a Clearing House would be allowed to carry on the Financial Services of Dealing in Investments as Principal, Dealing in Investments as Agent, Arranging Credit or Deals in Investments, Managing Assets, Providing Custody or Arranging Custody, where such services are carried out as an incidental and integral part of Operating a Clearing House.⁶

⁵ An AMI with endorsements to carry out both Operating an Exchange and a Clearing House has a combined carve-out in respect of both those activities – see GEN Rule 2.3.4.

⁶ This approach is consistent with the definition of Managing a Collective Investment Fund, where the Fund Manager is allowed to carry on a range of other activities (eg Managing Assets, Fund Administration, Dealing as Agent, Dealing as Principal, Providing Custody) which constitute Financial Services in their own right, as part of its Fund Management activities. See GEN Rule 2.12.1(2).

See the proposed carve-outs under GEN Rules 2.17.1(3) for an Exchange and GEN Rule 2.18.1(5) for a Clearing House – Appendix 2.

Issues for consideration

9. Do you have any concerns relating to the proposed replacement of the “by-way-of-business” carve-out with carve-outs that have more precise boundaries as proposed above? If so what are those concerns and how should they be addressed?
10. Are there any other types of Financial Services that should be expressly included within the proposed new carve-outs? If so, what are those Financial Services and why should they be included?

Introducing CSD operations as part of Clearing House operations and Providing Custody

38. Another change we propose to the current definitions of Financial Services is to bring within the ambit of the existing Financial Services of Operating a Clearing House and Providing Custody the activity of operating a Central Securities Depository (CSD). This proposal enables us to regulate the activities of a CSD through a number of bespoke requirements applicable to their CSD activities, as proposed in paragraph 41 below.
39. Both types of Clearing House operators (i.e. CCPs and SSSs) may operate a Central Securities Depository as an adjunct to their clearing and settlement functions. Given the closely related and overlapping nature of CSD activities with the activities of CCPs and SSS, we propose not to treat CSD operations as a distinct and stand-alone third sub-category of activity falling under Operating a Clearing House. Instead, we have included it as an added activity that may be carried on as part of the activities of a CCP or SSS, thereby obviating the need for a new Financial Service.
40. Similarly, an Authorised Firm with a Licence to Provide Custody could operate a CSD for an AMI or ATS. In that sense, a Custody Provider undertakes a function similar to the function of providing custody to a Fund Manager, which is included as part of the current definition of Providing Custody. In line with this approach, we propose to expand the definition of Providing Custody to include operating a CSD for an AMI or ATS.

See the proposed amendments to the definitions of Operating a Clearing House in GEN Rule 2.18.1 and the definition of Providing Custody in GEN Rule 2.13.1(3) – Appendix 2.

41. If CSD operations are undertaken by an AMI or Authorised Firm under their respective Licences, a number of additional requirements specific to CSD operations are proposed to address specific risks associated with such activities, particularly those arising where a CSD links with other CSDs. Accordingly, we propose to provide tailored regulation of this activity, without having to introduce a new category of Financial Service, and also without having to impinge on the current distinction drawn between Financial Services permitted to be undertaken by AMIs and Authorised Firms.

See the proposed requirements for Authorised Firms providing CSD for an AMI or ATS in COB chapter 10 – Appendix 3; and GEN section 7.5 for an AMI operating a CSD as part of Operating a Clearing House – Appendix 2.

Issues for consideration

11. Do you have any concerns relating to the proposed expansion of the Financial Services of Providing Custody and Operating a Clearing House to incorporate the activities of operating a CSD? If so what are those concerns and how should they be addressed?
12. Do you have any concerns about the proposed requirements to regulate CSD operations? If so what are those concerns and how should they be addressed?
13. Are there any other concerns relating to CSD related proposals? If so, what are those concerns and how should they be addressed?

Providing flexibility for AMIs to operate a Multilateral Trading Facility (MTF)

42. As highlighted before, functionally the difference between the activity of Operating an Exchange and of Operating an MTF is narrow (confined to the public interest based regulation of Exchanges as primary capital raising venues as well as secondary markets for Securities, whereas MTFs are only secondary trading venues). Under the EU model, MTFs can be operated by both investment firms (our equivalent being Authorised Firms) and regulated exchanges (our AMIs).⁷
43. We propose to provide flexibility for an AMI with a Licence to Operate an Exchange also to undertake the activity of Operating an MTF, which it would otherwise be prohibited from undertaking because, under the current regime, Operating an MTF is a Financial Service that can only be undertaken by an Authorised Firm Licensed to Operate an ATS.
44. We propose to provide such flexibility by allowing an AMI to operate an MTF by obtaining an endorsement on its Licence permitting it to do so. Such an endorsement does not alter the status of an AMI to that of an Authorised Firm but simply allows it to carry out, alongside its AMI business of Operating an Exchange, a Financial Service otherwise available only to an Authorised Firm.
45. We have adopted this approach because operating an MTF is a distinct and stand-alone activity from Operating an Exchange, which warrants distinct regulation (and hence this is different to CSD functions, which can be carried on as an adjunct to the Clearing House function or Providing Custody function).

See GEN Rules 2.2.11(c) and 2.2.12 – Appendix 2.
46. We also propose to require that an Operator of an Exchange which Operates an MTF alongside its Exchange must do so in accordance with the same requirements as those applying to it in respect of Operating an Exchange. However, the two facilities would need to be operated and maintained separately.⁸

⁷ Although OTFs are, like MTFs, secondary trading venues, they can only be operated by Authorised Firms, and not by Exchanges. This is because OTF operators have a higher degree of flexibility with regard to the rules subject to which the OTFs are operated but are subject to certain additional conduct requirements that apply only to Authorised Firms (eg suitability, best execution and client order handling requirements in COB).

⁸ This does not require the establishment of separate legal entities for each facility.

Issues for consideration

14. Do you have any concerns relating to the proposal that an AMI Operating an Exchange be allowed to also Operate an MTF? If so, what are those concerns and how should they be addressed?
15. Do you think that allowing an AMI to operate an MTF could create conflicts of interest and other operational issues that would need to be addressed through appropriate additional requirements? If so, what are those issues and what regulatory requirements should be used to address them?

Introducing a new regulated activity called Trade Repository

47. A new development in capital markets, as reflected in the IOSCO Principles,⁹ is the introduction of the regulated activity called a Trade Repository (TR). A TR is a centralised registry which maintains an electronic database of records of transactions in Investments (including OTC transactions).¹⁰
48. In light of the above developments, we propose to introduce a new category of activity called Trade Repository (“TR activity”), which can be undertaken by an AMI or Authorised Firm, subject to a few specific requirements applicable to the conduct of that activity in line with the IOSCO standards. According to our proposals, if an AMI or an Authorised Firm wishes to undertake TR activities, they would need an endorsement on their Licence indicating that they are undertaking TR activities in the DIFC. They would also need to comply with the requirements proposed in GEN APP5 with respect to their TR activities.
49. However, at this stage, we do not propose to make the activity of a TR be defined as a Financial Service for two reasons. First, we have not yet developed a transaction reporting regime, obliging any Person in the DIFC to report data relating to their transactions to a TR. Secondly, this activity does not seem to fit neatly within the conventional concept of Financial Services (as in the case of other Financial Services which are provided by Authorised Firms and AMIs to their Clients or Members). Therefore, until we address these issues and, also fully develop a transaction reporting regime applicable to regulated firms in the DIFC, it seems inappropriate to treat this as a Financial Service.
50. Nevertheless, by introducing TR as a regulated activity now, instead of waiting to do so after developing a transaction reporting regime applicable to

⁹ The proposed definitions of Trade Depository (TS) and the associated requirements are based on the IOSCO Market Infrastructure Principles – 2012.

¹⁰ According to IOSCO statements, the primary public benefit of regulating TRs is to improve market transparency and the provision of this data to relevant authorities and the public in line with their respective information needs. This is because the timely and reliable access to data stored in a TR has the potential to improve significantly the ability of relevant authorities and the public to identify and evaluate the potential risks posed to the broader financial system. Relevant authorities, in particular, should have effective and practical access to data stored in a TR, including participant-level data, which such authorities require to carry out their respective regulatory mandates and legal responsibilities.

DIFC based firms, we propose to create a regulatory environment in the DIFC where DIFC based TRs could provide their services to regulated firms in other jurisdictions where such firms are subject to transaction reporting obligations to a regulated TR (such as in the US or the EU).

See GEN Rules 2. 2.13 and App 5 of GEN – Appendix 2.

Issues for consideration

16. Do you think it is appropriate to introduce Trade Repository activity as a regulated activity? If not, what are your reasons?
17. Do you have any objections to Trade Repository activity not being treated as a Financial Service at this stage?
18. Do you think we should await the development of the transaction reporting regime that would support Trade Repository activities before attempting to regulate this activity? If so why?

Part B: Strengthening the governance of Authorised Market Institutions

Licensing of Key Individuals

51. One of our key initiatives to promote sound governance of AMIs is to introduce a licensing regime for Key Individuals responsible for significant Regulatory Functions within an AMI (e.g. Directors, senior managers and individuals performing Key Control Functions such as Risk Officer, MLRO and internal auditor).
52. Under the current AMI regime, although AMIs are required to have Key Individuals appointed to perform significant Regulatory Functions, such individuals are not subject to any DFSA approval or licensing requirement, as is the case for Licensed Individuals performing similar functions within an Authorised Firm. As a result, AMIs appointing Key Individuals to perform significant Regulatory Functions within the organisation do not have the benefit of the DFSA vetting process to ensure that such individuals have integrity and appropriate competency, independence and objectivity to perform the relevant functions assigned to them, in the same manner as in the case of individuals performing similar functions within an Authorised Firm.
53. Therefore, we propose to require Key Individuals performing Regulatory Functions (such as Members of the AMI's Governing Body, Senior Executive Officer (SEO) and individuals performing Key Control Functions such as the Risk Officer, the Money Laundering Reporting Officer (MLRO) and internal auditor) to be subject to a requirement for DFSA approval.

See section 5.3 of the proposed AMI module – Appendix 1.

Issues for consideration

19. Do you have any concerns that Key Individuals of an AMI be subject to a DFSA approval requirement? What are your reasons?

20. Are there any other functions which should be included as Key Individual functions, or alternatively, are there any proposed Key Individual functions which should not be treated as such? What are your reasons for including or excluding such functions?
21. Do you agree that only the SEO, Compliance Officer and MLRO should be required to be resident in the U.A.E? Are there other Key Individuals who should be resident in the U.A.E? Who are they and why should they be required to be resident in the U.A.E?

Conflicts of interest

54. Another significant area in which our proposals seek to promote proper governance of AMIs is by addressing potential conflicts of interest that arise in their operations. Conflicts of interest that are likely to impair the proper functioning of an AMI can arise due to personal interests of its Employees conflicting with the interests of the AMI in discharging their duties (eg personal account trading).
55. To address such conflicts, we propose that an AMI:
 - (a) has codes of conduct which contain detailed provisions to address matters such as personal account trading by its Employees;
 - (b) makes such codes of conduct contractually binding on its Employees; and;
 - (c) makes available copies of such codes to the DFSA upon request.

See AMI Rules 5.4.1, 5.4.2 and 5.4.3 of the proposed AMI module in Appendix 1.

Issues for consideration

22. Do you have any concerns about the proposed enhancements to the AMI regime to address conflicts of interest? If so, what are they, and how should they be addressed?
23. Are there other types of conflicts of interest which are not addressed? If so, what are they, and how should they be addressed?

Performance of Regulatory Functions

56. As an AMI plays a public interest function in operating an Exchange or Clearing House, it is important to ensure that the pursuit of its commercial interests does not adversely affect the AMI's performance of its Regulatory Functions. This is particularly important in the areas of allocation of adequate resources for risk management and compliance functions. To address such risks, we propose that an AMI be required to take all reasonable steps, including having adequate systems and controls, to ensure that the performance of its Regulatory Functions is not adversely affected by the pursuit of its commercial interests.

See AMI Rules 5.4.4 and 5.4.5 of the proposed AMI module and the associated Guidance in Appendix 1.

Issues for consideration

24. Do you have any concerns relating to the proposed requirements to promote effective discharge of Regulatory Functions by an AMI? If so, what are they, and how should they be addressed?

Introduction of user committees to advise the Governing Body of AMIs

57. We propose to introduce a requirement that an AMI establishes user committees to advise its Governing Body and senior management. This proposal is designed to further strengthen good governance resulting from stakeholder participation in decision making and by providing a mechanism for an AMI to obtain market feedback on relevant issues.

See AMI Rule 5.2.3(2)(b) and (3) – Appendix 1.

Issues for consideration

25. Do you have any concerns about the proposal to introduce user committees? If so, what are those concerns, and how should they be addressed?

Part C: Enhancing the regulatory regime applicable to AMIs**Proper Markets**

58. Whilst the current AMI regime contains some requirements relating to Proper Markets to promote fair, efficient and orderly conduct of trading of Investments on Exchanges, it is somewhat lagging behind market and regulatory practices, especially in light of IOSCO standards and the EU regime. Therefore, to enhance the AMI regime, we propose provisions dealing with:
- (a) pre-trade and post trade transparency, where an Exchange is required to disclose to the public on a continuous basis information relating to trading of Investments on its facilities, including the current bid and offer prices and volume, and the depth of interest shown at the prices and volumes advertised through its systems. These provisions also contain flexibility for dealing with dark pools and dark orders – see the proposed AMI Rules 6.4.1 and 6.4.2 and the associated Guidance in Appendix 1;
 - (b) volatility controls, where an Exchange is required to have in place effective controls to ensure that its trading systems are resilient and capable of operating in an orderly manner under conditions of market stress – see the proposed AMI Rules 6.5.1 and 6.5.2 in Appendix 1;
 - (c) error trades, where an Exchange is required to have adequate systems and controls to prevent, minimise and rectify, as appropriate, Error Trades – see the proposed AMI Rule 6.6.1 in Appendix 1;

- (d) short selling and position management, where an Exchange is required to have effective systems, controls and procedures to monitor and manage short selling in Securities and manage risks arising from position controls – see the proposed the AMI Rule 6.7.1 in Appendix 1; and
 - (e) liquidity incentive schemes, where an Exchange is required to obtain the DFSA's prior approval before introducing such schemes – see the proposed the AMI Rule 6.9.1 in Appendix 1.
59. The proposed requirements above are outcome based and designed to meet the IOSCO standards and in line with the EU regime.

Issues for consideration

- 26. Do you have any views relating to the proposed enhancements relating Proper Markets? What are those and why?
- 27. Are other enhancements needed to promote fair, efficient and orderly conduct of trading? What are they and why should such enhancements be made?

Foreign ownership restrictions

60. A feature related to Proper Markets that may affect DIFC based issuers whose Securities are traded on an AMI is the range of foreign ownership restrictions that may apply to such companies. For instance, whilst companies incorporated in the DIFC and listed on an AMI are not directly subject to any limits on foreign ownership, if they own shares in companies incorporated in the U.A.E (outside the DIFC), they become subject to the foreign ownership restrictions applicable to such equity/assets.
61. To promote orderly markets, we propose that AMIs put into place effective mechanisms to identify and deal with such ownership restrictions. Such measures include early warnings when any ownership limits are, or are about to be, breached and the ability for an AMI to require issuers of Securities affected by such restrictions to take appropriate measures to mitigate the impact of such restrictions on its trading activities.

See section 6.8 of the proposed AMI module – Appendix 1.

Issues for consideration

- 28. Do you have any concerns relating to the proposed requirements to address foreign ownership restrictions? What are they and how should they be addressed?
- 29. Are there any other means by which foreign ownership restrictions can be addressed so that such restrictions do not adversely affect functioning of Proper Markets? What are they and why should they be introduced?

Direct Electronic Access through Members

62. We are not proposing any changes to the current membership criteria of an AMI (which remains substantially limited to Authorised Persons and Recognised Persons), but we propose a number of related enhancements. Of particular significance are:
- (a) the new proposals that govern Direct Electronic Access (DEA criteria) to an AMI's facilities by clients of Members; and
 - (b) the requirement that an AMI ascertains the adequacy and appropriateness of organisational and technological capacity of Persons seeking access to its facilities, including their ability to meet the DEA criteria.
63. These enhancements are designed in line with the IOSCO Principles and the EU regime, and are already reflected in the policies and practices of the AMIs in the DIFC.

See section 5.7 of the proposed AMI module – Appendix 1.

Issues for consideration

30. Do you have any concerns relating to the proposed enhancements to membership related requirements? What are they and how should they be addressed?

Enhancing operational efficiency and resilience of AMIs

64. There are a number of areas in which our proposals seek to enhance the operational efficiency and resilience of AMIs, in particular, relating to systems and controls, risk management, technological resources and financial resources.
65. As a result of increased reliance on information technology for trading and clearing of Investments, not only by AMIs but also by their Members, we propose to strengthen the regulatory requirements relating to systems and controls as well as technology resources (i.e. testing of the Exchanges' and its Members' IT systems including any algorithms applied for automated trading), in line with the IOSCO standards and the EU regime.
66. We also propose fine tuning of the existing financial resource requirements applicable to AMIs in terms of the acceptable forms of assets to meet the financial resource requirement.

See section 5.5 and APP 1 of the proposed AMI module – Appendix 1.

Issues for consideration

31. Do you have any views relating to the proposed enhancements relating to information technology and capital resources? If so, are there any changes required to the current proposals to reflect those views?

Enhancements relating to safeguarding and administration of assets

67. Again, whilst retaining the main outcome based requirements that an AMI must provide adequate mechanisms to safeguard and protect member assets, we propose to provide greater clarity, in line with the IOSCO Principles and the EU regime, by stipulating minimum requirements for an AMI to meet this obligation. These cover requirements relating to segregation, reconciliation at appropriate intervals and identification of assets and their legal or beneficial ownership.
68. The minimum requirements proposed for safeguarding and administration of assets are substantially similar to those already applying to Authorised Firms and reflect best practice standards in the industry.

See section 5.10 of the proposed AMI module – Appendix 1.

Issues for consideration

32. Do you have any views relating to the proposed enhancements relating to safeguarding and administration of assets? If so, are there any changes needed to the current proposals to reflect those views?

Enhancements to support effective supervision of AMIs

69. An effective means of ensuring that AMIs meet the relevant requirements under the AMI regime on an on-going basis is to require prior approval of the DFSA for any material changes to organisational arrangements that an AMI has in place to discharge its Regulatory Functions (as is already the case for changes to its Business Rules).
70. The criteria and process proposed for such approval are not entirely new. However, we propose certain enhancements to provide greater clarity and certainty relating to the applicable regulatory process. In doing so we deal with issues such as when the DFSA would dispense with public consultation for any proposed changes to Business Rules on the basis of public interest, or where the changes are insignificant, and the time periods within which such approval should be sought and granted.

See section 4.3 and AMI Rules 5.6.4 – 5.6.7 of the proposed AMI module – Appendix 1.

Issues for consideration

33. Do you have any concerns relating to the proposed enhancements to the procedures dealing with material changes to existing arrangements to meet Regulatory Functions of an AMI, and amendments to Business Rules? If so what are they and how should they be addressed?

Part D: Enhancements relating to Clearing Houses

Proposed risk management requirements for Clearing Houses

71. Although AMIs are subject to general requirements relating to risk management under GEN chapter 5, those requirements are not sufficiently detailed to address risks associated with Clearing Houses which carry systemic risks, and hence the rationale for invoking public interest regulation. In line with the IOSCO Principles and the EU model, we propose to introduce a tailored regime of risk management for Clearing Houses.
72. Under these proposals, a Clearing House would be required to have a comprehensive risk management framework (i.e. systems and controls, including policies and procedures), that encompasses regular review of risks to which the Clearing House is exposed, and also of risks which it poses to other market participants. This framework should also be subject to periodic review to ensure it remains effective and operates as intended.
73. We also propose requirements relating to specific areas of risk to Clearing House operations, such as liquidity and legal risks, especially where their operations are cross jurisdictional.

See section 7.2 of the proposed AMI module – Appendix 1.

Issues for consideration

34. Do you have any concerns relating to the proposed requirements to address risk specific to Clearing Houses? If so, what are they and how should they be addressed?
35. Are there other areas of risk which should be addressed through additional requirements? What are those risks and what requirements should be applied to address them?

Proposed additional risk management requirements for CCPs

74. As CCPs incur liabilities as counterparties, they face additional risks. Of particular importance is the credit risk. In line with the IOSCO Principles, we propose to introduce specific requirements relating to credit risk management for CCPs. These include stress testing on a daily basis, using models containing standard and predetermined parameters and assumptions.
75. We also propose specific requirements to manage credit and market risks to which CCPs are exposed, again in line with the IOSCO Principles.

See section 7.3 of the proposed AMI module – Appendix 1.

Issues for consideration

36. Do you have any concerns relating to the proposed requirements to credit and market risks of CCPs? If so, what are they and how should they be addressed?

37. Are there other areas of risk to which CCPs are exposed, which should be addressed through additional requirements? What are those risks and what requirements should be applied to address them?

Part E: Enhancing regulatory requirements applicable to ATS

ATS to attract substantially similar regulation to Exchanges

76. We propose to regulate ATS Operators (i.e. both MTF and OTF Operators) in a manner substantially similar to that applying to an AMI Operating an Exchange, whilst recognising that ATSs are not capital raising venues. Accordingly, the proposed requirements for ATS Operators are substantially similar to those proposed for Exchanges, in particular:
- (a) operational rules for ATS Operators, which are similar to Business Rules of an AMI;
 - (b) membership criteria for ATS Operators, with a slightly wider category of Professional Clients than allowed as Members of an AMI to participate on an ATS;
 - (c) Investment criteria to be traded on an ATS, without the exception of admission to trading function which is available only to Exchanges; and
 - (d) technology resources and Proper Markets related requirements which are similar to those applying to Exchanges.

See chapter 9 of COB module – Appendix 3.

Issues for consideration

38. Do you have any concerns relating to the proposed requirements to regulate ATS Operators? If so, what are they and how should they be addressed?
39. Are there any areas of risk which should be addressed through additional requirements? What are those risks and what requirements should be applied to address them?

Membership criteria for ATS

77. Under the current ATS regime, any type of Professional Clients are permitted to participate as members of an ATS operated by an Authorised Firm. We propose to limit the type of Professional Clients to whom access may be provided by an ATS Operator. Accordingly, the membership of an ATS would be limited to an Authorised Firm, a Recognised Member, a Person classified under GEN Rule 2.3.2(2) (i.e. a Person undertaking Commodity Derivative transactions on the ATS on its own behalf or on behalf of a wholly owned holding company or subsidiary of it) or a Professional Client which is a listed company on an AMI or other Regulated Exchange, a Body Corporate with at

least US\$10 million called up share capital or any institutional investor whose main activity is to invest in financial instruments.

78. We are proposing such restrictions to better align the ATS regime with the AML regime, and to ensure that Persons who are provided with access to an ATS are institutional clients who have adequate organisational and professional competencies both to safeguard their own interests and to ensure proper operation of the ATS.

See chapter 9 of COB module – Appendix 3.

Issues for consideration

40. Is it appropriate to restrict the type of Professional Client to whom an ATS Operator may provide access to its facilities in the manner proposed? If not, why?
41. Are there any other types of Professional Client to whom ATS Operators should be permitted to allow access? Who are they and why should they be included within the membership criteria of ATS?

Financial resources requirement for ATS Operators

79. ATS Operators are currently treated as Prudential Category 4 firms attracting a base capital requirement of US\$10,000 or 6 weeks operational capital whichever is the higher. Whilst this may be seen as adequate for the orderly wind down of a small scale client-order-matching system, the collapse of a large MTF, particularly where it is providing a large platform for trading of Derivatives, could have a significant adverse impact on users of such a facility.
80. Under the EU model, investment firms operating an MTF or OTF are required to have minimum capital of US\$930,000, and Hong Kong requires the equivalent of US\$645,000 paid-up capital and US\$390,000 liquid capital.
81. We consider that a more appropriate capital regime for ATS Operators is US\$500,000 or 6 months operating expenses (whichever is the higher) as this is in line with the current Exchange related capital requirement and the EU regime. The DFSA has the power to impose additional capital requirements by way of Licence conditions in appropriate cases where the nature, scale and complexity of a proposed ATS warrants such imposition.

Issues for consideration

42. Is it appropriate to subject ATS Operators to a minimum capital requirement of US\$ 500,000 or 6 months operating expenses (whichever is the higher)? If not, what would be an appropriate capital requirement?
43. Should the DFSA introduce any new capital requirements immediately? If not, what are your reasons?

Part F: Miscellaneous enhancements and transitional arrangements

Transitional arrangements

82. We note that some aspects of the proposed regime, particularly those relating to licensing of Key Individuals, and other enhancements such as those relating to safe custody, conflicts of interest and technological resources, may require a reasonable time period for an AMI to migrate to the new regime.
83. As the objective of the proposed AMI regime is to ensure higher standards of governance and operations of AMIs in line with international best practice as reflected in IOSCO standards, we consider that grandfathering of the existing AMIs into the new regime would not be appropriate.
84. Therefore, we propose to allow existing AMIs existing at the date when the new AMI regime comes into force a period of six months to transition to the new regime.

See chapter 12 of the proposed AMI module – Appendix 1.

Issues for consideration

44. Do you agree with the view of the DFSA that grandfathering is not appropriate, If not, why not?
45. Is a six month transitional period adequate to allow existing AMIs to migrate to the new regime? If not, what would be a more appropriate transitional period?

Thematic rearrangements and other consequential changes

85. We have also been able to make a more cohesive thematic rearrangement of the requirements applicable to AMIs in the proposed AMI module, by setting out the General Requirements common to both types of AMIs (i.e. Exchanges and Clearing Houses) in chapter 5, and the additional requirements applicable to each type of AMI (see chapter 6 for additional requirements for Exchanges and chapter 7 for additional requirements applicable to Clearing Houses).
86. We have also made a range of clarificatory and consequential changes to the AMI regime. More significant aspects of such changes include:
- (a) enhancements relating to the provisions dealing with Market Abuse , whilst removing some of the anti-money laundering provisions to the proposed AML module which is currently under public consultation under Consultation Paper No. 86– See AMI Rule 5.11.2 in Appendix 1;
 - (b) enhancements relating to safeguarding and administration of assets belonging to Members of an AMI – see section 5.10 of the AMI module in Appendix 1; and
 - (c) introduction of requirements relating to the use of prices provided by Price Information Providers for trading and clearing of Investments – See the proposed AMI Rule 5.8.1(3) and APP2 in Appendix 1.

Issues for consideration

46. Are there any concerns relating to the above proposals? If so what are they and how should they be addressed?