CONSULTATION PAPER NO. 75

20 APRIL 2011

PROPOSED CHANGES TO THE MARKETS LAW REGIME

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Why are we issuing this paper?

1. The DFSA proposes to make significant changes to the requirements applicable in respect of:

   (a) the Offer of Securities to the Public in or from the DIFC;

   (b) the admission to trading of Securities on an Authorised Market Institution;

   (c) the governance of Reporting Entities;

   (d) market disclosure of information; and

   (e) the requirements applicable to Listed Funds.

   A substantial part of these requirements is currently contained in the Markets Law 2004 and in the Offer of Securities Rules (OSR) module of the DFSA Rulebook. For convenience, these provisions are collectively referred to as the "Markets Law Regime".

2. The changes proposed in this paper are designed primarily to bring the DFSA's Markets Law Regime into closer alignment with the EU requirements in the Prospectus Directive ("PD") and the Market Abuse Directive ("MAD"), while retaining features necessary to accommodate regional needs and circumstances.

Who should read this paper?

3. The proposals in this paper would be of interest to:

   (a) companies incorporated both in the DIFC and in other jurisdictions who wish to raise capital by offering their Securities to the public in or from the DIFC;

   (b) companies whose Securities are, or are to be, admitted to trading on an Authorised Market Institution;

   (c) Fund Managers where Units of the Funds they manage are or are to be admitted to trading on an Authorised Market Institution;

   (d) Persons investing or intending to invest in Securities offered in or from the DIFC;

   (e) Authorised Market Institutions and Regulated Exchanges and clearing houses, particularly in the in the GCC;

   (f) Authorised Firms acting as Financial Intermediaries in respect of offers of Securities or dealing or trading in Securities which are admitted to trading on an Authorised Market Institution or Regulated Exchange;

(g) Recognised Bodies and Recognised Members;

(h) Persons providing legal, accounting and audit services or acting or proposing to act as sponsors or other third party advisers in respect of offers of Securities; and

(i) Financial Services Regulators, particularly in the GCC.

How to provide comments?

4. 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. 75
Policy and Legal Services
DFSA
PO Box 75850
Dubai, UAE

Email: consultation@dfsa.ae

Tel: +971(0)4 3621500

What happens next?

5. The deadline for providing comments on the proposals is **18 July 2011**. Once we receive your comments, we shall consider if any further refinements are required to these proposals. We shall then proceed to recommend the proposed changes to the Markets Law 2004 to the President for enactment by the Ruler. If the proposed changes to the Markets Law 2004 are enacted, 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 Markets Law 2004 and DFSA Rulebook are made. We shall issue a notice on our website telling you when this happens.

Background

6. The proposals in this paper stem from a comprehensive review of the Markets Law 2004 and the OSR undertaken as part of the DFSA's rolling review of the legislation it administers, including its Rulebook modules, to ensure their adequacy and relevance in light of current regulatory and market developments.

Replacement of the Markets Law 2004 and the OSR module

7. Because the proposals involve significant augmentation and refinements to many of the current provisions in the Markets Law 2004 and the OSR, and a thematic re-arrangement of those provisions (see paragraph 60), we intend to repeal and replace this legislation in its entirety. The Markets Law 2004 will be replaced with the Markets Law 2011 (see Annex A) and the OSR will be replaced with the Markets Rules (MKT) module (see Annex (B)).

8. We also propose less extensive changes to other modules of the DFSA Rulebook, such as the Authorised Market Institutions (AMI) module (see Annex C) and the Glossary (GLO) module (see Annex D).

Structure of the paper

9. The proposals in this paper are structured, for convenience, to substantially mirror the chapter headings used in the Markets Rules (MKT) module as follows:

   (a) Terminology – paragraph 10;

   (b) Part 1: Prospectus requirements – Paragraphs 11 – 32;

   (d) Part 2: Authorised Market Institutions– Paragraphs 33 & 34;

   (e) Part 3: Obligations of Reporting Entities – Paragraphs 35 – 56;

   (f) Part 4: Market disclosure – Paragraphs 57 – 60;

   (g) Part 5: Accounting periods and financial reporting – Paragraph 61;

   (h) Part 6: Market abuse provisions – Paragraphs 62 & 63;

   (i) Part 7: Listed Funds – Paragraph 64 & 65; and

   (k) Part 8: Other changes – Paragraphs 66 – 68.

Terminology in this paper

10. 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. Any italicised words are terms not used in our legislation, but used in the EU Directives.

Part 1: Prospectus requirements

Trigger for a Prospectus

11. The proposed Prospectus disclosure regime reflects a significant change from the current Prospectus requirements in that it no longer classifies offers of Securities into three classes, i.e., "public offers", "exempt offers" and "unregulated offers". Instead, we are proposing a structure which is better aligned with the approach of the European Union's Prospectus Directive ("PD") and is centred around two types of activities which would trigger the need to have a Prospectus:

    (a) an Offer of Securities to the Public in or from the DIFC; and

    (b) having Securities admitted to trading on an Authorised Market Institution.

12. We propose that a Prospectus be required for the purposes of having any Securities admitted to trading on an Authorised Market Institution. This requirement is an essential feature for admission to trading of Securities in the European Union and other major jurisdictions to ensure full and proper disclosure relating to Securities at the point of their admission to trading on an exchange. The absence of such a requirement in the current OSR regime has led to significant difficulties in ensuring full and proper disclosure of information to markets, especially where Securities issued to professional/wholesale investors under limited disclosure are subsequently admitted to trading on an Authorised Market Institution and become open to retail investors.

A new definition of "Offers of Securities to the Public"

13. Under the current OSR, activities that constitute an "Offer of Securities" are defined in terms of "offers" and "invitations" directly or indirectly targeting investors. Where such offers are directed at or targeted to Retail Clients in the DIFC, they are classified as Public Offers. We propose to include in the Markets Law a new definition of activities constituting "Offers of Securities to the Public" in line with the PD definition. Under the proposed definition, "a communication to any person in any form or by any means, presenting information on the terms of the offer and the Securities offered, so as to enable an investor to decide to buy or subscribe for those Securities…" is an Offer of Securities to the Public and triggers the Prospectus requirement.

14. As this definition is very wide, in line with the PD, we have excluded from the definition of an "Offer of Securities to the Public" those communications made in connection with the trading of Securities on an Authorised Market Institution or other Regulated Exchange. This is to remove from its ambit communications made for the purposes of, or in connection with, the trading of Securities where such trading occurs on a fully informed basis on the secondary market, with the benefit of the disclosures made to, and under the supervision and scrutiny of, an Authorised Market Institution or other Regulated Exchange.

Exemptions from the Prospectus requirements

15. We propose to provide specific exemptions from the Prospectus requirement:

    (a) in the case of an Offer of Securities to the Public where the offer qualifies as an Exempt Offer (see MKT Rule 2.3.1); and

    (b) in the case of having Securities admitted to trading on an Authorised Market Institution where the Securities qualify as "Exempt Securities" (see MKT Rule 2.4.1).

16. In addition to the exemptions noted above, the requirements relating to Prospectuses in the Markets Law and MKT do not apply to an Exempt Offeror (i.e. a recognised government or other Person included in the DFSA's Exempt Offeror list). Accordingly, the Securities of an Exempt Offeror, or Securities which are unconditionally and irrevocably guaranteed by such an Exempt Offeror, are not subject to the Prospectus requirements, and can be offered to the public or admitted to trading on an Authorised Market Institution without having to comply with the Prospectus requirements in the Markets Law and MKT. However, should such an Exempt Offeror wish to voluntarily subject itself to the Prospectus regime, the DFSA has the power to modify the Markets Law to achieve this effect (see Guidance item no 4(b) under MKT Rule 1.1.3).

17. While these exemptions are substantially similar to the exemptions provided under the PD, we propose some adaptations to accommodate regional circumstances and the nature of DIFC markets (see paragraph 18 relating to natural Person Professional Clients).

    Individual Professional Clients

18. Under the PD approach, there is an exemption from the Prospectus requirement for offers made exclusively to *"qualified*" investors. This PD definition is analogous to our definition of a "Professional Client" and includes both institutional and individual investors. We propose to follow the PD approach except in one respect. We propose not to apply the exemption from the Prospectus requirement in the case of an Offer of Securities made to a Professional Client who is a natural person. This is because our current criteria for Professional Clients do not have a particularly high net asset test (currently set at US$500,000 based roughly on the MiFID test of EU500,000 portfolio of assets); and as such, does not warrant the removal of the benefit of Prospectus disclosure to such investors. (See MKT Rule 2.3.1(a)).

19. We note that although the PD provides an exemption from the Prospectus disclosure for offers made exclusively to *qualified investors*, it draws a distinction between natural person investors and institutional investors, in that it applies an opt-in approach for natural person investors to become *qualified investors*. Therefore we believe that the underlying intent of the PD and our approach are not inconsistent.

    Increase in the monetary threshold for non-retail investments

20. We propose to increase the monetary threshold for investments that qualify as "non-retail" investments (such as those currently available under the OSR for Debentures and Commercial Paper for minimum consideration of

US$50,000) in line with the recent changes made to the PD. Under these changes, the monetary threshold for the exemptions from the Prospectus requirement, where the minimum consideration paid or payable by an investor is at least EUR50,000 or where the Securities are denominated in amounts of at least EUR50,000, has been increased to EUR100,000. This is because, as noted by the Council of the EU, EUR50,000 is too low a threshold to be a true reflection of the distinction between retail investors and *qualified investors* in terms of investor capacity, as retail investors were found to have made investments more than EUR50,000 in one single transaction.

21. Accordingly, our proposals include exemptions from the Prospectus requirement to Offers of Securities to the Public where the consideration payable by an investor, or the denomination of the relevant Securities, is at least US100,000 (which is a rough equivalent to EUR100,000) (see MKT Rule 2.3.1(c)and (d)). See also under the small scale offerings discussed below where the monetary threshold to qualify as a small scale offer has been increased.

Small scale offerings

22. Under the current OSR regime, there are a number of exemptions for "small scale" capital raisings where:

    (a) no Prospectus is required for 50 or fewer private placements made in the DIFC within 12 months, with the total capital raised via those placements not exceeding US$1 million; and

    (b) less detailed disclosure than in a full Prospectus is required (based on an Exempt Offer Statement) for:

        (i) 50 Offers in the DIFC within 12 months; or

        (ii) a capital raising where the total consideration paid is less than US$1 million.

23. Under the PD, there are certain small scale capital raisings which are totally exempt from the Prospectus requirement as follows:

    (a) offers directed at fewer than 100 investors of any class (which number has recently been increased to fewer than 150 investors);

    (b) offers where the total capital raised is less than EUR1 million over a period of 12 months (where the monetary threshold is now increased to EUR 5 million);

    (c) offers of non-equity (i.e. debt) Securities issued by continuous issuers which are credit institutions and the total capital raised is at least EUR50 million (where the monetary threshold is now increased to EUR75 million); and

    (d) in the case of Securities admitted to trading, additional capital raising, over a period of 12 months, involving less than 10% of the number of Securities of the same class already admitted to trading.

24. Our proposed exemptions reflect, with one exception, the recent changes to the PD noted above. We propose to retain the current limit of 50 or fewer offers in or from the DIFC within 12 months, so that mass marketing in or from the DIFC without a Prospectus cannot be undertaken using this exemption. See MKT Rule 2.3.1(b) Guidance which clarifies that it is the number of offers made, rather than the actual issues or sales resulting from such offers, that would be relevant for the purposes of this exemption.

Secondary sales to retail investors

25. Under the current OSR regime, where Securities have previously been offered by way of a Prospectus, no subsequent (i.e. secondary) offers of those Securities are treated as new offers.

26. We propose, in line with the PD, that any secondary Offer of Securities to the Public where those Securities were previously offered without a Prospectus in reliance on an available exemption should be treated as a new Offer of Securities to the Public. As a result, unless the new offer in itself is an Exempt Offer as prescribed in MKT Rule 2.3.1, the subsequent offer would trigger the requirement for a Prospectus under our proposals (see MKT Rule 2.3.2).

27. Under the PD, where Securities are placed through a Financial Intermediary for subsequent resale to retail investors, the Financial Intermediary is permitted to use a Prospectus prepared by the initial issuer, provided the Prospectus meets the requirements relating to retail offerings, the issuer has consented to the use of the Prospectus by the Financial Intermediary and the Prospectus is current. This is to provide greater flexibility and clarity to issuers and Financial Intermediaries, whilst promoting adequate retail investor protection in secondary sales. We therefore propose to follow the PD approach by allowing Financial Intermediaries to use a Prospectus prepared by the Issuer subject to similar conditions. See MKT Rule 2.6.5.

Key Information to be included in the Summary and civil liability

28. The recent changes to the PD encompass more tailored and detailed key information to be included in a Prospectus in the form of a Summary. This enables investors to make informed decisions and more easily compare the Securities offered under the Prospectus with similar investments. In accordance with the PD approach, we propose to include a requirement for a more comprehensive Summary to be included in a Prospectus containing certain Key Information specified (see MKT Rule 2.5.2(1)(b)). We also propose provisions, in line with the PD, to ensure that Persons liable for the Prospectus are not exposed to civil liability in respect of the content of the Summary, unless the Summary, when read in conjunction with the other parts of the Prospectus, is misleading, inaccurate or inconsistent.

Validity of a Prospectus

29. The current OSR regime does not contain a requirement that limits the validity of a Prospectus to a specific period. Accordingly, a Prospectus, provided it contains all the relevant information required under the current regime, can be used without any need to replace it after a particular period. Under the recent changes to the PD, a Prospectus is valid for a period of 12 months from the date of its approval for the purposes of making an Offer of Securities to the

Public or for having Securities admitted to trading on an exchange, provided it contains all the relevant information. In line with the PD approach, as well as the Prospectus requirements applicable to Funds, we propose to limit the validity of a Prospectus to a period of 12 months from the date of its approval by the DFSA (see the Prospectus approval discussed below). However, should there be any developments between the approval of the Prospectus by the DFSA and the Offer of the Securities to the Public or the admission of the Securities to an Official List of Securities, the Prospectus must be updated by a Supplementary Prospectus (see MKT Rule 2.9.1). We also note that all the information in a Prospectus has to be up to date during the 12 month currency of a Prospectus. For example, the historical financial information that is included in a Prospectus cannot be older than 18 months from the date of the Registration Statement (or Prospectus) if audited interim financial accounts are included in it. See Guidance under MKT Rule 2.9.1.

Prospectus approval

30. We propose to change the current approach relating to Prospectus filing under which the DFSA accepts a Prospectus for filing but does not formally "approve" the Prospectus. Instead, we propose formally to approve a Prospectus before it can be used for the purposes of making a Public Offer to:

    (a) better align the DFSA's approach with the EU approach; and

    (b) enable the DFSA to be satisfied that the Prospectus is "fit for purpose" after a more comprehensive review of its content, especially where the issuers are less experienced.

31. The DFSA approval of a Prospectus signifies that the DFSA is satisfied that the Prospectus, at the time of its approval, meets the applicable requirements in the Markets Law and the MKT. It does not mean that the DFSA accepts responsibility for the accuracy, comprehensiveness or merits of the information included in the Prospectus. The liability for the content of the Prospectus lies with the issuer of the Prospectus and other Persons such as those whose opinions or statements are included in the Prospectus with their consent. To ensure that investors relying on the Prospectus to make investment decisions are made clearly aware of this, a Prospectus is required to include in its front page a clear and prominent statement that the DFSA does not accept any responsibility for the accuracy and comprehensiveness of the content of a Prospectus (see MKT Rule 2.5.1(3)(d).

32. The proposed approval process requires a formal application containing the draft Prospectus and the relevant information to be filed with the DFSA within a certain specified time before the intended date of the Prospectus Offer (see MKT Rule 2.6.1), and the DFSA approving the Prospectus only where it is reasonably satisfied that the Prospectus meets all the applicable requirements in the Law and the Rules (see MKT Rule 2.6.2). A Person intending to make a Prospectus Offer may file a draft version of the Prospectus with the DFSA for its early review to avoid unnecessary delays in getting the Prospectus approved (see Guidance to MKT Rule 2.6.2). The DFSA will, as soon as practicable after processing the application for approval, notify in writing the Person who submitted the application of its decision either to approve or not to approve the Prospectus (see MKT Rule 2.6.2(2)&(3)). A decision by the DFSA not to approve a Prospectus is appealable to the Regulatory Appeals Committee (see MKT Rule 2.6.2(4)).

Issues for consideration

1. Do you have any concerns relating to any of the changes proposed, in particular:

   a. requiring a Prospectus for having Securities admitted to trading on an Authorised Market Institution?

   b. the proposed definition of an Offer of Securities to the Public, and the exclusion of certain communications from that definition?

   c. requiring a Prospectus in the case of an Offer of Securities to the Public which is directed at a Professional Client who is a natural Person?

   d. the increase in the monetary threshold for high-worth offerings in line with the increase under the PD?

   e. treating any secondary offer of Securities which were previously offered under a Prospectus or any available exemption as a new Offer of Securities to the Public?

   f. introducing a Summary containing Key Information in a standardised format to facilitate comparison and well informed decision making by retail investors? and

   g. introducing a 12 month validity period for a Prospectus?

2. Do you have any concerns about the DFSA formally approving a Prospectus or any of the procedures proposed for the purposes of formally approving a Prospectus? If so, what are they and how should they be addressed?

3. Do you have any concerns about the adequacy of the warning that the DFSA is not liable for the content of the Prospectus, and if so how should such concerns be addressed?

4. Do you have any other concerns relating to the above issues or any other aspects of the proposals relating to the Prospectus regime? If so, what are they, and how should they be addressed?

Part 2: Authorised Market Institutions

Supervision of Authorised Market Institutions

33. As part of the streamlining and enhancement process we have undertaken relating to the markets provisions, we have placed in the AMI the provisions dealing with the listing procedures that are currently found in the OSR. In doing so, we have also removed some unintended effects and duplications. See chapter 8 of the AMI at Annex C.

34. There is one noteworthy change we have made to the Markets Law relating to Securities which are included in an Official List of Securities. The current OSR does not require any Securities admitted to an Official List of Securities to be also admitted to trading on an Authorised Market Institution. We propose that any Securities which are admitted to an Official List of Securities ought also to be admitted to trading on an Authorised Market Institution. This new requirement does not prevent Securities admitted to trading on an Authorised Market Institution from being also admitted to trading on other exchanges, including those outside the DIFC. It is designed to promote, consistently with international practice, a greater degree of transparency relating to the trading of the relevant Securities wherever such trading occurs (see Article 33(3) of the Markets Law). We have also included transitional provisions so that existing listings of debt Securities which are not admitted to trading on an Authorised Market Institution could continue to maintain their current status (see chapter 9 of the MKT).

Issues for consideration

5. Do you have any concerns about our proposal to require Securities admitted to an Official List of Securities to be also admitted to trading on an Authorised Market Institution? If so, what are those concerns and how should they be addressed?

Part 3: Obligations of Reporting Entities

Overview

35. Where a Person makes an Offer of Securities to the Public or has Securities admitted to trading on an Authorised Market Institution, such a Person becomes a Reporting Entity. In the case of a Fund, the Fund Manager of a Fund becomes a Reporting Entity only where the Units of the Fund are admitted to trading on an Authorised Market Institution (see Part 7 of this paper for requirements relating to Reporting Entities of Listed Funds).

36. A Reporting Entity attracts a range of obligations under the Markets Law and the Rules. These include matters relating to how a Reporting Entity is governed the disclosures to be made to markets of material information relating to matters such as its operations, developments and financial position and prospects (see Part 4 of the Markets Law and the associated Rules). The key aspects of these requirements, including the significant enhancements proposed, are set out below.

Definition of a Reporting Entity

37. We propose to insert in the Markets Law a substantive definition of a Reporting Entity, extending the current definition to cover Reporting Entities of Listed Funds. It also confers on the DFSA a power to declare a Person to be "a Reporting Entity" or, conversely, a Person who otherwise qualifies as a Reporting Entity to "not be a Reporting Entity". This power is particularly important to deal with situations where a Person other than an issuer of the Securities is the more appropriate Person to be declared as the Reporting Entity because that Person has access to all the relevant information required to be disclosed in respect of any Securities. An example is a Person who sets up a Special Purpose Vehicle (SPV) for securitisation of an asset held by

that Person, where the SPV will be the mere issuer of the Securities, with the Person setting up the SPV having access to all the relevant information in respect of such Securities. The declaration power is to be exercised by the DFSA subject to due process requirements, i.e. providing the relevant parties a right of representation and rights of appeal to the Regulatory Appeals Committee (see Article 37 of the Markets Law).

Governance of Reporting Entities

38. We issued for public consultation in March 2010 a version of corporate governance principles and best practice standards under CP68, on the basis that further changes might be made as part of the full package of reforms to the Markets Law regime which we now propose.

39. We now propose to amend the corporate governance framework to bring our regime into closer alignment with the UK Corporate Governance Code (the UK code) issued by the Financial Reporting Council on which our corporate governance regime is primarily modelled. The current version of the UK code was finalised only in June 2010. We have also taken into account:

    (a) the direction of international developments in corporate governance; and

    (b) regional circumstances relevant to the DIFC markets.

    Overarching outcome based governance principles

40. We have brought together a range of standards and requirements relating to the governance of a Reporting Entity under a new overarching outcome based provision in the Markets Law ("the overarching governance requirement"). This provision requires a Reporting Entity to have *"… a corporate governance framework which is adequate to promote prudent and sound management of the Reporting Entity in the long-term interests of the Reporting Entity and its shareholders."* (see Article 38(1) of the Markets Law).

41. In designing this overarching principle, we took into account the 'purpose of corporate governance' as stated in the UK Code, which states that the "purpose of corporate governance is to facilitate effective, entrepreneurial and prudent management that can deliver the long-term success of the company." We have considered it more appropriate to use the term "long-term interests" instead of the "long-term success" as used in the UK code, in line with the OECD considerations dealing with corporate governance issues in the aftermath of the financial market crisis. These considerations focus on the need to minimise poor governance practices that adversely affect the "long-term objectives and viability" of companies and organisations, at the expense of short term financial profit or success.

    Ambit of corporate governance requirements

42. The proposed overarching governance principle has enabled us to bring under it a wide spectrum of matters that go to the heart of good governance. These include provisions dealing with Directors' duties, conflicts of interests (see the provisions relating to Related Party Transactions and dealings by Restricted Persons) and shareholder protection provisions. These are not new provisions as such, but provisions currently located in various parts of the

OSR. In re-arranging these requirements under the overarching governance principle, we have also made changes to address identified weaknesses, gaps and anomalies.

Corporate Governance Principles

43. We propose to incorporate 7 corporate governance principles (the "Principles") that apply to Reporting Entities. These Principles will have the status of Rules and apply to Persons who become Reporting Entities in respect of Shares and not in respect of other Securities. These Principles are also formulated, like the overarching governance requirement in the Markets Law, as high level outcome based requirements designed to achieve the following:

(a) placing clear accountability on the Board of a Reporting Entity for ensuring that the Reporting Entity's business is managed prudently and soundly - Principle 1;

(b) establishing a clear division between the Board's responsibilities (which are to set the strategic objectives of the Reporting Entity and to provide oversight of the management of the Reporting Entity) and the Senior Management's responsibility (which is to manage the Reporting Entity's business in accordance with the strategic aims and risk parameters set by the Board) – Principle 2;

(c) setting the requirements relating to the Board composition, and the expertise and resources it must have, to be able to discharge its responsibilities effectively – Principle 3; and

(d) establishing a range of specific Board responsibilities such as those relating to sound risk management and internal controls (Principle 4), effective communication with shareholders (Principle 5), accurate and sound reporting on financial positions and prospects of the Reporting Entity (Principle 6) and sound remuneration practices (Principle 7).

Proportionality

44. The best practice standards included in App4 to the MKT set out measures which a Reporting Entity may adopt in order to achieve the outcomes intended by the Principles. These best practice standards provide greater flexibility for application by Reporting Entities taking into account the nature, scale and complexity of their own operations.

Comply or explain approach

45. The best practice standards in App4 are underpinned by a "comply or explain" approach which is similar to the approach reflected in the UK code. This essentially means that while it is mandatory for a Reporting Entity to achieve the outcomes intended by the Principles, it is free to adopt practices or procedures other than those set out in App4 to suit its own operations. For example, where the size of a Board of a particular Reporting Entity does not permit the creation of multiple committees of the Board, it may have a fewer number of Board committees undertaking multiple functions, provided there are no conflicting obligations. Where there is such a valid reason for

deviation from the best practice standards in App4, the Reporting Entity should be able to clearly explain those reasons.

Remuneration related issues

46. The version of the corporate governance principles on which we sought public comments under CP68 in March 2010 did not contain a principle relating to remuneration (although it contained some best practice standards relating to remuneration). We propose to bring to the principle-level a new outcome based remuneration related principle, which requires the Board "to ensure that the Reporting Entity has remuneration structures and strategies that are well aligned with the long-term interests of the entity". While there is significant debate and divergence relating to the level of detailed regulation of remuneration practices needed within corporations, the need to better align remuneration to long-term corporate and individual performance to promote sustainable performance is reflected in most corporate governance codes, including the UK code. Hence our proposal to include a specific high level remuneration related principle.

Directors' duties and treating shareholders fairly

47. The provisions dealing with Directors' duties and fair treatment of shareholders in section 3.3 of MKT are not new and are currently found scattered in various appendices in the OSR, are now brought together under the overarching governance requirement in the Markets Law. They impose on the Directors of a Reporting Entity a range of duties including those relating to acting in good faith and on an informed basis and exercising due diligence in discharging their functions. There are also other provisions explicitly dealing with shareholder approval and other procedures required in matters relating to normal conduct of affairs of a company, such as reduction in share capital and exercise of pre-emption rights.

48. These obligations are, in most jurisdictions, found in the company law regimes. Should the legal requirements applicable to a Reporting Entity in the jurisdiction of its incorporation contain more stringent requirements than these, compliance with those more stringent requirements suffices. Conversely, compliance with these minimum standards is required in the absence of any comparable or more stringent requirements (see Guidance item 2 under MKT Rule 3.3.1).

Conflicts of interests

Purpose

49. The proposed requirements relating to dealings by Restricted Persons (section 3.4) and Related Parties (section 3.5) are designed to address the critical issue of conflicts of interests having an adverse impact on the assets and interests of a Reporting Entity.

50. Restricted Persons are members of the senior management of the Reporting Entity (such as executive Directors and senior managers of the Reporting entity). As these Persons may have access to inside information due to their position, such persons are prohibited from dealing in Securities of the Reporting Entity except where certain clearance procedures are followed.

51. Related Parties of a Reporting Entity include a Director or senior manager of the Reporting Entity or a member of its Group, and Persons who hold 5% or more voting rights in the Reporting Entity or a member of its Group. These are Persons who could exert influence on the Reporting Entity to obtain more beneficial terms than those available to independent third parties when they or their Associates transact with the Reporting Entity.

52. Accordingly, the requirements relating to Restricted Persons and Related Parties are designed to mitigate the risk of such Persons being able to gain personal benefits through self-interested transactions directly or indirectly at the expense of the Reporting Entity. Disclosure to the markets is also required of such dealings and transactions.

53. In contrast, the Connected Person disclosure provisions that are dealt with in paragraph 58 below are distinctly different from the provisions dealing with Restricted Persons and Related Parties. The Connected Persons provisions are designed to provide disclosure to markets, the DFSA and the Reporting Entity of the identity of the Persons in positions of control or influence relating to the Reporting Entity. While there is some overlap of the Persons included within the respective definitions of the terms "Related Parties" and "Restricted Persons" (which are designed for dealing with conflicts of interests), and the definition of "Connected Persons" (which is designed to deal with disclosure of controllers), these are purpose built definitions designed to address different risks, in line with the benchmarked jurisdictions, particularly the UK regime.

Dealings by Restricted Persons

54. The proposed provisions relating to dealings by Restricted Persons are, as noted above, designed to address the risk that individuals within a Reporting Entity may be able to gain personal advantage by dealing in the Securities of the Reporting Entity. These are not new provisions and are currently found in the appendices to the OSR which are now brought into the main text, with some enhancements. The key enhancements made are:

(a) the inclusion of a definition of a "Restricted Person", which covers individuals in senior management functions such as the executive Directors and senior managers of a Reporting Entity (see MKT Rule 3.4.1(2)), which is an expansion from the current restriction which applies only to Directors of a Reporting Entity;

(b) the expansion of the current 'close period' to ensure that when information relating to the financial position of the Reporting Entity is likely to be accessible to Restricted Persons, which is generally from the end of the relevant financial reporting periods, such Persons being subject to controls relating to their dealings in the Securities of the Reporting Entity; and

(c) the elevation of clearance procedures for dealings by Restricted Persons from Guidance to Rule status (see MKT Rule 3.4.3).

Related Party Transactions

55. The proposed provisions dealing with Related Party Transactions are, as noted before, designed to address the risk that Persons closely associated with a Reporting Entity may be able to gain personal advantage to the detriment of the Reporting Entity in their commercial dealings and transactions with the Reporting Entity. We have made a number of enhancements, consistent with the UK approach (but less complex), to the current provisions dealing with related party transactions which are found in an appendix to the OSR. These enhancements include:

(a) providing a clear definition of Persons who qualify as a "Related-Party" of a Reporting Entity - see MKT Rule 3.5.2(a). This definition now captures persons who are likely to be able to obtain more advantageous terms than those available to independent third parties dealing with the Reporting Entity on an arm's length commercial basis, in line with the equivalent definitions under the UK regime;

(b) providing an improved definition of "Related Party Transactions" – see MKT Rule 3.5.2(b);

(c) setting out procedures that draw a distinction between two types of Related Party Transactions, i.e:

(i) those which are of a value of 5% or above of the net asset value of the Reporting Entity as at its last financial reports, which require prior shareholder consent by a majority vote (see MKT Rule 3.5.3(a)); and

(ii) those which are below the 5% threshold, which require a less costly procedure of notifications to the DFSA (see MKT Rule 3.5.3(b)); and

(d) providing exemptions from the procedures noted above for:

(i) insignificant transactions (i.e. transactions below the values of 0.25% of net asset value of the Reporting Entity);

(ii) transactions on commercial terms made in the ordinary course of business on terms no less favourable than those available to independent third parties; and

(iii) those relating to employee share or other incentive schemes and exercise of pre-emption rights (see MKT Rule 3.5.4).

56. While we have retained consistency with the UK approach, we have deviated from that approach in one regard, i.e. in relation to the 5% threshold of the voting rights attaching to the Reporting Entity or its holding companies, which forms one of the thresholds for a Person to qualify as a Related Party. Under the UK regime (and also in Hong Kong and Australia), the equivalent threshold is 10% of the voting rights, instead of the 5% of the holdings in the Reporting Entity or the holding companies. We have preferred to retain the current threshold of 5% given the nascent nature of the DIFC capital markets, and hence the need to cast the definition of Related Party a bit wider than in more established capital markets.

Issues for consideration

6. Do you have any concerns about the definition of Reporting Entities, including its extended coverage? If so, what are they and how should they be addressed?

7. Do you agree with our approach to include in the Markets Law an overarching corporate governance requirement that requires Reporting Entities to promote prudent and sound management of the Reporting Entity in the long-term interest of the Reporting Entity and its shareholders? If not, what are your concerns and how should they be addressed?

8. Do you agree with the substance and approach reflected in the 7 high level corporate governance principles? If not, what are your reasons?

9. Do you have any concerns relating to any aspects of the best practice standards proposed in App4, and if so how should such concerns be addressed. For example, is it appropriate or inappropriate for the roles of the Chair of the Board and the Chief Executive Officer to be held by the same person? What are your reasons?

10. Do you have any concerns relating to the "comply or explain" adopted in relation to the best practice standards included in App4 to achieve the outcomes required by the seven corporate governance principles proposed? If so, what are they and how should they be addressed?

11. Do you agree with the proposed definitions of Restricted Persons and Related Parties and the related procedures? If not, what are your reasons and what changes should be made to the proposed definitions and related procedures to address your concerns?

12. In particular, do you agree with our proposal to retain the current threshold for becoming a Related Party at 5% of voting rights? If not, what is the appropriate threshold?

Part 4: Market disclosure

Disclosure of Inside Information

57. We propose to make some refinements and enhancement to the market disclosure regime (under the current regime called "continuous disclosure"), consistently with the approach adopted in the EU in line with the requirements in MAD and in particular, the UK regime. The key aspects of the enhancements we propose include:

(a) replacing the concepts of "Material Information" and "Price Sensitive Information" with a single concept of "Inside Information" to simplify our market disclosure regime and to bring our requirements into line with MAD;

(b) replacing the current requirement for market disclosure of Inside Information "without delay" with the requirement for such disclosure to be made "as soon possible". This accommodates the exigencies that

may permit a short delay, for example, where a Reporting Entity is affected by an unexpected event and needs to clarify the situation or take legal advice, so that the information released to the market is accurate and not misleading – (see MKT Rule 4.2.1 and associated guidance);

(c) including an explicit power enabling the DFSA to direct a Reporting Entity to make market disclosure (see MKT Rule 4.5.1), instead of the current more limited power (see Article 48 of the Markets Law and section 4.5 of MKT);

(d) providing the DFSA the power to approve additional Regulatory Announcement Services through which market disclosure can be made by Reporting Entities (see MKT Rule 4.7.2); and

(e) adding a definition of an "insider" and requirements relating to control of Inside Information, which require Reporting Entities to have adequate systems and controls for managing Inside Information and providing training for employees. The proposed Rules contain minimum standards, and in some cases are simply incorporating what was previously included in an appendix to the OSR as guidance on Price Sensitive Information.

58. Although we have remained substantially true to the EU and UK approach, we have made a deviation with regard to the handling of commercially sensitive information, where the disclosure of such information is considered to be unduly detrimental to the legitimate interests of a Reporting Entity. A Reporting Entity is permitted to withhold disclosure of such information provided:

(a) it files with the DFSA a confidential report containing the details of the commercially sensitive information and the reasons for non-disclosure;

(b) It obtains the DFSA's prior approval for non-disclosure of the commercially sensitive information for a specified period determined by the DFSA; and

(c) no intervening circumstance occurs that requires the disclosure of such information prior to the end of the specified period under (b) (see MKT Rule 4.2.4(2)).

59. Under the UK regime, no such report is required to be filed with the regulator and hence the onus lies with the Reporting Entity alone to make the judgement as to whether or not it may reasonably rely on that exemption. We propose to retain the current position as it is not easy to identify when a Reporting Entity is relying on this exemption without such a report being filed with the DFSA, particularly given the nascent nature of the capital markets in the DIFC. We have also removed the current requirement that the DFSA approves the non disclosure of commercially sensitive information for 5 business days, instead leaving the DFSA the discretion to determine the appropriate period.

Disclosure by Connected Persons

60. The purpose of these provisions, as noted in paragraph 49, is to provide disclosure to the market, the DFSA and the Reporting Entity of the identity of the Persons in positions of control or influence relating to the Reporting Entity. We propose a number of changes to the current Connected Person disclosure requirements rationalising those provisions and, in the process, making some clarifications and enhancements, taking due account of the purpose of these provisions. The key aspects of the changes we propose include:

(a) removing from the Markets Law the current definition of Connected Persons and inserting it, with the enhancements noted below, in the Rules;

(b) enhancing the definition of Connected Persons by clearly identifying the Persons who are in a position of influence or control relating to the Reporting Entity either:

(i) by being a Director of the Reporting Entity or a controller of the Reporting Entity; or

(ii) by owning more than 5% of the voting rights of the Reporting Entity or its controllers (see MKT Rule 4.3.2(b)); and

(c) specifying the circumstances in which disclosure is required and removing some anomalies, such as the previous requirement for disclosure to the Reporting Entity when a person becomes or ceases to be a Director of the Reporting Entity (see MKT Rule 4.3.3).

Issues for consideration

13. Do you agree with the approach we have adopted in relation to market disclosure of Inside Information? If not, what are your concerns and how should they be addressed?

14. Do you have any concerns relating to the proposed enhancements relating to the Connected Person provisions including the definitions? If so, what are those concerns, and how should they be addressed?

Part 5: Accounting periods and financial reports

Financial reporting

61. While we have not made any substantial changes to the periodic financial reporting requirements applicable to Reporting Entities, we propose some enhancements, the key aspects of which include:

(a) changing the terminology of “Disclosure Documents” in the Markets Law to the more appropriate and commonly used terminology of “Financial Reports”;

(b) bringing into the Rules some substantive requirements relating to accounting periods and financial reports which are currently located in various appendices to OSR; and

(c) including provisions dealing with the content of semi-annual financial reports.

See chapter 5 of Part 4 of the Markets Law and chapter 5 of MKT.

Issues for consideration

15. Do you have any concerns or issues relating to the proposed changes relating to accounting periods and financial reports? If so, what are they and how should they be addressed?

Part 6: Market abuse provisions

Prevention of market abuse

62. We propose a number of enhancements to the current market misconduct provisions (contained in Part 8 of the current Markets Law) to better align those provisions with the EU approach reflected in the Markets Abuse Directive (MAD), as implemented by the UK regime. These provisions apply not only to Reporting Entities and Persons associated with Reporting Entities, but also to any Person dealing with Securities or Investments to address abusive and unacceptable behaviour in financial markets. The more substantive changes we propose are:

(a) the insertion of a prohibition against the use of fictitious devices and other forms of deception (see Article 54); and

(b) the insertion of a provision dealing with "Misuse of Information", which acts as a useful catch-all provision to deal with market abuse which does not otherwise fall within the definition of insider dealing but nonetheless relates to abuse of information which is "not generally available". Examples would be information relating to possible future developments which are not currently required to be disclosed because they are insufficiently precise, information on an issuer's imminent addition to a stock market index, or information which is to be the subject of official announcement by governments or central monetary or fiscal authorities (see Article 59 of the Markets Law); and

(c) amendment to the provision dealing with insider dealing to remove the reference to an Investment "of a Reporting Entity". This link to the Reporting Entity was designed to focus the prohibition on Investments which are listed on an Authorised Market Institution. We propose to remove this link in order to open up the insider dealing prohibition to capture conduct dealing with any Investments, in line with MAD and other key jurisdictions (see Article 56 of the Markets Law).

63. Various other enhancements and amendments we propose include:

(a) expanding the scope of the definition of Inside Information to include information relating to the "issuer", in addition to the Reporting Entity, as the issuer may not always be the Reporting Entity. See Article 61(1)(a) of the Regulatory Law;

(b) re-aligning various existing provisions to adopt the same or similar language to MAD, to first align the various tests with those in MAD and, second, to import some of the EU interpretational and other relevant material relating to market abuse provisions into the DIFC regime;

(c) moving offences dealing with "Misleading or deceptive statements" and "Statements relating to future matters" in Prospectuses to the Prospectus provisions, along with the associated defences (see Articles 20 to 23 of the Markets Law);

(d) changing the current reference to these provisions from "market misconduct" to "market abuse"; and

(e) conferring on the DFSA the power to issue a code of market conduct (see Article 8(2)(f) of the Markets Law).

Issues for consideration

16. Do you have any concerns or issues relating to the proposed changes to the markets abuse provisions? If so, what are they and how should they be addressed?

Part 7: Listed Funds

Listed Funds

64. We propose to bring together in a discrete chapter (see chapter 6 of MKT) all the requirements that apply to Reporting Entities of Listed Funds, with the exception of chapter 7 (sponsors) and chapter 8 (systems and controls) containing requirements applicable to all Reporting Entities, including a Listed Fund.

65. The requirements in chapter 6, although similar in some respects to the requirements that apply to other Reporting Entities, are sufficiently different to warrant being brought together in a distinct chapter, as adaptations were necessary to accommodate Fund specific aspects. For example:

(a) the Reporting Entity concept applies to a Fund only if the Units of the Fund are admitted to trading on an Authorised Market Institution. In contrast, in the case of Securities other than Units, there are two triggers for becoming a Reporting Entity, i.e. Offering Securities to the Public and having Securities admitted to trading on an Authorised Market Institution. This difference has required us to disapply the provisions in the Markets Law and the Rules relating to the Prospectus requirements for Funds where those are offered to the public but are not admitted to trading on an Authorised Market Institution;

(b) although a Person does not attract the Prospectus requirements in the Markets Law and the Rules referred to above, a Reporting Entity is required to have a Prospectus for the purposes of having Units of a Fund admitted to trading on an Authorised Market Institution. This has necessitated the introduction of provisions to ensure that a Reporting Entity of a Listed Fund must prepare and file with the DFSA and the Listing Authority a Prospectus which is prepared in accordance with the requirements in the Collective Investments Law 2010 and the CIR;

(c) the Reporting Entity of a Listed Fund is the Fund Manager of the Listed Fund, which is a separate legal entity distinct from the Listed Fund itself. The substantive requirements applicable to a Reporting Entity of a Listed Fund therefore apply to the Fund Manager in respect of the Listed Fund, and not in respect of itself. This contrasts with issuers of other Securities who become the Reporting Entity in respect of the issuer itself upon the offer of it's Securities to the Public or having such Securities admitted to trading on an Authorised Market Institution (see the definition of a Reporting entity in respect of a Fund in Article 37(1) of the Markets Law); and

(d) the requirements relating to the DFSA approval of a Fund Prospectus for the purposes of having Units admitted to trading on an Authorised Market Institution, particularly as the Collective Investment Law 2010 and the Rules made for the purposes of that law do not require formal approval of a Prospectus (see section 6.3 of the MKT).

Issues for consideration

17. Do you agree with the approach we have adopted in relation to the tailoring of Fund specific requirements for Listed Funds, and segregating them under a single chapter of the MKT (chapter 6)? If not what are your reasons?

18. Are there any aspects relating to Listed Funds which have not been adequately dealt with? If so what are they and how should they be addressed?

Part 8: Other changes

Sponsor regime and third-party certification

66. We propose to retain the current sponsor regime, which the DFSA may use on a discretionary basis where appropriate to require a Person making an Offer of Securities to the Public or having Securities admitted to trading on an Authorised Market Institution to appoint a sponsor or other third party adviser. Generally, the DFSA may do so in cases such as where the Reporting Entity is inexperienced or does not have a proven track-record (such as a start-up). We also propose to extend the DFSA's power to require third party certification on specific matters, such as the adequacy of working capital and systems and controls to ensure on-going compliance by the Reporting Entity with its financial reporting requirements.

Thematic rearrangements and other consequential changes

67. One of the predominant features of the revised regime is rationalising and thematically re-arranging the relevant provisions. This entailed:

(a) whilst retaining in the Markets Law substantive or fundamental provisions, moving to the relevant Rulebook modules the detailed requirements, including procedures to give effect to those substantive provisions In the Markets Law. See, for example, the Corporate Governance Principles which are now located in Chapter 3 of the MKT, which were previously contained in the Markets Law; and

(b) removing from the current OSR appendices substantive Rules and placing them in the MKT. For example, the provisions dealing with Related Party Transactions, dealings by Restricted Persons, and treating shareholders fairly, as well as some of the financial reporting requirements have been removed from the OSR appendices and placed as substantive Rules in the MKT.

Consequential changes

68. We also propose a range of consequential changes, such as the inclusion in the GLO revised or new defined terms used (see Annex D), changes to other Rulebook modules such as the IFR, to reflect the changes proposed.

Issues for consideration

19. Do you have any concerns or issues relating to the proposed retention of the sponsor regime? If so, what are they and how should they be addressed?

20. Do you consider that there are other relevant issues which have not been adequately dealt with under the proposed changes? If so, what are they and how should they be addressed?