DUBAI FINANCIAL SERVICES AUTHORITY

KEY POLICY REVIEW

Comments made in consultation

This note is provided for the information of firms and practitioners. It is not intended to be comprehensive nor to constitute legal advice. Interested persons must refer to the text of the Rules, and the DFSA recommends that you should obtain independent legal advice if required.

1. This note summarises the main issues arising in consultation on the DFSA's Key Policy Review (Consultation Papers 52, 53 and 54), and the DFSA's responses to comments received. Rules incorporating these responses were made by the DFSA's Board on 4 April 2008 and come into effect on 1 July 2008.

2. 26 sets of comments were received on the main Key Policy Review paper, CP 52, and a further set on the transitional arrangements in CP 54. Some of the comments consolidated points from more than one firm.

3. This note does not comment on every point made, but it does deal with the main themes, and those areas where material changes have been made. There is one further issue, relating to the exclusion of *sukuk* from the definition of a collective investment scheme, which we plan to deal with in a later consultation.

Retail access to the DIFC

4. On the central issue of allowing retail access in the Centre, the significant majority of comments received were in favour. The new Rules do not change the direction originally proposed. They therefore introduce the originally proposed demarcation into Professional and Retail Clients (with Market Counterparties as a subset of the former).

Client classification

5. On the boundary between Professional and Retail Clients, we asked for comment specifically on whether we were right to propose the use of a net asset (rather than a liquid asset or a financial portfolio test), and whether $500,000 represented an appropriate dividing line. On the first point, although we received comments favouring a liquid asset test, or a test based on investment portfolio, the large majority of those who commented supported a net asset test. On the second, the majority of comments supported a figure of $500,000, though there were suggestions of both higher and lower figures. We have adhered to the original proposals for a net asset test with a figure of $500,000.

Professional Clients and election to be Retail

6. Some comments suggested that the proposed procedures for a firm electing to deal only with Professional Clients needed clarification. We have made minor and clarificatory adjustments.

Continuing treatment of a Professional Client who is an ex-employee of an Authorised Firm

7. It was suggested in comments that former employees of Authorised Firms should be able to continue to benefit from Professional Client treatment, without meeting the net asset test. We recognise that losing this status on leaving the Authorised Firm could be problematic if someone were between jobs, or were forced to liquidate a portfolio at short notice. On the other hand, we should not want someone to qualify for Professional Client status on the basis of employment by an Authorised Firm in the distant past. We have therefore adopted new text to allow Professional Client treatment for up to two years after ceasing to be employed by an Authorised Firm (subject to the usual sophistication test). We have also made changes to limit Professional Client treatment to employees of the firm in question, or those employed in a professional capacity by other Authorised Firms.

Consent to be treated as a Market Counterparty

8. CP 52 raised the issue whether Professional Clients should be required to give express consent before being treated as Market Counterparties. Some comments asserted that this requirement could be an unnecessary regulatory burden. It was suggested that we should broadly follow the MiFID approach of having two classes of Market Counterparties: per se Market Counterparties, who could be treated as such without explicit consent (but with a right to object), and elective Market Counterparties. We have accepted these arguments, and have also broadened the range of possible Market Counterparties to align more closely with MiFID by including entities such as regulated pension funds and their operators, and institutional investors whose main activity is investment.

Direct and indirect holdings for the net asset test

9. CP 52 raised the issue whether the reference to holding assets "directly or indirectly" achieved the intended purpose or whether additional Guidance would be useful. We received six comments, five of which believed that the DFSA should provide further Guidance. We have done so.

Fund Prospectus Expiry Dates

10. We proposed to introduce an expiry date of a Prospectus being no later than 12 months after the date of the Prospectus.

11. One comment explicitly supported the proposal. However, one objected on the basis that Prospectuses should be continually updated as changes occur. Another commentator queried why a Prospectus for a closed-ended Fund should have an expiry date. A third suggested that the life of a Prospectus should be 18 months, as it takes 3 months to get a Fund off the ground.

12. In relation to the first comment, we note that a requirement to continually update for material changes already exists within the Collective Investment Law 2006. In relation to the latter comments, our review of a range of comparable jurisdictions indicates that Prospectus expiry dates broadly similar to our own proposals are accepted practice for both open and closed-ended vehicles. Accordingly, we have adhered to our original proposal.

13. Some of the comments may have been based on the misconception that a Prospectus is required even when a Fund is closed to new investors. Guidance has been added to address this point.

Outsourcing and delegation of certain Fund activities

14. We proposed in CP 52 to remove the current requirement that certain fund administration functions for a Domestic Public Fund (asset pricing and fund valuation, issue and redemption of units, and record keeping and the maintenance of the Unitholder Register) must be conducted in the DIFC. The centres outside the DIFC were to be limited to "Zone 1" jurisdictions (as defined in the Basel Accord) and those that are Recognised Jurisdictions pursuant to Article 20 of the Collective Investment Law 2006. A Service Provider located in such a jurisdiction would need to be authorised to carry out the relevant functions by a Financial Services Regulator.

15. The proposed liberalisation of fund administration was welcomed overall, including by one fund administrator in the DIFC, though criticised by other commentators with such operations. However, some comments suggested that the requirements remained too prescriptive. A further firm commented informally that in many jurisdictions, even advanced ones, the activities specified as part of fund administration are not regulated.

16. The Rules as made relax further the restrictions in this area. For Private Funds, they do not restrict the choice of administrator. For Public Funds, while maintaining a restriction to Zone 1 and Recognised Jurisdictions, they now admit any fund administrator who can lawfully carry on the activity in such a jurisdiction, without requiring that they be regulated.

Transactions and Offers in respect of Funds

17. One firm pointed out an anomaly in the current Rules on marketing of Units of Foreign Funds. The Rules as drafted do not cover "Offers" as well as "Transactions". This was unintended, and technical amendments have been made to address this.

Communication of Information and Marketing Material

18. CP 52 did not propose any significant change from the current provisions covering marketing material other than to add a new Rule in respect of "past performance and forecasts". In consultation it was suggested that regulated documents should be excluded from the definition of "marketing material", or that more specific exemptions should be given in respect of specific documents subject to other regulatory requirements.

19. We considered these points carefully, but concluded that the interaction of the different provisions in question did not result in a disproportionate regulatory burden. We have therefore made no change to the proposals.

Extent of application of the suitability assessment for Professional Clients

20. One commentator queried whether any useful purpose is being served by the suitability assessment for Professional Clients particularly where they require specific services, and also whether the proposed Rules required a full suitability assessment where a Professional Client requests a limited assessment. While our proposed Rules do not require a full suitability assessment for Professional Clients who request a limited assessment or specific service, we have added further Guidance to remove any uncertainties.

Impact of the inducement prohibition on referral fees

21. One firm commented that our provisions on inducements imposed too strict a standard by preventing a firm from being able to receive a commission for referring a client to a third party. This was not the intended effect, and we have added Guidance to make this clear.

Generic advice and referrals

22. The CP 52 proposals contained carve-outs from client classification, Client Agreement and suitability assessment, where only generic advice or referral was undertaken. Two related issues were raised. One was that the carve-outs as drafted arguably did not apply when both generic advice and referral services were offered to the same client as commonly done. The second pointed out that we had not covered all the Financial Services which can include giving generic advice. We accepted these arguments and have made drafting changes to address them.

Descriptions of Financial Services Activities

23. We proposed changes to the descriptions of two Financial Service activities: Operating a Collective Investment Fund, and Acting as the Trustee of a Fund. They were designed to incorporate other Financial Service activities that may be relevant in the activities of an Operator or Trustee. Comments indicated that our proposals were not clear enough. Accordingly, we have made minor drafting changes and added Guidance to clarify the intention.

Disclosures for Islamic financial business

24. We proposed enhancements to the disclosure requirements relating to Profit Sharing Investment Accounts (PSIAs). In the light of comments made by one firm, we have amended the text and added further Guidance, to improve clarity.

Alignment of Prospectus Offers with the new Client Classification

25. One commentator argued for it to be made more explicit that Prospectus Offers under the Offered Securities Rules may be made to Retail Clients. We have added Guidance to make this clear.

Destination Tables

26. We have attached two “Destination Tables” (Appendices A and B) to assist interested parties in locating Rules which have been relocated within the COB and CIR modules, or moved from the COB module into the CIR module.