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# The DFSA Rulebook

Conduct of Business Module

**(COB)**

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**Contents**

The contents of this module are divided into the following chapters, sections and appendices:

<b>1</b>	<b>INTRODUCTION .....</b>	<b>1</b>
1.1	Application.....	1
<b>2</b>	<b>CLIENT CLASSIFICATION .....</b>	<b>2</b>
2.1	Application.....	2
2.2	Overview .....	2
2.3	Types of Clients.....	6
2.4	Procedures relating to client classification .....	15
2.5	Record keeping .....	20
2.6	Transitional Rules.....	20
<b>3</b>	<b>CORE RULES – INVESTMENT BUSINESS, ACCEPTING DEPOSITS, PROVIDING CREDIT, PROVIDING TRUST SERVICES AND OPERATING A CROWDFUNDING PLATFORM .....</b>	<b>22</b>
3.1	Application.....	22
3.2	Communication of information and marketing material .....	22
3.3	Key information and Client Agreement .....	24
3.4	Suitability.....	26
3.5	Conflicts of interest.....	27
3.6	Record Keeping.....	30
<b>4</b>	<b>ADDITIONAL RULES - ACCEPTING DEPOSITS AND PROVIDING CREDIT .....</b>	<b>32</b>
4.1	Application.....	32
4.2	Accepting Deposits.....	32
4.3	Providing Credit.....	32
4.4	Depositor protection .....	32
<b>5</b>	<b>ADDITIONAL RULES – PROVIDING TRUST SERVICES.....</b>	<b>34</b>
5.1	Application.....	34
5.2	General .....	34
5.3	Reviews.....	35
5.4	Professional indemnity insurance cover.....	35
5.5	Dual control .....	35
5.6	Internal reporting .....	35
5.7	Recording of Selection Criteria .....	36
5.8	Qualification and experience of Trust Service Provider staff .....	36
5.9	Books and records.....	37
5.10	Due diligence.....	37
5.11	Fitness and Propriety of Persons acting as trustees .....	37
<b>6</b>	<b>ADDITIONAL RULES - INVESTMENT BUSINESS .....</b>	<b>39</b>

6.1	Application.....	39
6.2	Personal account transactions.....	39
6.3	Investment research and offers of securities.....	41
6.4	Best execution.....	44
6.5	Non-market price transactions.....	45
6.6	Aggregation and allocation.....	46
6.7	Record keeping – voice and electronic communications.....	47
6.8	Other dealing rules.....	48
6.9	Confirmation notes.....	50
6.10	Periodic statements.....	50
6.11	Client Assets.....	51
6.12	Client money.....	53
6.13	Client investments.....	55
6.14	Record keeping.....	57
6.15	Advising on or Arranging Direct Long-Term Insurance.....	57

**7 CORE RULES - INSURANCE .....59**

7.1	Application and interpretation.....	59
7.1A	Table illustrating the application of the Rules in this chapter.....	60
7.2	Insurance business, management and intermediation restrictions.....	60
7.3	Communication of information and marketing material.....	62
7.4	Client’s duty of disclosure.....	62
7.5	Authorised Firm’s duty of disclosure.....	62
7.6	Disclosure of costs and remuneration.....	64
7.7	Information about the proposed insurance.....	65
7.8	Suitability.....	66
7.9	Managing conflicts of interest.....	67
7.10	Placement of Insurance.....	67
7.11	Providing an ongoing service.....	68
7.12	Insurance monies.....	69

**8 SPECIFIC RULES – OPERATING A CREDIT RATING AGENCY .....74**

8.1	Application.....	74
8.2	Additional Principles for Credit Rating Agencies.....	74
8.3	Quality of the rating process.....	75
8.4	Integrity of the credit rating process.....	79
8.5	Conflicts of interest and independence.....	80
8.6	Independence of Rating Analysts and other Employees.....	83
8.7	Transparency and disclosure.....	84
8.8	Disclosure and presentation of Credit Ratings.....	86
8.9	Confidential information.....	87
8.10	Record keeping.....	88

**9 ADDITIONAL RULES: OPERATING AN ALTERNATIVE TRADING SYSTEM .....90**

9.1	Application and interpretation.....	90
9.2	Main requirements relating to trading on the facility.....	90
9.3	Member access criteria.....	93
9.4	Investment criteria.....	94

9.5	Technology resources .....	96
9.6	Proper Markets .....	98
9.7	Specific requirements applicable to Persons operating an OTF.....	106
<b>10</b>	<b>CUSTODY PROVIDERS ACTING AS A CENTRAL SECURITIES DEPOSITORY (“CSD”) .....</b>	<b>107</b>
<b>11</b>	<b>CROWDFUNDING .....</b>	<b>109</b>
11.1	Overview .....	109
11.2	Application and interpretation .....	109
11.3	Requirements for Crowdfunding Platforms .....	110
11.4	Loan Crowdfunding – extra requirements .....	120
11.5	Investment Crowdfunding – extra requirements.....	120
	<b>APP1 RECORDS OF ORDERS AND TRANSACTIONS.....</b>	<b>122</b>
A1.1	Minimum contents of transaction records .....	122
	<b>APP2 KEY INFORMATION AND CLIENT AGREEMENT .....</b>	<b>123</b>
A2.1	Key Information and content of the Client Agreement.....	123
	<b>APP3 CONFIRMATION OF TRANSACTIONS.....</b>	<b>127</b>
A3.1	Content of confirmation notes.....	127
	<b>APP4 PERIODIC STATEMENTS.....</b>	<b>129</b>
A4.1	Content of periodic statements: investment management .....	129
	<b>APP5 CLIENT MONEY PROVISIONS.....</b>	<b>131</b>
A5.1	Application.....	131
A5.2	General requirements.....	131
A5.3	Payment of client money into client accounts .....	131
A5.4	Client accounts.....	132
A5.5	Exceptions to holding client money in client accounts.....	133
A5.6	Appointment of a third party agent.....	134
A5.7	Payment of client money to a third party agent.....	134
A5.8	Payment of client money from client accounts .....	135
A5.9	Client disclosure .....	136
A5.10	Client reporting .....	137
A5.11	Reconciliation .....	137
A5.12	Auditor’s reporting requirements.....	139
A5.13	Client money distribution rules.....	139
A5.14	Failure to comply with this appendix .....	140
	<b>APP6 SAFE CUSTODY PROVISIONS .....</b>	<b>141</b>
A6.1	Application.....	141
A6.2	General requirements.....	141

A6.3	Recording, registration and holding requirements.....	141
A6.4	Client accounts in relation to Client Investments.....	141
A6.5	Holding or arranging custody with third party agents .....	143
A6.6	Safe custody agreements with third party agents .....	143
A6.7	Client disclosure .....	144
A6.8	Client reporting .....	145
A6.9	Reconciliation .....	145
A6.10	Auditor's reporting requirements.....	146

## **1 INTRODUCTION**

### **1.1 Application**

**1.1.1** This module (COB) applies to every Authorised Firm with respect to the carrying on, in or from the DIFC, of any:

- (a) Financial Service; or
- (b) activity which is carried on, or held out as being carried on, in connection with or for the purposes of such a Financial Service;

except to the extent that a provision of COB provides for a narrower application.

**1.1.2** COB does not apply to a Representative Office.

#### **Guidance**

An Authorised Firm may be able to rely on the Transitional Rules in section 2.6 for the purposes of meeting the client classification requirements in chapter 2.

## **2 CLIENT CLASSIFICATION**

### **2.1 Application**

- 2.1.1** (1) This chapter applies, subject to Rule 2.1.2, to an Authorised Firm, which carries on, or intends to carry on, any Financial Service with or for a Person.
- (2) For the purposes of this chapter, a Person includes a Fund, pension fund or trust, even if it does not have a separate legal personality.

#### **Exclusions**

- 2.1.2** (1) This chapter does not apply to a Credit Rating Agency in so far as it carries on, or intends to carry on, the Financial Service of Operating a Credit Rating Agency.
- (2) This chapter does not apply to an Authorised Firm in so far as it carries on the activity described in GEN Rule 2.26.1, provided that no other Financial Service is carried on.
- (3) This chapter does not apply to an Authorised ISPV.

#### **Guidance**

1. The activity described in GEN Rule 2.26.1 is marketing of financial services and financial products which are offered in a jurisdiction outside the DIFC. Such marketing activities can be conducted by an Authorised Firm, which holds a Representative Office Licence, provided the financial services or financial products marketed by it are those offered by its head office or a member of its Group.
2. As a Representative Office conducting marketing activities of the kind described in GEN Rule 2.26.1 does not have a client relationship with a Person to whom it markets a financial service or financial product, the client classification requirements in this chapter do not apply to the firm with regard to that Person.
3. Other Authorised Firms can also conduct marketing activities, of the kind described in GEN Rule 2.26.1, under the exclusion in GEN Rule 2.26.2.

### **2.2 Overview**

#### **Guidance**

1. This chapter sets out the manner in which an Authorised Firm is required to classify its Clients, as well as good practice it may follow. The scope of application of the Rulebook modules will vary depending on whether the Person with or for whom an Authorised Firm is carrying on Financial Services is classified as a Retail Client, Professional Client or Market Counterparty.

**Risk based approach**

2. The Rules in this chapter reflect the DFSA's risk based approach to regulation. Therefore, to achieve the underlying objective of client classification, which is to ensure that firms provide to their clients an appropriate level of regulatory protection, the Rules, for example:
  - a. take into account the higher degree of knowledge and experience ('expertise') and resources available to certain institutional and wholesale clients (see Rule 2.3.4);
  - b. take into account who primarily bears the risk associated with a particular type of a Financial Service (see Rule 2.3.5);
  - c. take into account the type of Persons to whom a Financial Service is usually provided (see Rules 2.3.6, 2.3.7 and 2.3.8);
  - d. provide flexibility for an Authorised Firm to rely on a client classification made by its head office or a Group member, provided risks associated with such reliance are effectively addressed (see Rules 2.4.4 and 3.3.4);
  - e. provide flexibility for group-based Financial Services to be provided where risks associated with such services are effectively addressed (see Rule 2.4.5); and
  - f. provide flexibility for look-through arrangements where reliance can be placed on expertise and resources available to a Client, such as at its Holding Company or controller level (see Rule 2.3.8(2)).

**Types of clients**

3. There are three types of Clients:
  - a. a Retail Client;
  - b. a Professional Client; or
  - c. a Market Counterparty.

However, a Person may be classified as a Professional Client in relation to one Financial Service or financial product, but a Retail Client in relation to another. Similarly, a Person classified as a Professional Client may be classified as a Market Counterparty in relation to some Financial Services or financial products but not others (see paragraphs 8 and 9 below).

**Retail Clients**

4. A Person who cannot be classified as a Professional Client or Market Counterparty in accordance with the Rules is required to be classified as a Retail Client (see Rule 2.3.2). If an Authorised Firm chooses to provide Financial Services to a Person as a Retail Client, it may do so by simply classifying that Person as a Retail Client without having to follow any further procedures as required for classifying Persons as Professional Clients or Market Counterparties.

**Professional Clients**

5. There are three routes through which a Person may be classified as a Professional Client:
  - a. 'deemed' Professional Clients under Rule 2.3.4. As these Persons have significant assets under their control, and, therefore, either possess, or have the resources to obtain, the necessary expertise to manage such assets, they can be classified as 'deemed' Professional Clients without having to meet any additional net asset and expertise criteria;



- b. 'service-based' Professional Clients under Rule 2.3.5, Rule 2.3.6 or Rule 2.3.6A. Due to their inherent nature, certain Financial Services activities such as credit provided to an Undertaking for business purposes ('commercial credit'), advisory and arranging activities relating to corporate structuring and financing and crowdfunding services provided to a Body Corporate that is a borrower or an Issuer, are generally provided to Persons with sufficient expertise to obtain such services or are of relatively low risk to the Client. Therefore, a Person to whom such a Financial Service is provided can be classified as a 'service-based' Professional Client; and
- c. 'assessed' Professional Clients under Rules 2.3.7 and 2.3.8. These Persons are either individuals or Undertakings which can be classified as a Professional Client only if they meet the specified net assets and expertise requirements set out in Rules 2.4.2 and 2.4.3.

Investment vehicles and family member joint account holders of individuals who are themselves Professional Clients can also be classified as Professional Clients where certain conditions are met – see Rule 2.3.7(2) and (3).

### **Market Counterparties**

- 6. A 'deemed' Professional Client under Rule 2.3.4 may be classified as a Market Counterparty provided the Authorised Firm has complied with the procedures set out in Rule 2.3.9(2). When an Authorised Firm carries on Financial Services with a Market Counterparty, only a limited number of requirements in the Rulebook modules apply to such firms. This is because an Authorised Firm transacts with a Market Counterparty on an equal footing and, therefore, most of the client protection provisions in the Rulebook modules are not needed to protect such a party.
- 7. When an Authorised Firm carries on Financial Services with another Authorised Firm or a Regulated Financial Institution, such services would generally qualify as Financial Services that can be carried on with a Market Counterparty (provided the procedures in Rule 2.3.9(2) are met). Examples of such services include:
  - a. providing reinsurance or insurance management services to an insurer; and
  - b. providing one or more Financial Services of custody, managing assets, or fund administration services to a fund manager, collective investment fund or a pension fund.

Such activities would not attract most of the client protection provisions contained in the Rulebook modules for the reasons set out under item 6 above.

### **Multiple classifications**

- 8. In some circumstances, an Authorised Firm may provide a Financial Service to a Person who qualifies under more than one category of Professional Client. For example, a Client to whom an Authorised Firm provides commercial credit or corporate structuring and financing advice or arranging credit, in the circumstances specified in Rule 2.3.5 or Rule 2.3.6, may also be a 'deemed' Professional Client under Rule 2.3.4. In such circumstances, an Authorised Firm can classify such a Person as a 'deemed' Professional Client, in which case the firm may also be able to classify that Client as a Market Counterparty following the procedures in Rule 2.3.9(2).
- 9. It is also possible that an Authorised Firm may provide a range of Financial Services to a single Client. If the Client can be classified as a Professional Client with regard to certain Financial Services (such as Providing Credit under the requirements in Rule 2.3.5, and similarly providing corporate structuring and financing advice or arranging credit under Rule 2.3.6), and not so with regard to other Financial Services, an Authorised Firm needs to take care that the Client is appropriately and correctly classified with respect to each Financial Service. This may mean that the same Client may receive both Professional Client treatment with regard to some Financial Services and Retail Client treatment with regard to other Financial Services. Where a Client

cannot be classified as a Professional Client with regard to some Financial Services, the Authorised Firm can only provide such services to the Client if it has a Retail Endorsement on its Licence.

#### **Client classifications and Client Agreements**

10. Rule 2.4.4 provides a degree of flexibility for an Authorised Firm which is a Branch operation or member of a Group to rely on client classifications made by its head office or any other branch of the same legal entity, or by a member of its Group. Where such reliance is placed, the Authorised Firm should be able to demonstrate to the satisfaction of the DFSA that the reliance is reasonable because the applicable requirements are substantially similar and, where this is not the case, any identified differences (i.e. gaps) are suitably addressed to enable the firm to meet its obligations relating to client classification under this chapter.
11. It is also possible that an Authorised Firm which is a member of a Group may have some Clients to whom it provides Financial Services as a Retail Client, whilst other Group members may provide Financial Services to the same Client as a Professional Client. While an Authorised Firm may rely on the client classifications made by a Group member under Rule 2.4.4, it is the responsibility of the firm to ensure that the correct classification is adopted by it for the purposes of the Financial Services it provides to the Client (see Rule 2.4.4). See also Rule 3.3.4, which provides a degree of flexibility for an Authorised Firm which is a Branch to rely on a Client Agreement made by its head office or any other branch of the same legal entity, or by a member of the Group, provided the requirements in that Rule are met.

#### **Group clients**

12. Rule 2.4.5 is designed to provide a greater degree of flexibility to an Authorised Firm providing Financial Services to a Client in a Group context, where more than one member of the Group may be providing Financial Services which form a bundle of services. Each Group may have different arrangements to provide a number of services to a Client. Depending on the nature of the arrangement the Group adopts, and the Financial Services involved, risks associated with such arrangements could also differ. Therefore, Rule 2.4.5 sets out the outcomes which need to be achieved by an Authorised Firm where it participates in a Group arrangement under which a bundle of Financial Services is provided to a Client by different members within its Group. See also Rule 3.3.4, which provides a degree of flexibility for an Authorised Firm participating in an arrangement under which a bundle of Financial Services is provided to a Client where reliance can be made on a Client Agreement executed by a Group member, provided the requirements in that Rule are met.

#### **Transitional Rules**

13. Section 2.6 contains provisions designed to enable Authorised Firms to make a smooth transition to the new client classification regime that came into force on 1 April 2015. These Rules, among other things:
  - a. keep in force the client classifications made under the old client classification regime for the Financial Services that were provided to those Clients under that regime;
  - b. provide for the increased asset threshold of \$1 million to come into effect on 1 April 2016; and
  - c. retain the asset threshold at \$500,000 until 1 April 2016.

## 2.3 Types of Clients

- 2.3.1** (1) An Authorised Firm must, before carrying on a Financial Service with or for a Person, classify that Person as a:
- (a) Retail Client;
  - (b) Professional Client; or
  - (c) Market Counterparty,
- in accordance with the requirements in this chapter.
- (2) An Authorised Firm may classify a Person as a different type of a Client for different Financial Services or financial products that are to be provided to such a Client.
- (3) If an Authorised Firm is aware that a Person ('the agent'), with or for whom it is intending to carry on a Financial Service is acting as an agent for another Person ('the principal') in relation to the service then, unless the agent is another Authorised Firm or a Regulated Financial Institution, the Authorised Firm must treat the principal as its Client in relation to that service.
- (4) If an Authorised Firm intends to provide any Financial Service to a trust, it must, unless otherwise provided in the Rules, treat the trustee of the trust, and not the beneficiaries of the trust, as its Client.

### Guidance

1. When a Person becomes a Client of an Authorised Firm is a question of fact that needs to be addressed by the firm in light of the nature of the relevant Financial Service (or financial product) involved, and the relations and interactions which the firm has with that Person. For instance, in certain types of Financial Services (such as corporate advisory services), a number of conversations (such as marketing and promotional activities) may occur between an Authorised Firm and a potential client before it may appear to the firm on a reasonable basis that the Person is likely to obtain a Financial Service from the firm, at which point a client classification is required.
2. Given the many different circumstances in which interactions between a potential client and an Authorised Firm take place, it is not possible to include a more specific requirement than the current provision which requires the client classification to occur "before" a firm provides a Financial Service to a Person – see Rule 2.3.1(1). This provides an Authorised Firm flexibility to determine when exactly it would be appropriate for the firm to undertake client classification.
3. The DFSA expects Authorised Firms to adopt practices which are consistent with the underlying intent of the client classification provisions, which is to provide Clients an appropriate level of regulatory protection in light of the resources and expertise available to such Clients. Therefore, as soon as it is reasonably apparent that a potential customer is likely to obtain a Financial Service from the firm, it would need to undertake the client classification process relating to that customer (unless such a customer is classified as a Retail Client for the purposes of the Rules – see Rule 2.3.2).
4. For example, an Authorised Firm is not expected to undertake advising or arranging activities relating to a Financial Service or financial product which is suited to Professional Clients (such as complex derivatives) with a potential customer without having a reasonable basis to consider

that such a customer has sufficient knowledge and experience relating to the relevant service or product. While a formal client classification may not be needed at the early stages of interaction with a potential customer, a firm is expected to form a reasonable view about the professional status of a potential customer when exposing such a customer to Financial Services or financial products (such as investments in a Qualified Investor Fund) which are intended for Professional Clients.

5. Rule 2.3.1(2) allows an Authorised Firm to classify a Client as a Retail Client in respect of some Financial Services and a Professional Client in respect of other Financial Services. For example, a Client classified as a 'service-based' Professional Client under Rule 2.3.5 for the Financial Service of Providing Credit may not necessarily meet the criteria to be classified as an 'assessed' Professional Client under Rule 2.3.7 or Rule 2.3.8 in respect of any other Financial Service to be provided to that Client. Therefore, such a Client would need to be classified as a Retail Client with respect to Financial Services other than Providing Credit.

### **Retail Clients**

- 2.3.2** An Authorised Firm must classify as a Retail Client any Person who is not classified as a Professional Client or a Market Counterparty.

### **Professional Clients**

- 2.3.3** (1) An Authorised Firm may classify a Person as a Professional Client if that Person:
  - (a) meets the requirements to be:
    - (i) a "deemed" Professional Client pursuant to Rule 2.3.4;
    - (ii) a "service-based" Professional Client pursuant to Rule 2.3.5, Rule 2.3.6 or Rule 2.3.6A; or
    - (iii) an "assessed" Professional Client pursuant to either Rule 2.3.7 or Rule 2.3.8; and
  - (b) has not opted-in to be classified as a Retail Client in accordance with the requirements in Rule 2.4.1.
- (2) If an Authorised Firm becomes aware that a Professional Client no longer fulfils the requirements to remain classified as a Professional Client, the Authorised Firm must, as soon as possible, inform the Client that this is the case and the measures that are available to the firm and the Client to address that situation.

### **Guidance**

The measures referred to in Rule 2.3.3(2) may include classifying the Client as a Retail Client with respect to any future Financial Services to be provided to that Client or, if the firm does not have a Retail Endorsement, discontinuing the provision of Financial Services to that Client.

### **'Deemed' Professional Clients**

- 2.3.4** (1) For the purposes of Rule 2.3.3(1)(a)(i), a Person is a 'deemed' Professional Client if that Person is:

- (a) a supranational organisation whose members are either countries, central banks or national monetary authorities;
  - (b) a properly constituted government, government agency, central bank or other national monetary authority of any country or jurisdiction;
  - (c) a public authority or state investment body;
  - (d) an Authorised Market Institution, Regulated Exchange or regulated clearing house;
  - (e) an Authorised Firm, a Regulated Financial Institution or the management company of a regulated pension fund;
  - (f) a Collective Investment Fund or a regulated pension fund;
  - (g) a Large Undertaking as specified in (2);
  - (h) a Body Corporate whose shares are listed or admitted to trading on any exchange of an IOSCO member country;
  - (i) any other institutional investor whose main activity is to invest in financial instruments, including an entity dedicated to the securitisation of assets or other financial transactions;
  - (j) a trustee of a trust which has, or had during the previous 12 months, assets of at least \$10 million; or
  - (k) a holder of a licence under the Single Family Office Regulations with respect to its activities carried on exclusively for the purposes of, and only in so far as it is, carrying out its duties as a Single Family Office.
- (2) A Person is a Large Undertaking if it met, as at the date of its most recent financial statements, at least two of the following requirements:
- (a) it has a balance sheet total of at least \$20 million;
  - (b) it has a net annual turnover of at least \$40 million; or
  - (c) it has own funds or called up capital of at least \$2 million.
- (3) In (2):
- (a) a 'balance sheet total' means the aggregate of the amounts shown as assets in the balance sheet before deducting both current and long-term liabilities;
  - (b) 'own funds' mean cash and investments as shown in the balance sheet; and
  - (c) 'called up capital' means all the amounts paid-up on allotted shares, less any amounts owing on allotted shares.

**Guidance**

1. Although an Authorised Firm is not required to undertake a detailed assessment of a 'deemed' Professional Client's expertise or net assets (as is required in the case of an 'assessed' Professional Client), a firm still needs to have a reasonable basis for classifying a Person as falling within the list of 'deemed' Professional Clients in Rule 2.3.4(1) or (2). For example, in order to verify whether a trustee of a trust can be classified as a 'deemed' Professional Client under Rule 2.3.4(1)(j), an Authorised Firm should obtain a verified copy of the most recent balance sheet of the relevant trust.
2. An individual trustee on the board of a trust where the trust has at least \$10 million assets under its control can qualify as a 'deemed' Professional Client under Rule 2.3.4(1)(j) but only in relation to that particular trust.

**'Service-based' Professional Clients**
**Guidance**

Rule 2.3.5, Rule 2.3.6 and Rule 2.3.6A each set out different circumstances in which a Person can be classified as a 'service-based' Professional Client. The professional status allowed under these three 'service-based' Professional Client categories can only be used for those three Financial Services and not for any other Financial Service provided to the same Client. If such a Client also obtains other Financial Services from the same firm, unless the Client can qualify either as a 'deemed' or 'assessed' Professional Client, that Client will need to be classified as a Retail Client for those other Financial Services.

- 2.3.5** (1) For the purposes of Rule 2.3.3(1)(a)(ii), a Person is a 'service-based' Professional Client if:
- (a) the Financial Service provided to that Person is Providing Credit;
  - (b) the Person is an Undertaking; and
  - (c) the Credit Facility in question is provided for use in the business activities of:
    - (i) the Person;
    - (ii) a controller of the Person;
    - (iii) any member of the Group to which the Person belongs; or
    - (iv) a joint venture of a Person referred to in (i) – (iii).
- (2) In (1)(c)(ii), a controller is an individual who:
- (a) owns a majority of the shares of the Undertaking;
  - (b) is able to appoint or remove a majority of the board members of the Undertaking; or
  - (c) controls a majority of the voting rights of the Undertaking (or that of a Holding Company of the Undertaking).

**Guidance**

1. Rule 2.3.5(1)(c) enables an Authorised Firm to classify an Undertaking as a Professional Client for the purposes of Providing Credit for businesses purposes, not only for the Undertaking itself, but also for its related entities (such as a controller or member of its Group) as specified in that Rule, provided that the Undertaking has not opted-in to be classified as a Retail Client.
2. It is possible that an Undertaking obtaining credit may also fall within the category of a 'deemed' Professional Client under Rule 2.3.4 – see, for example, a Large Undertaking under Rule 2.3.4(2). An Authorised Firm may Provide Credit to such a Person without having to meet the requirements in Rule 2.3.5.
3. Joint ventures are generally contractual arrangements under which parties contribute their assets and/or expertise to develop or to undertake specified business activities. An Undertaking can be set up by a number of joint venture partners for obtaining credit for use in the ordinary course of their joint venture business. Although joint venture partners would themselves not have a controlling interest in the joint venture, as credit is obtained for use in the joint venture business, they have the benefit of the professional client status available to the Undertaking under Rule 2.3.5.
4. While an Authorised Firm is not required to undertake a detailed assessment of a 'service-based' Professional Client's expertise or net assets (as required in the case of an 'assessed' Professional Client), a firm still needs to have a reasonable basis for classifying a Person as falling within the circumstances specified in this Rule (or Rule 2.3.6). For example, to verify that an Undertaking is obtaining credit for use in the business of its Holding Company or another member of its Group, a firm would need some documentation to demonstrate the Group member relationship. Such documents may include a diagram of the Group structure and copies of certificates of incorporation and shareholdings of the relevant companies.

- 2.3.6** (1) For the purposes of Rule 2.3.3(1)(a)(ii), a Person is a 'service-based' Professional Client if:
- (a) the Financial Service provided to that Person is "Advising on Financial Products", "Arranging Deals in Investments", or "Arranging Credit and Advising on Credit"; and
  - (b) the service in (a) is provided for the purposes of 'corporate structuring and financing'.
- (2) In (1), 'corporate structuring and financing':
- (a) includes:
    - (i) providing advice relating to an acquisition, disposal, structuring, restructuring, financing or refinancing of a corporation or other legal entity; or
    - (ii) arranging credit for a purpose referred to in (i); and
  - (b) excludes any Advising on Financial Products, Arranging Deals in Investments or Arranging Credit and Advising on Credit, provided to an individual for the purposes of, or in connection with, the management of that individual's investments.



**Guidance**

1. This Rule enables an Authorised Firm to classify a Person obtaining advice or arranging credit for the purposes of corporate structuring and financing as a Professional Client based on the nature of such activities, which are generally sought by Persons with greater expertise and resources than Retail Clients. Such advice and arranging occurs in the context of takeovers and merger activities and capital raising activities of companies, including any Initial Public Offerings or other offers of securities for capital raising purposes.
2. If a Client seeking corporate structuring and financing services is also a Person who falls within the category of a 'deemed' Professional Client under Rule 2.3.4, an Authorised Firm may provide to such a Person those services without having to meet the requirements in Rule 2.3.6.
3. Under Rule 2.3.6(2)(b), any advisory and arranging services given to an individual who is a wealth management Client for the purposes of their investment activities or portfolio management are excluded because such Clients are not necessarily Professional Clients. Therefore, for such a Client to qualify as a Professional Client, he would need to be an 'assessed' Professional Client, which requires an assessment of his net assets and expertise against the requirements in Rules 2.4.2 and 2.4.3.

**2.3.6A** For the purposes of the reference in Rule 2.3.3(1)(a)(ii) to this Rule, a Person is a 'service-based' Professional Client if:

- (a) the Financial Service being provided to the Person is Loan Crowdfunding or Investment Crowdfunding; and
- (b) the Person is a Body Corporate and is using the service to borrow funds from lenders or to obtain funds from investors.

**'Assessed' Professional Clients**
**Individuals**

**2.3.7** (1) For the purposes of Rule 2.3.3(1)(a)(iii), an individual is an 'assessed' Professional Client if:

- (a) the individual has net assets of at least \$1 million calculated in accordance with Rule 2.4.2; and
  - (b) either:
    - (i) the individual is, or has been, in the previous two years, an Employee in a relevant professional position of an Authorised Firm or a Regulated Financial Institution; or
    - (ii) the individual appears, on reasonable grounds, to have sufficient experience and understanding of relevant financial markets, products or transactions and any associated risks, following the analysis set out in Rule 2.4.3.
- (2) An Authorised Firm may classify any legal structure or vehicle, such as an Undertaking, trust or foundation, which is set up solely for the purpose of facilitating the management of an investment portfolio of an individual assessed as meeting the requirements in (1) as a Professional Client.



- (3) An Authorised Firm may also classify as a Professional Client another individual (the “joint account holder”) who has a joint account with an individual assessed as meeting the requirements in (1) (the “primary account holder”) if:
  - (a) the joint account holder is a family member of the primary account holder;
  - (b) the account is used for the purposes of managing investments for the primary account holder and the joint account holder; and
  - (c) the joint account holder has confirmed in writing that investment decisions relating to the joint account are generally made for, or on behalf of, him by the primary account holder.
- (4) In (3), a ‘family member’ of the primary account holder is:
  - (a) his spouse;
  - (b) his children and step-children, his parents and step-parents, his brothers and sisters and his step-brothers and step-sisters; and
  - (c) the spouse of any individual within (b).

**Guidance**

1. Under Rule 2.6.3, the net asset test referred to in Rule 2.3.7(1)(a) remains \$500,000 until 1 April 2016.
2. An individual can generally only be classified as a Professional Client if he meets the requirements in Rule 2.3.7(1) or (3). This is because all the other criteria relevant to Professional Clients in this chapter apply to Undertakings and not to individuals, with the possible exception of a trustee of a trust under Rule 2.3.4(j).
3. An individual classified as a Professional Client may operate a joint account with more than one family member. Under the general principle of interpretation that the singular includes the plural, provided each such family member meets the requirements set out in Rule 2.3.7(3), they can all be classified as Professional Clients.
4. A legal structure or vehicle of a Professional Client, which is itself classified as a Professional Client under Rule 2.3.7(2), does not have a right to opt-in as a Retail Client, as that right belongs to the Professional Client for whose purposes the vehicle is set up.
5. A family member of a Professional Client classified as a Professional Client under Rule 2.3.7(3) also does not per se have a right to opt-in to be classified as a Retail Client with regard to the operation of the joint account. However, such an individual has the right to withdraw his confirmation given under Rule 2.3.7(3)(c) to have decisions on behalf of him made by the Professional Client who is the primary account holder of the joint account. An Authorised Firm must ensure that once such a withdrawal is made, the withdrawing individual is no longer classified as a Professional Client. The joint account arrangements would also need to be reviewed as the primary account holder would no longer have the power to make decisions on behalf of the withdrawing individual.
6. In the case of a joint account operated by a primary account holder who is a parent or legal guardian of a minor, the procedures for obtaining the formal consent referred to in Rule 2.3.7(3)(c) would generally not be required, as such parent or guardian would have the authority to act for the minor where he is the joint account holder.

### Undertakings

- 2.3.8** (1) For the purposes of Rule 2.3.3(1)(a)(iii), an Undertaking is an ‘assessed’ Professional Client if the Undertaking:
- (a) has own funds or called up capital of at least \$1 million; and
  - (b) appears, on reasonable grounds, to have sufficient experience and understanding of relevant financial markets, products or transactions and any associated risks, following the analysis set out in Rule 2.4.3.
- (2) An Authorised Firm may also classify an Undertaking as a Professional Client if the Undertaking has:
- (a) a controller;
  - (b) a Holding Company;
  - (c) a Subsidiary; or
  - (d) a joint venture partner,
- who meets the requirements to be classified as an ‘assessed’ Professional Client pursuant to either Rule 2.3.7(1)(a) and (b)(ii) or Rule 2.3.8(1) as applicable, or a ‘deemed’ Professional Client pursuant to Rule 2.3.4(1).
- (3) In this Rule:
- (a) the terms ‘own funds’ and ‘called up capital’ in (1)(a) have the meaning given under Rule 2.3.4(3)(b) or (c) as the case may be; and
  - (b) the term ‘controller’ in (2)(a) means an individual who meets the criteria in Rule 2.3.5(2).

### Guidance

1. Under Rule 2.6.3, the asset test referred to in Rule 2.3.8(1)(a) remains \$500,000 until 1 April 2016.
2. Where an Authorised Firm proposes to classify an Undertaking as a Professional Client under (2), the firm must assess whether the Person on whom reliance is placed, i.e. a Person referred to in (2)(a) to (d) as is relevant, meets the Professional Client criteria, unless that Person falls within a category of ‘deemed’ Professional Client.
3. Where an Undertaking is set up by partners in a joint venture for the purposes of their joint venture, the Undertaking itself can be treated as a Professional Client provided a joint venture partner meets the Professional Client criteria (see Guidance paragraph 3 under Rule 2.3.5 for a description of a joint venture). To be able to rely on a joint venture partner’s Professional Client status, such a partner should generally be a key decision maker with respect to the business activities of the joint venture, and not just a silent partner.

### Market Counterparties

- 2.3.9** (1) An Authorised Firm may classify a Person as a Market Counterparty if:

- (a) that Person is:
    - (i) a 'deemed' Professional Client pursuant to Rule 2.3.4;
    - (ii) an 'assessed' Professional Client pursuant to Rule 2.3.8(2)(b) which is wholly owned by a Holding Company that is a 'deemed' Professional Client pursuant to Rule 2.3.4(1)(g) or (h); or
    - (iii) a 'deemed' Market Counterparty pursuant to Rule (1A); and
  - (b) in the case of Persons referred to in (a)(i) and (ii), the requirements in (2) have been met.
- (1A) An Insurer, Insurance Intermediary or Insurance Manager may 'deem' any one or more of the following Persons to be a Market Counterparty:
- (a) a ceding insurer; and
  - (b) in respect of the services provided to that ceding insurer, any reinsurer, insurance agent or insurance broker that facilitates the provision of the services to the ceding insurer.
- (2) For the purposes of (1)(b), an Authorised Firm must, before classifying a Person as a Market Counterparty, ensure that:
- (a) the Person has been given a prior written notification of the classification as a Market Counterparty; and
  - (b) that Person has not requested to be classified otherwise within the period specified in the notice.
- (3) The notification in (2)(a) may be given in respect of particular Financial Services or Transactions or in respect of all Financial Services and Transactions.
- (4) The notification in (2)(a) need only be given:
- (a) in the case of a Fund, either to the Fund or its Fund Manager; and
  - (b) in the case of a pension fund, either to such fund or its management company.

**Guidance**

When an Authorised Firm carries on, or provides or obtains, Financial Services with or from another Authorised Firm or a Regulated Financial Institution, as those entities are 'deemed' Professional Clients under Rule 2.3.4(1), they could be classified as Market Counterparties, provided the procedures set out in Rule 2.3.9(2) are complied with. For example, such services may include providing the Financial Services of custody, managing assets, or fund administration services to a Fund Manager of a Collective Investment Fund or a pension fund.

## 2.4 Procedures relating to client classification

### Option for a Professional Client to be classified as a Retail Client

- 2.4.1** (1) For the purpose of Rule 2.3.3(1)(b), an Authorised Firm must, subject to (4), when first establishing a relationship with a Person as a Professional Client, inform that Person in writing of:
- (a) that Person's right to be classified as a Retail Client;
  - (b) the higher level of protection available to Retail Clients; and
  - (c) the time within which the Person may elect to be classified as a Retail Client.
- (2) If the Person does not expressly elect to be classified as a Retail Client within the time specified by the Authorised Firm, the Authorised Firm may classify that Person as a Professional Client.
- (3) If a Person already classified as a Professional Client by an Authorised Firm expressly requests the Authorised Firm to be re-classified as a Retail Client, the Authorised Firm must, subject to (4), re-classify such a Person as a Retail Client.
- (4) If an Authorised Firm does not provide Financial Services to Retail Clients, it must inform the Person of this fact and any relevant consequences.

### Guidance

1. The obligation in Rule 2.4.1(1) applies to an Authorised Firm when it first provides, or intends to provide, a Financial Service to a Professional Client.
2. Once an Authorised Firm has first classified a Person as a Professional Client, under the procedures in Rule 2.3.3(1), that Professional Client has a right at any subsequent time to ask, under Rule 2.4.1(3), to be re-classified as a Retail Client to obtain a higher level of protection. Although the right to ask the firm to be re-classified as a Retail Client is available to the Professional Client, as a matter of good practice:
  - a. the firm should also periodically review whether the circumstances relating to the particular Client remain the same; and
  - b. if the firm becomes aware of any circumstances which would warrant a re-classification of the Client, initiate the process with the Client to give that Client a more appropriate classification.
3. Where an existing Professional Client is offered a new Financial Service or new financial product, a re-classification might be appropriate if:
  - a. the new Financial Service or financial product is substantially different to those previously offered to that Client; and
  - b. the Client's experience and understanding appears not to extend to the new Financial Service or financial product.

4. An Authorised Firm cannot provide Financial Services to a Retail Client unless it has a Retail Endorsement on its Licence. However, such a firm may refer to another appropriately licensed firm any Person who elects to opt-in as a Retail Client.

### **Assessment of net assets**

**2.4.2** An Authorised Firm, when calculating net assets of an individual for the purposes of the requirement under Rule 2.3.7(1)(a):

- (a) must exclude the value of the primary residence of that Person; and
- (b) may include any assets held directly or indirectly by that Person.

### **Guidance**

1. The reference to “assets held directly or indirectly” is designed to include assets held by direct legal ownership, by beneficial ownership (for example, as a beneficiary in a trust), or by both legal and beneficial ownership. Such assets may be held, for instance, through a special purpose or personal investment vehicle, a foundation, or the like. Similarly, any real property held subject to an Islamic mortgage, where the lender has the legal title to the property, may be counted as indirectly held property of a Client, less the amount owing on the mortgage, where it is not a primary residence.
2. As the test is to determine the net assets (not gross assets) of an individual, any mortgages or other charges held over the property to secure any indebtedness of the individual should be deducted from the value of the assets.
3. An individual’s primary residence is excluded from the calculation of their net assets. If an individual who is an expatriate has a primary residence in his home country, such a residence should not generally be counted for the purposes of meeting the net asset test, particularly if the current residence in their host country is rented. However, if the current residence in the host country is owned by the individual, then that may be treated as their primary residence and the value of the residence in the home country of the individual may be counted for the purposes of meeting the net asset test, provided there is sufficient evidence of ownership and an objective valuation of the relevant premises.
4. An Authorised Firm should be able to demonstrate that it has objective evidence of the ownership and valuation of any assets taken into account for the purposes of meeting the net asset test.

### **Assessment of knowledge and experience**

**2.4.3** (1) For the purpose of the analysis required under Rules 2.3.7(1)(b)(ii) and 2.3.8(1)(b), an Authorised Firm must include, where applicable, consideration of the following matters:

- (a) the Person’s knowledge and understanding of the relevant financial markets, types of financial products or arrangements and the risks involved either generally or in relation to a proposed Transaction;
- (b) the length of time the Person has participated in relevant financial markets, the frequency of dealings and the extent to which the Person has relied on professional financial advice;
- (c) the size and nature of transactions that have been undertaken by, or on behalf of, the Person in relevant financial markets;

- (d) the Person's relevant qualifications relating to financial markets;
  - (e) the composition and size of the Person's existing financial investment portfolio;
  - (f) in the case of credit or insurance transactions, relevant experience in relation to similar transactions to be able to understand the risks associated with such transactions; and
  - (g) any other matters which the Authorised Firm considers relevant.
- (2) Where the analysis is being carried out in respect of an Undertaking, the analysis must be applied, as appropriate, to those individuals who are authorised to undertake transactions on behalf of the Undertaking.

**Guidance**

Generally, an Authorised Firm may consider a Person to have relevant experience and understanding where such a Person:

- a. has been involved in similar transactions in a professional or personal capacity sufficiently frequently to give the Authorised Firm reasonable assurance that the Person is able to make decisions of the relevant kind, understanding the type of risks involved; or
- b. is found to be acting, in relation to the particular transaction involved, in reliance on a recommendation made by an Authorised Firm or Regulated Financial Institution.

**Reliance on a classification made elsewhere**

- 2.4.4** (1) This Rule applies to an Authorised Firm which is a Branch or is a member of a Group.
- (2) An Authorised Firm may, subject to (3), rely on a client classification made, if it is a Branch, by its head office or any other branch of the same legal entity, or if it is a member of a Group, by any other member of its Group, if it has reasonable grounds to believe that such a client classification is substantially similar to the client classification required under this chapter.
- (3) If any gaps are identified between the requirements applicable to the Authorised Firm under this chapter and the requirements under which the client classification is carried out by another entity referred to in (2), the Authorised Firm may only rely on such a client classification if it has effectively addressed the identified gaps.

**Guidance**

- 1. Generally, an Authorised Firm relying on this Rule should be able to demonstrate to the DFSA the due diligence process that it had undertaken to assess whether the client classification made by its head office or other branch of the same legal entity or a member of its Group substantially meets the client classification requirements in this chapter and, if any gaps are identified, how those gaps are effectively addressed. See Rule 2.5.3, which requires the provision of unrestricted access to records for demonstrating to the DFSA due compliance with this Rule.

2. If an Authorised Firm wishes to use any client classification undertaken by any third party other than its head office or another branch of the same legal entity, or a member of its Group, such an arrangement is generally treated as an outsourcing arrangement. Therefore, the Authorised Firm would need to meet the GEN requirements relating to outsourcing.

### Group clients

**2.4.5** (1) This Rule applies to an Authorised Firm which:

- (a) is a member of a Group; and
- (b) provides to a Client one or more Financial Services where the services provided by the firm form part of a bundle of financial services provided to that Client by it and its Group members.

(2) An Authorised Firm referred to in (1) must ensure that:

- (a) the client classification it adopts for any Financial Service which it provides to the Client is both consistent with the requirements in this chapter and appropriate for the overall bundle of financial services provided to that Client;
- (b) the Client has a clear understanding of the arrangement under which Financial Services are provided to the Client by the Authorised Firm in conjunction with the other members of the Group; and
- (c) any risks arising from the arrangements referred to in (b) are identified and appropriately and effectively addressed.

### Guidance

1. The provision of a 'bundle' of financial services may involve different arrangements within different Groups. The DFSA considers that the provision of a 'bundle' of financial services occurs where:
  - a. several members of a Group provide discrete stand-alone financial services to a single Client but do so as part of providing a complete suite of related financial services to that Client. An example would be where one member of the Group gives investment advice to the Client, another member of the Group executes the transaction (based on the advice) relating to a financial product and yet another member of the Group is the issuer of that financial product;
  - b. several members of a Group provide different aspects of the same financial service to a single Client; or
  - c. the bundle comprises any combination of both (a) and (b).
2. A bundle of financial services referred to in 1 above can be project specific. An example is where a number of members within a Group providing discrete aspects of expertise that go to facilitate a merger and acquisition project of a Client. In such a situation, different members of the Group could prepare and provide:
  - a. advice relating to a proposed restructure;
  - b. advice relating to financing of the restructure; and



- c. arranging credit for financing the restructure.
  3. In order to provide flexibility for Authorised Firms which are members of a Group to provide such bundles of financial services to their Clients in a manner that suits the Client's needs and the nature of the service, Rule 2.4.5 sets out the overarching objectives that must be achieved (i.e. outcome based requirements), rather than any detailed requirements. This Rule goes beyond a simple reliance on a 'client classification' made by another member of a Group under Rule 2.4.4.
  4. Depending on the nature of the arrangement under which Group members choose to provide to the same Client a bundle of Financial Services, and the nature of the Financial Services involved, the risks associated with such arrangements may vary. Some of the common risks that could arise, and therefore would need to be addressed, include:
    - a. conflicting legal requirements applicable to the provision of the relevant Financial Services, particularly if the members of the Group are located in different jurisdictions; and
    - b. a Client not being able to identify clearly the actual service provider or providers and resulting legal exposure to the Client that may arise for all members of the Group. To address this risk, it is good practice for each member of the Group to set out in writing (e.g. in the client agreement) the services for which it is responsible. See also Rule 3.3.4(3)(b) for the firm's obligations.
  5. GEN section 5.3 sets out the systems and controls requirements that apply to all Authorised Firms. In order to meet those GEN requirements, an Authorised Firm relying on Rule 2.4.5 should consider, at a minimum, having the following:
    - a. a clear description of the Group arrangement under which a bundle of financial services is provided – such as which member of the Group is responsible for which aspects of the bundle of Financial Service provided to the Client, or alternatively, that collective responsibility would be assumed by all or some members of the Group;
    - b. how the Client is classified for the purposes of the relevant Financial Service provided by the firm;
    - c. identification of where records relating to client classification and Financial Services provided to the Client are maintained;
    - d. which firm, if any, is responsible for the overall bundle of financial services and, if this is not the case, how the accountability for the financial services is apportioned among members within the Group;
    - e. a client agreement (whether entered into by the Authorised Firm or by a member of its Group under Rule 3.3.4) which adequately covers all the financial services provided to the Client, including those provided by the firm; and
    - f. what the identified risks are and how they are being addressed.
  6. See Rule 2.5.3 which requires the provision of unrestricted access to records for demonstrating to the DFSA due compliance with this Rule.
  7. Rule 2.4.5 is not expressly extended to a Branch as it is not a separate legal entity, and hence would generally have greater flexibility than Group members providing a bundle of services when providing Financial Services to a Client in conjunction with its head office or any other branch of the same legal entity. However, to the extent a Branch operates as a stand-alone entity, it may use the same outcome-based approach reflected in Rule 2.4.5 where it provides any Financial Services to a Client in conjunction with its head office or other branches of the same legal entity.
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## **2.5 Record keeping**

**2.5.1** An Authorised Firm must keep records of:

- (1) the procedures which it has followed under the Rules in this chapter, including any documents which evidence the Client's classification; and
- (2) any notice sent to the Client under the Rules in this chapter and evidence of despatch.

**2.5.2** (1) The records in Rule 2.5.1 must be kept by an Authorised Firm for at least six years from the date on which the business relationship with a Client has ended.

- (2) In complying with (1), an Authorised Firm may, if the date on which the business relationship with the Client ended is unclear, treat the date of the completion of the last Transaction with the Client as the date on which the business relationship ended.

**2.5.3** (1) Without limiting the generality of the record keeping requirements applicable to an Authorised Firm, an Authorised Firm must, where it relies on Rule 2.4.4 and Rule 2.4.5, ensure that the DFSA has unrestricted access to all the records required for the firm to be able to demonstrate to the DFSA its compliance with the applicable requirements, including any records maintained by or at its head office or any other branch of the same legal entity, or a member of its Group.

- (2) An Authorised Firm must notify the DFSA immediately if, for any reason, it is no longer able to provide unrestricted access to records as required under (1).

### **Guidance**

1. See GEN Rules 5.3.24 – 5.3.27 for the requirements relating to record keeping. These Rules require, among other things, that Authorised Firms be able to produce records, however kept, within a reasonable period not exceeding three business days.
2. If an Authorised Firm is aware of any restrictions that prevent it from being able to produce relevant records relating to a client classification referred to in Rule 2.5.3(1), that firm would need to undertake its own client classifications.

## **2.6 Transitional Rules**

**2.6.1** An Authorised Firm may continue to treat a Person as a Retail Client, Professional Client, or Market Counterparty, as the case may be, without having to re-classify the Person under section 2.3:

- (a) where the Authorised Firm was treating that Person as such a Client (including under a waiver or modification in force) immediately prior to 1 April 2015; and
- (b) with regard to the Financial Services carried on with or for that Client prior to that date.

**2.6.2** Without limiting the generality of Rule 2.6.1, and for the avoidance of doubt, any client classification adopted, Transaction carried on with or for a Client, or Client Agreement entered into with a Client for the purposes of section 3.3, prior to 1 April 2015, remains in force on and after that date.

**Guidance**

1. The introduction of the new client classification regime does not trigger the need to re-classify existing Clients. However, with regard to an existing Client who has been grandfathered under Rule 2.6.1, the need for a re-classification may subsequently arise in a number of circumstances such as those set out in paragraphs 2, 3 and 4.
2. Where a Professional Client grandfathered under Rule 2.6.1 subsequently requests to opt-in as a Retail Client under Rule 2.4.1(3), the Authorised Firm will need to re-classify that Client in accordance with the requirements in that Rule.
3. Where a grandfathered Client wishes to obtain a new Financial Service after the new regime came into force, an Authorised Firm will not be able to rely on the existing client classification relating to that Client in respect of the new Financial Service. This is because Rule 2.6.1 only applies in respect of the Financial Services carried on with or for a Client before the new regime came into force. Therefore, the firm will need to make a new classification relating to such a Client in respect of the new Financial Service and do so under the new client classification regime.
4. If an Authorised Firm becomes aware that a grandfathered professional client no longer fulfils the requirements to remain classified as a Professional Client, it will need to comply with the requirements in Rule 2.3.3(2).

- 2.6.3** (1) For the purposes of classifying a Person as an ‘assessed’ Professional Client under either Rule 2.3.7 or Rule 2.3.8, the reference to \$1 million in each of Rules 2.3.7(1)(a) and 2.3.8(1)(a) is to be read as a reference to \$500,000 on and before 31 March 2016.
- (2) An Authorised Firm may continue to treat a Person as an ‘assessed’ Professional Client in reliance on the lower asset threshold specified in (1) on and after 1 April 2016 provided:
- (a) it is in respect of the Financial Services carried on with or for the Client prior to that date; and
  - (b) the firm continues to ensure that all the other applicable requirements in this chapter are met in respect of that Client.

### **3 CORE RULES – INVESTMENT BUSINESS, ACCEPTING DEPOSITS, PROVIDING CREDIT, PROVIDING TRUST SERVICES AND OPERATING A CROWDFUNDING PLATFORM**

#### **Guidance**

1. The Rules in this chapter give support to the Principles in GEN section 4.2 and in particular Principles 1, 2, 6 and 7.
2. There are additional Rules that apply to Authorised Firms in other chapters of this module, which are more specific to the nature of the Financial Service conducted by the Authorised Firm.

#### **3.1 Application**

**3.1.1** This chapter applies to an Authorised Firm which carries on or intends to carry on:

- (a) Investment Business;
- (b) Accepting Deposits;
- (c) Providing Credit;
- (d) Providing Trust Services; or
- (e) Operating a Crowdfunding Platform,

except where it is expressly provided otherwise.

#### **3.2 Communication of information and marketing material**

##### **General**

**3.2.1** When communicating information to a Person in relation to a financial product or financial service, an Authorised Firm must take reasonable steps to ensure that the communication is clear, fair and not misleading.

**3.2.2** An Authorised Firm must not, in any form of communication with a Person, including an agreement, attempt to limit or avoid any duty or liability it may have to that Person or any other Person under legislation administered by the DFSA.

**3.2.3** Where a Rule in COB requires information to be sent to a Client, the Authorised Firm must provide that information directly to the Client and not to another Person, unless it is on the written instructions of the Client.

##### **Guidance**

In Rule 3.2.2, a communication would include a financial promotion, a client agreement, terms of business, financial product terms and conditions, a mandate, power of attorney entered into for the purposes of a financial service or product and any other communication which relates in whole or in part to the provision of a financial service or product.

**Marketing material**

- 3.2.4** (1) An Authorised Firm must ensure that any marketing material communicated to a Person contains the following information:
- (a) the name of the Authorised Firm communicating the marketing material or, on whose behalf the marketing material is being communicated;
  - (b) the Authorised Firm's regulatory status as required under GEN section 6.4; and
  - (c) if the marketing material is intended only for Professional Clients or Market Counterparties, a clear statement to that effect and that no other Person should act upon it.
- (2) In (1), marketing material includes any invitation or inducement to enter into an agreement:
- (a) in relation to a financial product or to engage in a Financial Service with the Authorised Firm; or
  - (b) in relation to a financial product or financial service offered by a Person other than the Authorised Firm.
- (3) An Authorised Firm which communicates marketing material in (2)(b) must:
- (a) ensure that the marketing material complies with the applicable Rules and any legislation administered by the DFSA; and
  - (b) not distribute such marketing material if it becomes aware that the Person offering the financial product or financial service to which the material relates is in breach of the regulatory requirements that apply to that Person in relation to that product or service.
- 3.2.5** An Authorised Firm must take reasonable steps to ensure that:
- (a) any marketing material intended for Professional Clients is not sent or directed to any Persons who are not Professional Clients; and
  - (b) no Person communicates or otherwise uses the marketing material on behalf of the Authorised Firm in a manner that amounts to a breach of the requirements in this section.

**Past performance and forecasts**

- 3.2.6** An Authorised Firm must ensure that any information or representation relating to past performance, or any future forecast based on past performance or other assumptions, which is provided to or targeted at Retail Clients:
- (a) presents a fair and balanced view of the financial products or financial services to which the information or representation relates;

- (b) identifies, in an easy to understand manner, the source of information from which the past performance is derived and any key facts and assumptions used in that context are drawn; and
- (c) contains a prominent warning that past performance is not necessarily a reliable indicator of future results.

**Guidance**

In presenting information relating to past performance of a financial product or financial service, the Authorised Firm should follow, to the extent relevant, the Global Investment Performance Standards (GIPS) issued by Institute of Chartered Financial Analysts of the USA or a reputable independent actuarial, financial or statistical reporting service provider.

### **3.3 Key information and Client Agreement**

**Application**

**3.3.1** The Rules in this section do not apply to an Authorised Firm when it is:

- (a) carrying on a Financial Service with or for a Market Counterparty;
- (b) Accepting Deposits;
- (c) Providing Credit;
- (d) carrying on an activity of the kind described in GEN Rule 2.26.1 that constitutes marketing; or
- (e) a Fund Manager of a Fund Offering the Units of a Fund it manages.

**3.3.2** (1) Subject to (2), an Authorised Firm must not carry on a Financial Service with or for a Person unless:

- (a) there is a Client Agreement containing the key information specified in App2 which is either entered into:
  - (i) between the Authorised Firm and that Person; or
  - (ii) in accordance with the requirements in Rule 3.3.4; and
- (b) before entering into the Client Agreement with the Person, the Authorised Firm has provided to that Person the key information referred to in (a) in good time to enable him to make an informed decision relating to the relevant Financial Service.

(2) An Authorised Firm may provide a Financial Service to a Client without having to comply with the requirement in (1);

- (a) subject to (3), where it is, on reasonable grounds, impracticable to comply; or
- (b) where the Client has expressly agreed to dispense with the requirement in regard to a personal investment vehicle.

- (3) When (2)(a) applies, an Authorised Firm providing the Financial Service must:
  - (a) first explain to the Person why it is impracticable to comply; and
  - (b) enter into a Client Agreement as soon as practicable thereafter.

**Guidance**

1. App 2 sets out the core information that must be included in every Client Agreement and additional disclosure for certain types of activities to which this chapter applies. The information content for Client Agreements with Retail Clients is more detailed than for Professional Clients.
2. For the purposes of Rule 3.3.2(1)(b), an Authorised Firm may either provide a Person with a copy of the proposed Client Agreement, or give that information in a separate form. If there are any changes to the terms and conditions of the proposed agreement, the Authorised Firm should ensure that the Client Agreement to be signed with the Person accurately incorporates those changes.
3. For the purposes of Rule 3.3.2(2)(a), an Authorised Firm may consider it is reasonably impracticable to provide the key information to a Person if that Person requests the Authorised Firm to execute a Transaction on a time critical basis. Where an Authorised Firm has given the explanation referred to in Rule 3.3.2(3)(a) verbally, it should maintain records to demonstrate to the DFSA that it has provided that information to the Client.

**Changes to the client agreement**

- 3.3.3** If the Client Agreement provided to a Retail Client allows an Authorised Firm to amend the Client Agreement without the Client's prior written consent, the Authorised Firm must give at least 14 days notice to the Client before providing a Financial Service to that Client on any amended terms, unless it is impracticable to do so.

**Reliance on a Client Agreement made by another entity**

- 3.3.4**
- (1) An Authorised Firm may, for the purposes of Rule 3.3.2(1)(a)(ii), rely on a Client Agreement executed in accordance with the requirements in either (2) or (3).
  - (2) For the purposes of (1), an Authorised Firm which is a Branch may rely on a Client Agreement, executed by its head office or any other branch of the same legal entity, if:
    - (a) the Client Agreement adequately and clearly applies to the Financial Services provided by the Branch; and
    - (b) the Authorised Firm ensures that the Client Agreement is available to the DFSA on request.
  - (3) For the purposes of (1), an Authorised Firm may rely on a Client Agreement, executed by a member of its Group if:
    - (a) it is providing a Financial Service pursuant to Rule 2.4.5;
    - (b) the Client Agreement clearly sets out:

- (i) the Financial Service provided by the Authorised Firm and;
  - (ii) that the Client's rights in respect of (i) are enforceable against the Authorised Firm; and
- (c) the Authorised Firm ensures that the Client Agreement is available to the DFSA on request.
- (4) An Authorised Firm must notify the DFSA immediately if, for any reason, it is no longer able to provide unrestricted access to a Client Agreement as required under (2) or (3).

### **3.4 Suitability**

#### **Application**

**3.4.1** The Rules in this section do not apply where the Authorised Firm:

- (a) undertakes a Transaction with a Market Counterparty;
- (b) undertakes an Execution-Only Transaction;
- (c) undertakes the activities of Accepting Deposits or Providing Credit;
- (d) carries on an activity of the kind described in GEN Rule 2.26.1 that constitutes marketing, or
- (e) carries on the activity of operating an MTF.

#### **Suitability assessment**

- 3.4.2** (1) Subject to (2), an Authorised Firm must not recommend to a Client a financial product or financial service, or execute a Transaction on a discretionary basis for a Client, unless the Authorised Firm has a reasonable basis for considering the recommendation or Transaction to be suitable for that particular Client. For this purpose, the Authorised Firm must:
- (a) undertake an appropriate assessment of the particular Client's needs and objectives, and, financial situation, and also, to the extent relevant, risk tolerance, knowledge, experience and understanding of the risks involved; and
  - (b) take into account any other relevant requirements and circumstances of the Client of which the Authorised Firm is, or ought reasonably to be aware.
- (2) An Authorised Firm may, subject to (3), limit the extent to which it will consider suitability when making a recommendation to, or undertaking a

Transaction on a discretionary basis for or on behalf of, a Professional Client if, prior to carrying on that activity, the Authorised Firm:

- (a) has given a written warning to the Professional Client in the form of a notice clearly stating either that the Authorised Firm will not consider suitability, or will consider suitability only to the extent specified in the notice; and
  - (b) the Professional Client has given his express consent, after a proper opportunity to consider the warning, by signing that notice.
- (3) Where an Authorised Firm manages a Discretionary Portfolio Management Account for a Professional Client, it must ensure that the account remains suitable for the Professional Client, having regard to the matters specified in (1) (a) and (b).

**Guidance**

1. An Authorised Firm Providing Trust Services does not have to undertake an assessment of the factors such as risk tolerance, knowledge and experience of a Client when assessing the suitability of the service to a particular Client. This is because those considerations are not relevant to the activity of Providing Trust Services.
2. The extent to which an Authorised Firm needs to carry out a suitability assessment for a Professional Client depends on its agreement with such a Client. The agreement may limit the suitability assessment to a specified extent, or may dispense with the suitability assessment completely. To the extent a limited suitability assessment is agreed upon, the firm must carry out the suitability assessment as agreed. Limitations may, for example, relate to the objectives of the Client or the product range in respect of which the recommendations are to be made.

**3.4.3** An Authorised Firm must take reasonable steps to ensure the information it holds about a Client is accurate, complete and up to date.

## **3.5 Conflicts of interest**

**Fair treatment**

- 3.5.1**
- (1) An Authorised Firm must take reasonable steps to ensure that conflicts and potential conflicts of interest between itself and its Clients and between one Client and another are identified and then prevented or managed in such a way that the interests of a Client are not adversely affected and to ensure that all its Clients are fairly treated and not prejudiced by any such conflicts of interest.
  - (2) Where an Authorised Firm is aware of a conflict or potential conflict of interest, it must prevent or manage that conflict of interest by using one or more of the following arrangements as appropriate:
    - (a) establishing and maintaining effective Chinese Walls to restrict the communication of the relevant information;
    - (b) disclosing the conflict of interest to the Client in writing either generally or in relation to a specific Transaction; or



- (c) relying on a written policy of independence, which requires an Employee to disregard any conflict of interest when advising a Client or exercising a discretion.
- (3) If an Authorised Firm is unable to prevent or manage a conflict or potential conflict of interest as provided in (2), it must decline to act for that Client.

### **Attribution of knowledge**

**3.5.2** When a COB Rule applies to an Authorised Firm that acts with knowledge, the Authorised Firm will not be taken to act with knowledge for the purposes of that Rule as long as none of the relevant individuals involved for on behalf of the Authorised Firm acts with that knowledge as a result of a Chinese Wall arrangement established under Rule 3.5.1(2)(a).

### **Inducements**

- 3.5.3**
- (1) An Authorised Firm must have systems and controls including policies and procedures to ensure that neither it, nor an Employee or Associate of it, offers, gives, solicits or accepts inducements such as commissions or other direct or indirect benefits where such inducements are reasonably likely to conflict with any duty that it owes to its Clients.
  - (2) Subject to (3), an Authorised Firm must, before recommending a financial product as defined in GEN Rule 2.11.1(4) to, or Executing a Transaction for, a Retail Client, disclose to that Client any commission or other direct or indirect benefit which it, or any Associate or Employee of it, has received or may or will receive, in connection with or as a result of the firm making the recommendation or executing the Transaction.
  - (3) An Authorised Firm need not disclose to a Retail Client under (2) any details about inducements where it:
    - (a) believes on reasonable grounds that the Retail Client is already aware of the relevant inducements;
    - (b) is undertaking an Execution-Only Transaction for that Retail Client; or
    - (c) is executing a Transaction pursuant to the terms of a Discretionary Portfolio Management Agreement for that Retail Client.
  - (4) An Authorised Firm may provide the information required under (2) in summary form, provided it informs the Client that more detailed information will be provided to the Client upon request and complies with such a request.

### **Guidance**

In relation to Rule 3.5.3 (1), in circumstances where an Authorised Firm believes on reasonable grounds that the Client's interests are better served by a Person to whom the referral is to be made, any commission or other benefit which the firm or any of its Employees or Associates receives in respect of such a referral would not be a prohibited inducement under that Rule.

**3.5.4** An Authorised Firm may only accept goods and services under a Soft Dollar Agreement if the goods and services are reasonably expected to:

- (a) assist in the provision of Investment Business services to the Authorised Firm's Clients by means of:
  - (i) specific advice on dealing in, or on the value of, any Investment;
  - (ii) research or analysis relevant to (i) or about Investments generally; or
  - (iii) use of computer or other information facilities to the extent that they are associated with specialist computer software or research services, or dedicated telephone lines;
- (b) provide custody services relating to Investments belonging to, or managed for, Clients;
- (c) provide services relating to portfolio valuation or performance measurement services; or
- (d) provide market price services.

**Guidance**

An Authorised Firm should undertake a thorough assessment of the nature of the goods and services and the terms upon which they are to be provided under a Soft Dollar Agreement to ensure that the receipt of such goods and services provide commensurate value. This is particularly the case if any costs of such goods and services are to be passed through to Clients. Where the Client bears the cost of the goods and services, the disclosure obligation relating to costs and charges under Rule 3.3.2 (see App 2) will apply to such costs.

**3.5.5** An Authorised Firm must not Deal in Investments as Agent for a Client, either directly or indirectly, through any broker under a Soft Dollar Agreement, unless:

- (a) the agreement is a written agreement for the supply of goods or services described in Rule 3.5.4, which do not take the form of, or include, cash or any other direct financial benefit;
- (b) Transaction execution by the broker is consistent with any best execution obligations owed to the Client;
- (c) the Authorised Firm has taken reasonable steps to ensure that the services provided by the broker are competitive, with no comparative price disadvantage, and take into account the interests of the Client;
- (d) for Transactions in which the broker acts as principal, the Authorised Firm has taken reasonable steps to ensure that Commission paid under the agreement will be sufficient to cover the value of the goods or services to be received and the costs of execution; and
- (e) the Authorised Firm makes adequate disclosure in accordance with Rules 3.5.6 and 3.5.7.

**3.5.6** Before an Authorised Firm enters into a Transaction for or on behalf of a Retail Client or Professional Client, either directly or indirectly, with or through the agency of another Person, in relation to which there is a Soft Dollar Agreement which the Authorised Firm has, or knows that another member of its Group has, with that other Person, it must disclose to its Client:

- (a) the existence of a Soft Dollar Agreement; and
- (b) the Authorised Firm's or its Group's policy relating to Soft Dollar Agreements.

**3.5.7** (1) If an Authorised Firm or member of its Group has a Soft Dollar Agreement under which either the Authorised Firm or member of its Group Deals for a Client, the Authorised Firm must provide that Client with the following information:

- (a) the percentage paid under Soft Dollar Agreements of the total Commission paid by or at the direction of:
    - (i) the Authorised Firm; and
    - (ii) any other member of the Authorised Firm's Group which is a party to those agreements;
  - (b) the value, on a cost price basis, of the goods and services received by the Authorised Firm under Soft Dollar Agreements, expressed as a percentage of the total Commission paid by or at the direction of:
    - (i) the Authorised Firm; or
    - (ii) other members of the Authorised Firm's Group;
  - (c) a summary of the nature of the goods and services received by the Authorised Firm under the Soft Dollar Agreements; and
  - (d) the total Commission paid from the portfolio of that Client.
- (2) The information in (1) must be provided to that Client at least once a year, covering the period since the Authorised Firm last reported to that Client.

## **3.6 Record Keeping**

**3.6.1** An Authorised Firm must, for a minimum of six years, maintain sufficient records in relation to each activity and function of the Authorised Firm. These must include, where applicable, the following:

- (a) any marketing material issued by, or on behalf of, the Authorised Firm;
- (b) any financial products or Financial Services provided to a Client and each advice or recommendation made to a Client,
- (c) a record of each Client Agreement including any subsequent amendments to it as agreed with the Client;
- (d) records relating to the suitability assessment undertaken by the Authorised Firm to demonstrate compliance with Rule 3.4.2;
- (e) records to demonstrate compliance with the requirements relating to inducements under section 3.5, including any disclosure made to Clients

under that section and if any goods and services are received by the Authorised Firm under a Soft Dollar Agreement, the details relating to those agreements; and

- (f) any other disclosures made to Clients.

**3.6.2** For the purposes of Rule 3.6.1, the six year period commences:

- (a) in the case of the requirement in Rule 3.6.1(a), from the date on which the marketing material was last provided to a Person;
- (b) in the case of the requirement in Rule 3.6.1(b) to (d), from the date the Client ceases to be a Client of the Authorised Firm; and
- (c) in the case of the requirement in Rule 3.6.1(e), from the date on which the relevant inducements were last received.

## **4 ADDITIONAL RULES - ACCEPTING DEPOSITS AND PROVIDING CREDIT**

### **4.1 Application**

**4.1.1** The Rules in this chapter apply to an Authorised Firm with respect to Accepting Deposits or Providing Credit through an establishment maintained by it in the DIFC.

### **4.2 Accepting Deposits**

**4.2.1** A Bank, in the course of Accepting Deposits, must not:

- (a) Accept Deposits from the State's markets;
- (b) Accept Deposits in the U.A.E. Dirham;
- (c) undertake currency or foreign exchange transactions involving the U.A.E. Dirham; or
- (d) Accept Deposits from Retail Clients.

### **4.3 Providing Credit**

**4.3.1** (1) An Authorised Firm may, subject to (2), Provide Credit to a:

- (a) Professional Client; and
- (b) Retail Client, but only where:
  - (i) the Retail Client is an Undertaking; and
  - (ii) the Credit Facility is provided to the Retail Client for a business purpose.

(2) An Authorised Firm, in the course of Providing Credit, must not:

- (a) Provide Credit in the U.A.E. Dirham; or
- (b) undertake currency or foreign exchange transactions involving the U.A.E. Dirham.

### **4.4 Depositor protection**

**4.4.1** (1) Subject to (2), to the extent that the Rules in this section are inconsistent with the Insolvency Law 2009 and any regulations made for the purposes of that law the Rules in this section will prevail.

- (2) The following provisions of laws, Rules and Regulations prevail over the Rules in this section:
- (a) parts A5.13.2 (a), (b), (c) and (d)(ii) of the Client Money Distribution Rules;
  - (b) Article 65 of the Insolvency Law 2009;
  - (c) the DIFC Preferential Creditor Regulations; and
  - (d) Regulations 5.45.4 and 5.52 of the DIFC Insolvency Regulations.

**4.4.2** (1) In the event of:

- (a) the appointment of a provisional liquidator, liquidator, receiver or administrator, or trustee in bankruptcy, over a Bank which is a Domestic Firm; or
- (b) a direction by the DFSA to a Bank which is a Domestic Firm under Article 76 of the Regulatory Law 2004 to deal with all or substantially all its Deposits in a specified manner,

eligible depositors of the Bank have priority over, and shall be paid in priority to, all other unsecured creditors of the Bank.

- (2) In (1), an “eligible depositor” means, subject to (3), a Person who, at the relevant time, is a creditor of a Bank referred to in (1) by virtue of being owed an amount of Money held by the Bank as a Deposit.
- (3) In (2), eligible depositor excludes any creditor which is:
- (i) a Market Counterparty; or
  - (ii) a bank.

**Guidance**

Article 101 of the DIFC Insolvency Law 2009 gives the DFSA a power to modify the application of provisions of that law and the Regulations made for the purposes of it in particular cases or classes of case. It permits the DFSA to make Rules which provide for the orderly conduct of affairs or winding up of an Authorised Firm and to prescribe procedures and priorities for dealing with assets of the Authorised Firm or other persons in the event of pending or actual insolvency or other default.

## **5 ADDITIONAL RULES – PROVIDING TRUST SERVICES**

### **5.1 Application**

**5.1.1** This chapter applies to a Trust Service Provider with respect to the conduct of Providing Trust Services.

#### **Guidance**

The requirements in chapter 3 also apply to Trust Service Providers.

### **5.2 General**

**5.2.1** For the purposes of this chapter, a settlor, a trustee or a named beneficiary of a trust in respect of which the Trust Service Provider is engaged in Providing Trust Services may be treated as a Client of the Authorised Firm.

**5.2.2** A Trust Service Provider must maintain adequate knowledge of, and comply with, all applicable DIFC laws, Rules and Regulations relevant to Providing Trust Services.

**5.2.3** A Trust Service Provider must be able to demonstrate that it is in compliance with appropriate standards of corporate governance.

**5.2.4** A Trust Service Provider must transact its business (including the establishing, transferring or closing of business relationships with its Clients) in an expeditious manner where appropriate unless there are reasonable grounds to do otherwise.

#### **Exercise of Discretion**

**5.2.5** Where a Trust Service Provider is responsible for exercising discretion for, or in relation to, its Clients, it must take all reasonable steps to obtain sufficient information in order to exercise, subject to Rule 5.2.6, its discretion or other powers in a proper manner.

**5.2.6** A Trust Service Provider must only exercise its power or discretion for a proper purpose.

**5.2.7** The Trust Service Provider must ensure that its understanding of a Client's business is refreshed by means of regular reviews.

**5.2.8** The Trust Service Provider must ensure that any trustee exercises his discretion in accordance with his fiduciary and other duties under the laws governing the trust of which he is a trustee.

#### **Delegation of duties or powers**

**5.2.9** Any delegation of duties or powers by a Trust Service Provider, whether by Power of Attorney or otherwise, must only be entered into for a proper purpose, permissible by law and limited and monitored as appropriate.

### **5.3 Reviews**

**5.3.1** A Trust Service Provider must ensure that adequate procedures are implemented to ensure that regular reviews at appropriate intervals are conducted in respect of Providing Trust Services to its Clients.

### **5.4 Professional indemnity insurance cover**

**5.4.1** A Trust Service Provider must maintain professional indemnity insurance cover appropriate to the nature and size of the Trust Service Provider's business.

**5.4.2** A Trust Service Provider must:

- (a) provide the DFSA with a copy of its professional indemnity insurance cover; and
- (b) notify the DFSA of any changes to the cover including termination and renewal.

**5.4.3** A Trust Service Provider must provide the DFSA on a yearly basis, with the details of the arrangements in force together with evidence of the cover. Any claims in excess of \$10,000 or changes to the arrangements previously notified to the DFSA under this Rule must be notified to the DFSA as they arise.

### **5.5 Dual control**

**5.5.1** The Trust Service Provider must have adequate internal controls, including having two Persons with appropriate skills and experience managing the business.

**5.5.2** While a Trust Service Provider may have a single Person with overall responsibility, at least another Person must have the skills and experience to be able to run the business of the Trust Service Provider in the absence of the senior Person and must be in a position to challenge the actions of the senior Person where they consider that those actions may be contrary to the provisions of DIFC Laws, Rules or Regulations or any other applicable legislation, may not be in the interests of the Client, or may be contrary to sound business principles.

### **5.6 Internal reporting**

**5.6.1** A Trust Service Provider must have arrangements for internal reporting to ensure that the directors or the partners can satisfy themselves that:

- (a) the requirements of the relevant legislation are being met on an on going basis;
- (b) the Trust Service Provider's business is being managed according to sound business principles and, in particular, that it can meet its financial commitments as they fall due;



- (c) the affairs of its Clients are being managed in accordance with the service agreements;
- (d) the trustees are acting in accordance with their fiduciary and other duties;
- (e) the affairs of its Clients are being properly monitored and in particular that the Client is not using the trust structure to hide assets from legitimate enquiry, to avoid proper obligations in other jurisdictions or to engage in illegal activities in other jurisdictions;
- (f) the assets of its Clients are properly managed and safeguarded; and
- (g) the recruitment, training and motivation of staff is sufficient to meet the obligations of the business.

## **5.7 Recording of Selection Criteria**

**5.7.1** Where the Trust Service Provider seeks the advice of a third party in connection with a Client's affairs, for example to advise on or manage investments, the Trust Service Provider must record the criteria for selection of the adviser and the reasons for the selection made.

**5.7.2** The Trust Service Provider must monitor the performance of the adviser and ensure that it is in a position to change advisers if it is in the interests of the Client.

## **5.8 Qualification and experience of Trust Service Provider staff**

**5.8.1** Staff employed or Persons recommended by the Trust Service Provider must have appropriate qualifications and experience.

**5.8.2** A Trust Service Provider must ensure that all transactions or decisions entered into, taken by or on behalf of Clients are properly authorised and handled by Persons with an appropriate level of knowledge, experience, qualifications and status according to the nature and status of the transactions or decisions involved (this applies also to decisions taken by trustees who are recommended by, but not employed by, a Trust Service Provider).

**5.8.3** A Trust Service Provider must ensure that, each of its officers and employees, agents, Persons acting with its instructions and Persons it recommends to act as trustees have an appropriate understanding of the fiduciary and other duties of a trustee and any duties arising under the laws relevant to the administration and affairs of Clients for which they are acting in the jurisdictions in which they are carrying on business and in which the assets being managed are held.

**5.8.4** A Trust Service Provider must ensure that staff competence is kept up to date through training and continuous professional development as appropriate.

## **5.9 Books and records**

**5.9.1** The books and records of a Trust Service Provider must be sufficient to demonstrate adequate and orderly management of Clients' affairs. A Trust Service Provider must prepare proper accounts, at appropriately regular intervals on the trusts and underlying companies administered for its Clients. Where trusts and underlying companies are governed by the laws of a jurisdiction that require accounts to be kept in a particular form, the Trust Service Provider must meet those requirements. In any case, the Trust Service Provider's books and records must be sufficient to allow the recreation of the transactions of the business and its Clients and to demonstrate what assets are due to each Client and what liabilities are attributable to each Client.

## **5.10 Due diligence**

**5.10.1** A Trust Service Provider must, at all times, have verified documentary evidence of the settlors, trustees (in addition to the Trust Service Provider itself) and principal named beneficiaries of trusts for which it Provides Trust Services. In the case of discretionary trusts with the capacity for the trustee to add further beneficiaries, a Trust Service Provider must also have verified, where reasonably possible, documentary evidence of any Person who receives a distribution from the trust and any other Person who is named in a memorandum or letter of wishes as being a likely recipient of a distribution from a trust.

**5.10.2** A Trust Service Provider must demonstrate that it has knowledge of the source of funds that have been settled into trusts or have been used to provide capital to companies, or have been used in transactions with which the Trust Service Provider has an involvement.

## **5.11 Fitness and Propriety of Persons acting as trustees**

**5.11.1** Where a Trust Service Provider arranges for a Person who is not an employee of the Trust Service Provider to act as trustee for a Client of the Trust Service Provider, the Trust Service Provider must ensure that such Person is fit and proper.

**5.11.2** A Trust Service Provider must notify the DFSA of the appointment of a Person under Rule 5.11.1, including the name and business address if applicable and the date of commencement of the appointment.

**5.11.3** Prior to the appointment of such a Person to act as a trustee, the Trust Service Provider must take reasonable steps to ensure that the Person has the required skills, experience and resources to act as a trustee for a Client of the Trust Service Provider.

**5.11.4** A Trust Service Provider must notify the DFSA immediately if the appointment of such a Person is or is about to be terminated, or on the resignation of such Person, giving the reasons for the resignation and the measures which have been taken to ensure that a new trustee has been appointed.

- 5.11.5** A Person appointed to act as trustee for a Client of a Trust Service Provider who is not an Employee of the Trust Service Provider, must agree in writing to be bound by and comply with the same legal and regulatory requirements as if he were an Employee of the Trust Service Provider.

## **6 ADDITIONAL RULES - INVESTMENT BUSINESS**

### **6.1 Application**

- 6.1.1** (1) The Rules in this chapter apply to an Authorised Firm when conducting Investment Business.
- (2) Sections 6.11, 6.12, 6.13 and 6.14 also apply to an Authorised Firm in respect of Client Assets that it holds or controls (within the meaning of Rule 6.11.4) in the course of, or in connection with, Operating a Crowdfunding Platform.
- (3) The requirements in this chapter apply to an Authorised Firm regardless of the classification of the Client, unless expressly provided otherwise.

#### **Guidance**

The requirements in chapter 3 also apply to the conduct of Investment Business.

### **6.2 Personal account transactions**

#### **Conditions for personal account transactions**

**6.2.1** An Authorised Firm must establish and maintain adequate policies and procedures so as to ensure that:

- (a) an Employee does not undertake a Personal Account Transaction unless:
- (i) the Authorised Firm has, in a written notice, drawn to the attention of the Employee the conditions upon which the Employee may undertake Personal Account Transactions and that the contents of such a notice are made a term of his contract of employment or services;
  - (ii) the Authorised Firm has given its written permission to that Employee for that transaction or to transactions generally in Investments of that kind; and
  - (iii) the transaction will not conflict with the Authorised Firm's duties to its Clients;
- (b) it receives prompt notification or is otherwise aware of each Employee's Personal Account Transactions; and
- (c) if an Employee's Personal Account Transactions are conducted with the Authorised Firm, each Employee's account must be clearly identified and distinguishable from other Clients' accounts.

**6.2.2** The written notice in Rule 6.2.1(a)(i) must make it explicit that, if an Employee is prohibited from undertaking a Personal Account Transaction, he must not, except in the proper course of his employment:

- (a) procure another Person to enter into such a Transaction; or
- (b) communicate any information or opinion to another Person if he knows, or ought to know, that the Person will as a result, enter into such a Transaction or procure some other Person to do so.

**6.2.3** Where an Authorised Firm has taken reasonable steps to ensure that an Employee will not be involved to any material extent in, or have access to information about, the Authorised Firm's Investment Business, then the Authorised Firm need not comply with the requirements in Rule 6.2.1 in respect of that Employee.

**6.2.4** An Authorised Firm must establish and maintain procedures and controls so as to ensure that an Investment Analyst does not undertake a Personal Account Transaction in an Investment if the Investment Analyst is preparing Investment Research:

- (a) on that Investment or its Issuer; or
- (b) on a related investment, or its Issuer;

until the Investment Research is published or made available to the Authorised Firm's Clients.

#### **Record Keeping**

- 6.2.5** (1) An Authorised Firm must maintain and keep a record of:
- (a) the written notice setting out the conditions for Personal Account Transactions under Rule 6.2.1(a)(i);
  - (b) each permission given or denied by the Authorised Firm under Rule 6.2.1(a)(ii);
  - (c) each notification made to it under Rule 6.2.1(b); and
  - (d) the basis upon which the Authorised Firm has ascertained that an Employee will not be involved in to any material extent, or have access to information about, the Authorised Firm's Investment Business for the purposes of Rule 6.2.3.
- (2) The records in (1) must be retained for a minimum of six years from the date of:
- (a) in (1)(a) and (1)(d), termination of the employment contract of each Employee;
  - (b) in (1)(b), each permission given or denied by the Authorised Firm; and
  - (c) in (1)(c), each notification made to the Authorised Firm.

## **6.3 Investment research and offers of securities**

### **Application**

**6.3.1** This section applies to an Authorised Firm preparing or publishing Investment Research.

### **Guidance**

Investment Research is seen as a significant potential source of conflicts of interest within an Authorised Firm and therefore an Authorised Firm preparing or publishing investment research is expected to have adequate procedures, systems and controls to manage effectively any conflicts that arise.

**6.3.2** An Authorised Firm that prepares and publishes Investment Research must have adequate procedures and controls to ensure:

- (a) the effective supervision and management of Investment Analysts;
- (b) that the actual or potential conflicts of interest are proactively managed in accordance with section 3.5 ;
- (c) that the Investment Research issued to Clients is impartial; and
- (d) that the Investment Research contains the disclosures described under Rules 6.3.3 and 6.3.4.

### **Guidance**

An Authorised Firm's procedures, controls and internal arrangements, which may include Chinese Walls, should limit the extent of Investment Analysts participation in corporate finance business and sales and trading activities, and ensure remuneration structures do not affect their independence.

### **Disclosures in investment research**

**6.3.3** When an Authorised Firm publishes Investment Research, it must take reasonable steps to ensure that the Investment Research:

- (a) clearly identifies the types of Clients for whom it is principally intended;
- (b) distinguishes fact from opinion or estimates, and includes references to sources of data and any assumptions used;
- (c) specifies the date when it was first published;
- (d) specifies the period the ratings or recommendations are intended to cover;
- (e) contains a clear and unambiguous explanation of the rating or recommendation system used;
- (f) includes a distribution of the different ratings or recommendations, in percentage terms:
  - (i) for all Investments;
  - (ii) for Investments in each sector covered; and

- (iii) for Investments, if any, where the Authorised Firm has undertaken corporate finance business with or for the Issuer over the past 12 months; and
- (g) if intended for use only by a Professional Client or Market Counterparty, contains a clear warning that it should not be relied upon by or distributed to Retail Clients.

**Guidance**

An Authorised Firm may consider including a price chart or line graph depicting the performance of the Investment for the period that the Authorised Firm has assigned a rating or recommendation for that investment, including the dates on which the ratings were revised for the purposes of the requirements such as in (d) and (e) of Rule 6.3.3.

**6.3.4** For the purposes of this section, an Authorised Firm must take reasonable steps to ensure that when it publishes Investment Research, and in the case where a representative of the Authorised Firm makes a Public Appearance, disclosure is made of the following matters:

- (a) any financial interest or material interest that the Investment Analyst or a Close Relative of the analyst has, which relates to the Investment;
- (b) the reporting lines for Investment Analysts and their remuneration arrangements where such matters give rise to any conflicts of interest which may reasonably be likely to impair the impartiality of the Investment Research;
- (c) any shareholding by the Authorised Firm or its Associate of 1% or more of the total issued share capital of the Issuer;
- (d) if the Authorised Firm or its Associate acts as corporate broker for the Issuer;
- (e) any material shareholding by the Issuer in the Authorised Firm;
- (f) any corporate finance business undertaken by the Authorised Firm with or for the Issuer over the past 12 months, and any future relevant corporate finance business initiatives; and
- (g) that the Authorised Firm is a Market Maker in the Investment, if that is the case.

**Guidance**

The requirements in Rule 6.3.4(a) and (b) apply to an Authorised Firm in addition to other requirements in the DFSA Rulebook. For example, an Authorised Firm is required to take reasonable steps to identify actual or potential conflicts of interest and then prevent or manage them under GEN Rule 4.2.7 (Principle 7 – Conflicts of Interest). Further, COB Rule 6.3.2 requires an Authorised Firm to have adequate procedures and controls when it prepares or publishes Investment Research.

**Restrictions on publication**

**6.3.5** If an Authorised Firm acts as a manager or co-manager of an initial public offering or a secondary offering, it must take reasonable steps to ensure that:

- (a) it does not publish Investment Research relating to the Investment during a Quiet Period; and
- (b) an Investment Analyst from the Authorised Firm does not make a Public Appearance relating to that Investment during a Quiet Period.

**Guidance**

The DFSA does not consider the same conflicts of interest mentioned in this section arise if an Investment Analyst prepares Investment Research solely for an Authorised Firm's own use and not for publication. For example, if the research material is prepared solely for the purposes of the Authorised Firm's proprietary trading then the use of this information would fall outside the restrictions placed on publications.

**Restriction on own account transactions**

- 6.3.6**
- (1) Unless Rule 6.2.2 applies, an Authorised Firm or its Associate must not knowingly execute an Own Account Transaction in an Investment or related Investments, which is the subject of Investment Research, prepared either by the Authorised Firm or its Associate, until the Clients for whom the Investment Research was principally intended have had a reasonable opportunity to act upon it.
  - (2) The restriction in (1) does not apply if:
    - (a) the Authorised Firm or its Associate is a Market Maker in the relevant Investment;
    - (b) the Authorised Firm or its Associate undertakes an Execution-Only Transaction for a Client; or
    - (c) it is not expected to materially affect the price of the Investment.

**Guidance**

The exceptions in Rule 6.3.6(2) allow an Authorised Firm to continue to provide key services to the market and to its Clients even if the Authorised Firm would be considered to have knowledge of the timing and content of the Investment Research which is intended for publication to Clients, for example when it is impractical for an Authorised Firm to put in place a Chinese Wall because the Authorised Firm has few Employees or cannot otherwise separate its functions.

**Offers of securities**

- 6.3.7** When an Authorised Firm carries out a mandate to manage an Offer of Securities, it must implement adequate internal arrangements, in accordance with section 3.5, to manage any conflicts of interest that may arise as a result of the Authorised Firm's duty to two distinct sets of Clients namely the corporate finance Client and the investment Client.

**Disclosure**

- 6.3.8** For the purposes of Rule 6.3.7, when an Authorised Firm accepts a mandate to manage an Offer, it must take reasonable steps to disclose to its corporate finance Client:
- (a) the process the Authorised Firm proposes to adopt in order to determine what recommendations it will make about allocations for the Offer;



- (b) details of how the target investor group, to whom it is planned to Offer the Securities, will be identified;
- (c) the process through which recommendations are prepared and by whom; and
- (d) (if relevant) that it may recommend placing Securities with a Client of the Authorised Firm for whom the Authorised Firm provides other services, with the Authorised Firm's own proprietary book, or with an Associate, and that this represents a potential conflict of interest.

**Guidance**

It is the DFSA's expectation that an Authorised Firm's procedures to identify and manage conflicts of interest should extend to the allocation process for an offering of Securities.

## **6.4 Best execution**

### **Application**

- 6.4.1** (1) The Rules in this section do not apply to an Authorised Firm with respect to any Transaction which:
- (a) it undertakes with a Market Counterparty;
  - (b) it carries out for the purposes of managing a Fund of which it is the Fund Manager;
  - (c) is an Execution-Only Transaction; or
  - (d) it undertakes on an MTF which it operates.
- (2) Where an Authorised Firm undertakes an Execution-Only Transaction with or for a Client, the Authorised Firm is not relieved from providing best execution in respect of any aspect of that Transaction which lies outside the Client's specific instructions.

### **Providing best execution**

- 6.4.2** (1) When an Authorised Firm agrees, or decides in the exercise of its discretion, to Execute any Transaction with or for a Client in an Investment, it must provide best execution.
- (2) An Authorised Firm provides best execution if it takes reasonable care to determine the best overall price available for that Investment under the prevailing market conditions and deals at a price which is no less advantageous to that Client.
- (3) An Authorised Firm which is an ATS Operator is not required to provide best execution for Persons who are its Clients in circumstances where such Persons are dealing with each other on the Authorised Firm's ATS and the Authorised Firm is not acting for or on behalf of any such Persons in relation to a deal on that ATS.

**Requirements**

- 6.4.3** In determining whether an Authorised Firm has taken reasonable care to provide the best overall price for a Client in accordance with Rule 6.4.2, the DFSA will have regard to whether an Authorised Firm has:
- (a) discounted any fees and charges previously disclosed to the Client;
  - (b) not taken a Mark-up or Mark-down from the price at which it Executed the Transaction, unless this is disclosed to the Client; and
  - (c) had regard to price competition or the availability of a range of price sources for the execution of its Clients' Transactions. In the case where the Authorised Firm has access to prices of different Authorised Market Institutions, other regulated financial markets or alternative trading systems, it must Execute the Transaction at the best overall price available having considered other relevant factors.
- 6.4.4** If another Person is responsible for the execution of a Transaction an Authorised Firm may rely on that Person to provide best execution where that Person has undertaken to provide best execution in accordance with this section.

**Guidance**

When determining best execution, an Authorised Firm should consider the direct costs and indirect costs and the relevant order type and size, settlement arrangements and timing of a Client's order that could affect decisions on when, where and how to trade.

**6.5 Non-market price transactions****Application**

- 6.5.1**
- (1) Subject to (2), this section applies to an Authorised Firm conducting Investment Business regardless of the classification of the Client.
  - (2) This section does not apply to a Client to whom a Person operating an MTF provides its MTF services.

**General prohibition**

- 6.5.2**
- (1) An Authorised Firm must not enter into a non-market price Transaction in any capacity, with or for a Client, unless it has taken reasonable steps to ensure that the Transaction is not being entered into by the Client for an improper purpose.
  - (2) The requirement in (1) does not apply in relation to a non-market price Transaction subject to the Rules of an Authorised Market Institution or regulated exchange.

**Record keeping**

**6.5.3** An Authorised Firm must make and retain, for a minimum of six years, a record of the steps it has taken in relation to each Transaction under this section.

**Guidance**

1. A non-market price Transaction is a Transaction where the dealing rate or price paid by the Authorised Firm or its Client differs from the prevailing market rate or price to a material extent or the Authorised Firm or its Client gives materially more or less in value than it receives in return.
2. In general, Authorised Firms should undertake transactions at the prevailing market price. Failure to do this may result in an Authorised Firm participating, whether deliberately or unknowingly, in the concealment of a profit or loss, or in the perpetration of a fraud.

**6.6 Aggregation and allocation****Application**

**6.6.1** The Rules in this section do not apply to an Authorised Firm with respect to any Transaction which:

- (a) it undertakes with a Market Counterparty;
- (b) it carries out for the purposes of managing a Fund of which it is the Fund Manager; or
- (c) is undertaken on an MTF which it operates.

**Aggregation of orders**

**6.6.2** An Authorised Firm may aggregate an order for a Client with an order for other Clients or with an order for its own account only where:

- (a) it is unlikely that the aggregation will operate to the disadvantage of any of the Clients whose Transactions have been aggregated;
- (b) the Authorised Firm has disclosed in writing to the Client that his order may be aggregated and that the effect of the aggregation may operate on some occasions to his disadvantage;
- (c) the Authorised Firm has made a record of the intended basis of allocation and the identity of each Client before the order is effected; and
- (d) the Authorised Firm has in place written standards and policies on aggregation and allocation which are consistently applied and should include the policy that will be adopted when only part of the aggregated order has been filled.

**Allocation of investments**

- 6.6.3** Where an Authorised Firm has aggregated a Client order with an order for other Clients or with an order for its own account, and part or all of the aggregated order has been filled, it must:
- (a) promptly allocate the Investments concerned;
  - (b) allocate the Investments in accordance with the stated intention;
  - (c) ensure the allocation is done fairly and uniformly by not giving undue preference to itself or to any of those for whom it dealt; and
  - (d) make and maintain a record of:
    - (i) the date and time of the allocation;
    - (ii) the relevant Investments;
    - (iii) the identify of each Client concerned; and
    - (iv) the amount allocated to each Client and to the Authorised Firm recorded against the intended allocation as required in (b).

**Record keeping**

- 6.6.4** An Authorised Firm must retain the records required in Rules 6.6.2 (d) and 6.6.3 for six years from the date on which the order is allocated.

**6.7 Record keeping – voice and electronic communications**

- 6.7.1** (1) An Authorised Firm must, subject to (2), take reasonable steps to ensure that it makes and retains recordings of its voice and electronic communications when such communications are with a Client or with another Person in relation to a Transaction, including the receiving or passing of related instructions.
- (2) The obligation in (1) does not apply in relation to voice and electronic communications which are not intended to lead to the conclusion of a specific Transaction and are general conversations or communications about market conditions.

**Guidance**

The effect of Rule 6.7.1 is that an Authorised Firm may conduct the kind of business contemplated in (1) over a mobile phone or other handheld electronic communication device but only if the Authorised Firm is able to record such communications. Further, mere transmission of instructions by front office personnel to back office personnel within an Authorised Firm would not ordinarily be subject to this Rule.

- 6.7.2** (1) An Authorised Firm must be able to demonstrate prompt accessibility of all records.

- (2) Records must be maintained in comprehensible form or must be capable of being promptly so reproduced.
- (3) The Authorised Firm must make and implement appropriate procedures to prevent unauthorised alteration of its records.

**6.7.3** Voice and electronic communication recordings must be retained for a minimum of six months.

**Records of orders and transactions**

- 6.7.4**
- (1) When an Authorised Firm receives a Client order or in the exercise of its discretion decides upon a Transaction, it must promptly make a record of the information set out in App1 under Rule A1.1.1.
  - (2) When an Authorised Firm Executes a Transaction, it must promptly make a record of the information set out in App1 under Rule A1.1.2.
  - (3) When an Authorised Firm passes a Client order to another Person for Execution, it must promptly make a record of the information set out in App 1 under Rule A1.1.3.

**6.7.5** The records referred to in Rule 6.7.4 must be retained by an Authorised Firm for a minimum of six years.

**6.8 Other dealing rules**

**Application**

- 6.8.1**
- (1) Subject to (2), the Rules in this section, other than Rule 6.8.7, do not apply to an Authorised Firm with respect to any Transaction which it:
    - (a) undertakes with a Market Counterparty; or
    - (b) carries out for the purposes of managing a Fund of which it is the Fund Manager.
  - (2) The Rules in this section do not apply to an Authorised Firm in respect of any Transactions which it undertakes on an MTF which it operates.

**Churning**

- 6.8.2**
- (1) An Authorised Firm must not Execute a Transaction for a Client in its discretion or advise any Client to transact with a frequency or in amounts to the extent that those Transactions might be deemed to be excessive.
  - (2) The onus will be on the Authorised Firm to ensure that such Transactions were fair and reasonable at the time they were entered into.

**Timely execution**

- 6.8.3**
- (1) Once an Authorised Firm has agreed or decided to enter into a Transaction for a Client, it must do so as soon as reasonably practical.

- (2) An Authorised Firm may postpone the execution of a Transaction in (1) if it has taken reasonable steps to ensure that it is in the best interests of the Client.

#### **Fairly and in due turn**

- 6.8.4** An Authorised Firm must deal with Own Account Transactions and Client Transactions fairly and in due turn.

#### **Averaging of prices**

- 6.8.5** (1) An Authorised Firm may execute a series of Transactions on behalf of a Client within the same trading day or within such other period as may be agreed in writing by the Client, to achieve one investment decision or objective, or to meet Transactions which it has aggregated.
- (2) If the Authorised Firm does so, it may determine a uniform price for the Transactions executed during the period, calculated as the weighted average of the various prices of the Transactions in the series.

#### **Timely allocation**

- 6.8.6** (1) An Authorised Firm must ensure that a Transaction it Executes is promptly allocated.
- (2) The allocation must be:
- (a) to the account of the Client on whose instructions the Transaction was executed;
  - (b) in respect of a discretionary Transaction, to the account of the Client or Clients with or for whom the Authorised Firm has made and recorded, prior to the Transaction, a decision in principle to execute that Transaction; or
  - (c) in all other cases, to the account of the Authorised Firm.

#### **Direct Electronic Access**

- 6.8.7** Where an Authorised Firm provides a Client (including a Market Counterparty) with direct electronic access to an Authorised Market Institution, Alternative Trading System, Regulated Exchange or regulated multilateral trading facility, the Authorised Firm must:
- (a) establish and maintain policies, procedures, systems and controls to limit or prevent a Client from placing an order that would result in the Authorised Firm exceeding its existing position limits or credit limits; and
  - (b) ensure that such policies, procedures, systems and controls remain appropriate and effective on an on-going basis.

#### **Guidance**

An Authorised Firm should undertake on-going monitoring of its systems and controls to ensure that they are operating effectively and as intended and remain appropriate.

## **6.9 Confirmation notes**

### **Application**

**6.9.1** The Rules in this section do not apply to an Authorised Firm with respect to any Transaction which it:

- (a) undertakes with a Market Counterparty; or
- (b) carries out for the purposes of managing a Fund of which it is the Fund Manager.

### **Sending confirmation notes**

**6.9.2** (1) When an Authorised Firm Executes a Transaction in an Investment for a Client, it must ensure a confirmation note is sent to the Client as soon as possible and in any case no later than 2 business days following the date of Execution of the Transaction.

(2) Where an Authorised Firm has executed a Transaction or series of Transactions in accordance with Rule 6.8.5, the Authorised Firm must send a confirmation note relating to those Transactions as soon as possible, but no later than 2 business days following the last Transaction.

(3) The confirmation note must include the details of the Transaction in accordance with App3 section A3.1.

(4) An Authorised Firm is not required to issue a confirmation note where a Professional Client has advised in writing that he does not wish to receive such confirmation notes.

### **Record keeping**

**6.9.3** An Authorised Firm must retain a copy of each confirmation note sent to a Client and retain it for a minimum of six years from the date of despatch.

## **6.10 Periodic statements**

### **Application**

**6.10.1** The Rules in this section do not apply to an Authorised Firm with respect to any Transaction which it:

- (a) undertakes with a Market Counterparty; or
- (b) carries out for the purposes of managing a Collective Investment Fund of which it is the Fund Manager.

### **Investment management and contingent liability investments**

**6.10.2** (1) When an Authorised Firm:

- (a) acts as an Investment Manager for a Client; or

- (b) operates a Client's account containing uncovered open positions in a Contingent Liability Investment;

it must promptly and at suitable intervals in accordance with (2) provide the Client with a written statement ("a periodic statement") containing the matters referred to in App4 section A4.1.

- (2) For the purposes of (1), a "suitable interval" is:
  - (a) six-monthly;
  - (b) monthly, if the Client's portfolio includes an uncovered open position in Contingent Liability Investments; or
  - (c) at any alternative interval that a Client has on his own initiative agreed with the Authorised Firm but in any case at least annually.

### **Record keeping**

- 6.10.4** An Authorised Firm must make a copy of any periodic statement provided to a Client and retain it for a minimum of six years from the date on which it was provided.

## **6.11 Client Assets**

### **Application**

- 6.11.1** (1) This section applies to an Authorised Firm which:
  - (a) holds or controls Client Assets; or
  - (b) Provides Custody.
- (2) This section applies to an Authorised Firm Arranging Custody only to the extent specified in Rule 6.11.2(3).

### **Guidance**

1. Client Assets is defined in the GLO Module as "Client Money and Client Investments".
2. Principle 9 of the Principles for Authorised Firms (Customer assets and money) requires an Authorised Firm to arrange proper protection for Clients' Assets when the firm is responsible for them. An essential part of that protection is that an Authorised Firm must properly safeguard Client Money and Client Investments held or controlled on behalf of a Client in the course of, or in connection with, the carrying on of Investment Business in or from the DIFC.
3. Rule 6.11.3 requires an Authorised Firm to introduce adequate organisational arrangements to minimise the risk of the loss or diminution of Client Assets, or of rights in connection with Client Assets, as a result of, for example, the Authorised Firm's or a third party's insolvency, fraud, poor administration, inadequate record-keeping or negligence.
4. For information about the difference between Providing Custody and Arranging Custody, see Guidance under GEN Rule 2.13.1.



5. The Client Asset provisions apply only to a limited extent to an Authorised Firm that Arranges Custody, as such a firm does not hold or control Client Assets (see Rule 6.11.2(3)).

### General requirements

- 6.11.2** (1) An Authorised Firm which holds or controls Client Money must comply with sections 6.12 and 6.14.
- (2) An Authorised Firm which holds or controls Client Investments or Provides Custody must comply with sections 6.13 and 6.14.
- (3) An Authorised Firm which Arranges Custody must comply with the requirements in Rule A6.5.1A (on suitability of non-DIFC custodians) and A6.7.1(1) (on disclosure) in APP 6 and in section 6.14 (Record keeping).
- 6.11.3** (1) An Authorised Firm must have systems and controls to ensure that Client Assets are identifiable and secure at all times.
- (2) Where the Authorised Firm holds a mandate, or similar authority over an account with a third party, in the Client's own name, its systems and controls must:
- (a) include a current list of all such mandates and any conditions placed by the Client or by the Authorised Firm on the use of the mandate;
  - (b) include the details of the procedures and authorities for the giving and receiving of instructions under the mandate; and
  - (c) ensure that all Transactions entered into using such a mandate are recorded and are within the scope of the authority of the Employee and the Authorised Firm entering into such Transactions.

### Guidance

Authorised Firms are reminded that they must ensure that their auditor produces a Client Money Auditor's Report and a Safe Custody Auditor's Report as applicable, in accordance with GEN 8.6.

### Holding or controlling client assets

- 6.11.4** Client Assets are held or controlled by an Authorised Firm if they are:
- (a) directly held by the Authorised Firm;
  - (b) held in an account in the name of the Authorised Firm;
  - (c) held by a Person, or in an account in the name of a Person, controlled by the Authorised Firm; or
  - (d) held in the Client's own name, but the Authorised Firm has a mandate from the Client to manage those assets on a discretionary basis.

**Guidance**

- 1 For the purposes of Rule 6.11.4, the DFSA would consider a Person to be controlled by an Authorised Firm if that Person is inclined to act in accordance with the instructions of the Authorised Firm.
2. The DFSA would consider an account to be controlled by an Authorised Firm if that account is operated in accordance with the instructions of the Authorised Firm.
3. If an Authorised Firm has a discretionary portfolio mandate from a Client, even though the assets are to be held in the name of the Client (for example, under a power of attorney arrangement), the firm controls those assets as it can execute transactions relating to those assets, within the parameters set out in the mandate.
4. In relation to assets referred to in Guidance item 3 that are held in the Client's name, only specific Rules in App 5 (Client Money Provisions) and App 6 (Safe Custody Provisions) are likely to be relevant, as the assets are already held in the Client's own name and the firm will control rather than hold the assets. A firm with such a discretionary mandate will also need to comply with other relevant requirements in the Rulebook, such as GEN Rule 2.2.10A requiring an endorsement to hold or control Client Assets, and GEN 8.6 section requiring an audit report relating to Client Assets.

**6.12 Client money**

**6.12.1** All Money held or controlled on behalf of a Client in the course of, or in connection with, the carrying on of Investment Business or the Operation of a Crowdfunding Platform in or from the DIFC is Client Money, except Money which is:

- (a) held by the Authorised Firm as a Bank in an account with itself, provided the Authorised Firm notifies the Client in writing that the Client Money is held by it as a Bank and not in accordance with this chapter;
- (b) immediately due and payable by the Client to the Authorised Firm;
- (c) belonging to another Person within the Authorised Firm's Group unless that Person is an Authorised Firm or Regulated Financial Institution and that Person has confirmed to the Authorised Firm, in writing, that the beneficial owner of the Money is a Person who is not part of the Authorised Firm's Group;
- (d) in an account in the Client's name over which the Authorised Firm has a mandate or similar authority and where the Authorised Firm is in compliance with Rule 6.11.3(2), provided it is not a mandate to manage the Money on a discretionary basis;
- (e) received in the form of a cheque, or other payable order, made payable to a third party other than a Person or account controlled by the Authorised Firm, provided the cheque or other payable order is intended to be forwarded to the third party within 1 business day of receipt; or
- (f) Fund Property of a Fund.

**Guidance**

1. Authorised Firms are reminded that the exemption in Rule 6.12.1(a) would not apply to Money which is passed to a third party i.e. not held in an account with the Authorised Firm itself.
2. Pursuant to Rule 6.12.1(b), examples of Money which is immediately due and payable to an Authorised Firm includes Money which is:
  - a. paid by the way of brokerage, fees and other charges to the Authorised Firm or where it is entitled to deduct such remuneration from the Client Money held or controlled;
  - b. paid by the Authorised Firm in relation to a Client purchase or in settlement of a margin payment in advance of receiving a payment from the Client; or
  - c. owed by the Client to the Authorised Firm in respect of unpaid purchases by or for the Client if delivery of Investments has been made to the Client or credited to his account.
3. The CIR module contains specific provisions relating to the handing of Fund Property and also provisions relating to a Fund Administrator holding or controlling monies or assets belonging to third parties.

**Client money provisions**

- 6.12.2**
- (1) An Authorised Firm in Category 4 must not hold Client Money, except if it does so in connection with it Operating a Crowdfunding Platform.
  - (2) An Authorised Firm which holds or controls Client Money for a Client must, subject to (3), comply with the Client Money Provisions in App5.
  - (3) Where the Client is a Market Counterparty, an Authorised Firm may exclude the application of the Client Money Provisions but only where it has obtained the prior written consent of the Market Counterparty to do so.

**Guidance**

In accordance with GEN chapter 8, an Authorised Firm which holds or controls Client Money must arrange for a Client Money Auditor's Report to be submitted to the DFSA on an annual basis.

**Client disclosure**

- 6.12.3**
- (1) If an Authorised Firm holds or controls Client Money which is not subject to the Client Money Provisions pursuant to Rule 6.12.2 (2), it must disclose to that Market Counterparty in writing that:
    - (a) the protections conferred by the Client Money Provisions do not apply to such Client Money;
    - (b) as a consequence of (a), such Client Money may be mixed with Money belonging to the Authorised Firm, and may be used by the Authorised Firm in the course of the Authorised Firm's business; and
    - (c) in the event of insolvency, winding up or other Distribution Event stipulated by the DFSA:

- (i) in the case of a Domestic Firm, such Client Money will be subject to and distributed in accordance with the DFSA Client Money Distribution Rules; and
  - (ii) in the case of a non-Domestic Firm, such Client Money will be subject to a regime which may differ from the regime applicable in the DIFC.
- (2) The Authorised Firm must obtain that Market Counterparty's written acknowledgement of the disclosures made in (1) prior to holding or controlling Client Money for that Market Counterparty.

#### **Distribution event**

**6.12.4** Following a Distribution Event, an Authorised Firm must comply with the Client Money Distribution Rules and all Client Money will be subject to such Rules.

#### **Record keeping**

- 6.12.5** (1) An Authorised Firm must maintain records:
- (a) which enable the Authorised Firm to demonstrate compliance with Rule 6.11.2;
  - (b) which enable the Authorised Firm to demonstrate and explain all entries of Money held or controlled in accordance with this chapter; and
  - (c) of all cheques received and forwarded in accordance with Rule 6.12.1(e).
- (2) Records must be kept for a minimum of six years.

#### **Guidance**

The DFSA expects an Authorised Firm to maintain proper books and accounts based on the double-entry booking principle. They should be legible, up to date and contain narratives with the entries which identify and provide adequate information about each transaction. Entries should be made in chronological order and the current balance should be shown on each of the Authorised Firm's ledgers.

### **6.13 Client investments**

**6.13.1** An Authorised Firm must treat all Investments held or controlled on behalf of a Client in the course of, or in connection with, the carrying on of Investment Business as Client Investments.

**6.13.2** An Authorised Firm which holds or controls Client Investments must have systems and controls in place to ensure the proper safeguarding of Client Investments.

#### **Guidance**

Instead of safeguarding Client Investments, an Authorised Firm may choose to safeguard Client Money equal to the value of the Client Investments.

- 6.13.3** (1) Subject to (2), an Authorised Firm:
- (a) holding or controlling Client Investments; or
  - (b) Providing Custody,
- in or from the DIFC must do so in accordance with the Safe Custody Provisions in App6.
- (2) The Safe Custody Provisions in App6 do not apply to Client Investments held as Collateral unless stated otherwise.

**Guidance**

An Authorised Firm Arranging Custody must comply with the requirements specified in Rule 6.11.2(3).

**Holding collateral**

- 6.13.4** Before an Authorised Firm holds Collateral from a Client it must disclose to that Client:
- (a) the basis and any terms governing the way in which the Collateral will be held, including any rights which the Authorised Firm may have to realise the Collateral;
  - (b) if applicable, that the Collateral will not be registered in that Client's own name;
  - (c) if applicable, that the Authorised Firm proposes to return to the Client Collateral other than the original Collateral, or original type of Collateral; and
  - (d) that in the event of the insolvency, winding up or other Distribution Event stipulated by the DFSA:
    - (i) of a Domestic Firm, any excess Collateral will be sold and the resulting Client Money shall be distributed in accordance with the DFSA Client Money Distribution Rules; or
    - (ii) of a non-Domestic Firm, that Collateral will be subject to a regime which may differ from the regime applicable in the DIFC.
- 6.13.5** Before an Authorised Firm deposits Client's Collateral with a third party it must notify the third party that:
- (a) the Collateral does not belong to the Authorised Firm and must therefore be held by the third party in a segregated Client Account in a name that clearly identifies it as belonging to the Authorised Firm's Clients; and
  - (b) the third party is not entitled to claim any lien or right of retention or sale over the Collateral except to cover the obligations owed to the third party which gave rise to that deposit, pledge, charge or security arrangement or any charges relating to the administration or safekeeping of the Collateral.

- 6.13.6** (1) An Authorised Firm may only permit Client's Collateral to be held by a third party where it has reasonable grounds to believe that the third party is, and remains, suitable to hold that Collateral.
- (2) An Authorised Firm must be able to demonstrate to the DFSA's satisfaction the grounds upon which it considers the third party to be suitable to hold Client's Collateral.
- 6.13.7** (1) An Authorised Firm must take reasonable steps to ensure that the Collateral is properly safeguarded.
- (2) An Authorised Firm must withdraw the Collateral from the third party where the Collateral is not being properly safeguarded unless the Client has indicated otherwise in writing.
- 6.13.8** An Authorised Firm holding Client's Collateral must send a statement every six months to the Client in accordance with section A6.8.
- 6.13.9** An Authorised Firm must reconcile the Client's Collateral in accordance with section A6.9.

## **6.14 Record keeping**

- 6.14.1** (1) An Authorised Firm must maintain records:
- (a) which enable the Authorised Firm to demonstrate compliance with Rule 6.11.2; and
- (b) which enable the Authorised Firm to demonstrate and explain all entries of Client Investments and Collateral held or controlled in accordance with this chapter.
- (2) Records must be kept for a minimum of six years.

## **6.15 Advising on or Arranging Direct Long-Term Insurance**

- 6.15.1** If an Authorised Firm advises on or arranges Direct Long-Term Insurance for a Retail Client, it must disclose to the Client:
- (a) the method of calculation of any bonuses;
- (b) an indication of surrender values and paid-up values, and the extent to which any such values are guaranteed;
- (c) for unit-linked insurance contracts, definition of the units to which they are linked, and a description of the underlying assets;
- (d) the basis of any projections included in the information; and
- (e) any facts that are material to the decision to invest, including any risks associated with the investment and factors that may adversely affect the performance of the investments.

**Guidance**

An Authorised Firm can only advise on Long-Term Insurance, or arrange Long-Term Insurance, if it has an authorisation for the Financial Services in GEN Rule 2.9.1 or GEN Rule 2.11.1, as is relevant.

## **7 CORE RULES - INSURANCE**

### **7.1 Application and interpretation**

- 7.1.1** (1) The Rules in this chapter apply to an Authorised Firm with respect to the conduct in or from the DIFC of Insurance Business, Insurance Intermediation or Insurance Management to the extent specified in any Rule.
- (2) The Rules in this chapter do not apply to an Insurer that is an Authorised ISPV with the exception of the Rules in section 7.2.
- (3) Only section 7.2, Rules 7.3.1, 7.6.1 and 7.9.1 and sections 7.10 and 7.12 in this chapter apply to an Insurer, Insurance Intermediary or Insurance Manager when it carries on a Financial Service with or for a Market Counterparty.
- 7.1.2** In this chapter, unless otherwise stated, a reference to an “insurer” is a reference to both an Insurer and a Non-DIFC insurer.
- 7.1.3** (1) In this chapter, unless otherwise stated, a reference to a Client of an Insurance Manager is a reference to:
- (a) an insurer to whom the Insurance Manager provides its Insurance Management services; and
  - (b) a Policyholder with whom the Insurance Manager interacts when carrying out its Insurance Management activities.
- (2) In section 7.12, when an Insurance Manager provides Insurance Management services to a Captive Insurer, a reference to a Client in (1)(a) is a reference to:
- (a) the Captive Insurer;
  - (b) any shareholder of the Captive Insurer; and
  - (c) any Person on whose behalf the Insurance Manager undertakes to establish that Person as an insurer.
- (3) In (2):
- (a) a Captive Insurer includes a Cell of a Protected Cell Company which is an Insurer; and
  - (b) a shareholder includes a holder of Cell Shares.

#### **Guidance**

The Rules in this chapter apply to Authorised Firms conducting Insurance Business and Insurance Management in relation to all classes of Contracts of Insurance. However, those Rules apply to Authorised Firms conducting Insurance Intermediation only in relation to Contracts of Insurance that are not contracts of Long-Term Insurance. Other COB Rules relating to the Financial Services of



Advising on Financial Products or Credit and Arranging Credit or Deals in Investments will apply to advising and arranging on contracts of Long-Term Insurance.

## 7.1A Table illustrating the application of the Rules in this chapter

### Guidance

Rule	Insurer	Insurance Intermediary	Insurance Manager
Section 7.1: Application and interpretation	✓	✓	✓
Section 7.1A: Table illustrating the application of Rules	✓	✓	✓
Section 7.2: Insurance business, management and intermediation restrictions	✓	✓ (other than Rules 7.2.3, 7.2.4 and 7.2.5)	✓ (only Rules 7.2.2 and 7.2.6)
Section 7.3: Communication of information and marketing material	✓	✓	✓ (other than Rule 7.3.1(3))
Section 7.4: Client's duty of disclosure	✓ (other than Rules 7.4.2, 7.4.3)	✓	X
Section 7.5: Authorised Firm's duty of disclosure	✓ (other than Rules 7.5.2 and 7.5.3)	✓	✓ (other than Rule 7.5.3)
Section 7.6: Disclosure of costs and remuneration	✓	✓	✓ (other than Rule 7.6.2)
Section 7.7: Information about the proposed insurance	✓	✓	X
Section 7.8: Suitability	✓	✓	X
Section 7.9: Managing Conflicts of Interests	X	✓	✓
Section 7.10: Placement of Insurance	X	✓	✓
Section 7.11: Providing an ongoing service	✓	✓	X
Section 7.12: Insurance Monies	X	✓	✓

## 7.2 Insurance business, management and intermediation restrictions

**7.2.1** An Authorised Firm may only conduct Insurance Business or Insurance Intermediation with or for a Client to the extent specified in this section.

**7.2.2 (1)** An Insurer must ensure that it does not Effect a Contract of Insurance or Carry Out a Contract of Insurance through an establishment maintained by it in the DIFC where the contract is in relation to a risk situated within the State, unless the risk is situated in the DIFC, or the contract is one of re-insurance.

(2) An Insurance Intermediary must ensure that it does not act as agent in relation to a Contract of Insurance where the contract is in relation to a risk situated within the State, unless the risk is situated in the DIFC, or the contract is one of re-insurance.

- (3) An Insurance Manager must ensure that it does not act in relation to a Contract of Insurance where the contract is in relation to a risk situated within the State, unless the risk is situated in the DIFC, or the contract is one of re-insurance.

**Guidance**

The classes of insurance are set out in GEN App4. These include both insurance and reinsurance contracts relating to life insurance and non-life insurance (such as accident, sickness, property and travel insurance). However, the prohibitions in Rule 7.2.2 only apply to a Contract of Insurance that is not a contract of re-insurance.

- 7.2.3** An Insurer must ensure that it does not carry on, through an establishment maintained by it in the DIFC, both Long-Term Insurance Business and General Insurance Business unless the General Insurance Business is restricted to Class 1 or Class 2 or both.

- 7.2.4** An Insurer which is a Protected Cell Company must ensure that all Insurance Business is attributable to a particular Cell of that Insurer.

- 7.2.5** An Insurer must not carry on any activity other than Insurance Business unless it is an activity in direct connection with or for the purposes of such business. For the purposes of this Rule, Managing Assets is not an activity in connection with or for the purposes of Insurance Business.

**Guidance**

1. The following activities will normally be considered in direct connection with or for the purposes of Insurance Business carried on by an Insurer:
  - a. investing, reinvesting or trading, as investor or rabb ul maal and for the Insurer's own account, that of its Subsidiary, its Holding Company or any Subsidiary of its Holding Company but not any other party, in Securities, loans, investment accounts, units or shares in collective investment funds, certificates of mudaraba, certificates of musharaka or other forms of investments that are intended to earn profit or return for the investor;
  - b. rendering other services related to Insurance Business operations including, but not limited to, actuarial, risk assessment, loss prevention, safety engineering, data processing, accounting, claims handling, loss assessment, appraisal and collection services;
  - c. acting as agent for another insurer in respect of contracts of insurance in which both insurers participate;
  - d. establishing Subsidiaries or Associates engaged or organised to engage exclusively in one or more of the businesses specified above; and
  - e. giving advice relating to its own Contracts of Insurance.
2. The DFSA may give individual guidance on other business activities that may be determined to be in direct connection with Insurance Business.

- 7.2.6** An Insurance Manager must not underwrite on behalf of a Non-DIFC insurer in relation to a Contract of Insurance with or for a Retail Client, unless the Insurance Manager has obtained the prior written approval of the DFSA in respect of that insurer.

**Guidance**

For the purposes of Rule 7.2.6, an Insurance Manager should submit to the DFSA sufficient information to establish that the Non-DIFC insurer for which it proposes to act is fit and proper and is subject to adequate regulation in its home jurisdiction.

**7.3 Communication of information and marketing material**
**General obligation**

- 7.3.1** (1) When communicating any information in relation to Insurance Business, Insurance Intermediation or Insurance Management to a Person, an Authorised Firm must take reasonable steps to ensure that the communication is clear, fair and not misleading.
- (2) An Insurer, Insurance Intermediary or Insurance Manager must not, in any form of communication with a Person, including an agreement, attempt to limit or avoid any duty or liability it may have to that Person under legislation administered by the DFSA.
- (3) An Insurer or Insurance Intermediary must, when providing or directing marketing material to a Client, comply with the requirements in section 3.2, if the marketing material relates to a Direct Long-Term Insurance Contract.

**7.4 Client's duty of disclosure**

- 7.4.1** An Insurer or Insurance Intermediary must explain to a Client:
- (a) the Client's duty to disclose all circumstances material to the insurance both before the insurance commences and during the continuance of the policy; and
- (b) the consequence of any failure by the Client to make such disclosures.
- 7.4.2** An Insurance Intermediary must explain to a Client that all answers or statements given on a proposal form, claim form or any other relevant document are the Client's own responsibility and that the Client is responsible for checking the accuracy of such information.
- 7.4.3** If an Insurance Intermediary believes that any disclosure of material facts by a Client is not true, fair or complete, it must request the Client to make the necessary true, fair or complete disclosure, and if this is not forthcoming must consider declining to continue acting on that Client's behalf.

**7.5 Authorised Firm's duty of disclosure**
**Guidance**

If an Authorised Firm is required to provide information to a Client or potential Client under this section or any other section in this Chapter before providing a service or doing anything, then the

information should be provided in good time before providing the service or doing the thing so that the Client has sufficient time to make an informed decision.

- 7.5.1** (1) An Insurer, Insurance Intermediary or Insurance Manager must, subject to (3), disclose to a Client:
- (a) the name and address of the insurer or insurers effecting the Contract of Insurance;
  - (b) its own name and address where different; and
  - (c) contact details of the Person to whom a claim is to be notified.
- (2) The disclosures in (1) must be made before effecting or placing the Contract of Insurance, or as soon as reasonably practicable thereafter.
- (3) An Insurance Manager is not required to make the disclosure under (1) to an insurer to whom it provides Insurance Management services.

- 7.5.2** (1) An Insurance Intermediary or Insurance Manager must, subject to (3), disclose to a Client if:
- (a) it has a direct or indirect holding representing 10% or more of the voting rights or capital in an insurer; or
  - (b) an insurer, or its parent undertaking, has a direct or indirect holding representing 10% or more of the voting rights or capital in the Insurance Intermediary or Insurance Manager.
- (2) The disclosures in (1) must be made before providing Insurance Intermediation or Insurance Management services to the Client.
- (3) An Insurance Manager is not required to make a disclosure under (1) to an insurer to whom it provides Insurance Management services.

**Guidance**

An Insurance Intermediary or Insurance Manager is required to disclose the information under Rule 7.5.1(1) and Rule 7.5.2(1) to any Policyholder with whom it interacts when carrying out its Insurance Intermediation or Insurance Management activities.

- 7.5.3** (1) An Insurance Intermediary must, before providing any Insurance Intermediation service to a Person as a Retail Client, disclose whether any advice or information is or will:
- (a) be provided on the basis of a fair analysis of the market;
  - (b) not be provided on the basis of a fair analysis of the market because of any contractual agreement it has with any particular insurer or insurers to deal with only their products; or
  - (c) even if there are no contractual agreements of the type referred to in (b), not be provided on the basis of a fair analysis of the market.

- (2) If (1) (b) or (c) applies, the Insurance Intermediary must, if requested by the Retail Client, provide to that Client a list of insurers with whom it deals or may deal in relation to the relevant Contracts of Insurance.
- (3) An Insurance Intermediary must, before providing any Insurance Intermediation service to a Client, disclose to that Client whether it acts on behalf of an insurer or any other Person or acts independently on behalf of Clients.

**Guidance**

1. An Insurance Intermediary should not represent itself as providing advice or information on the basis of a fair analysis of the market under Rule 7.5.3(1) unless it has considered a sufficiently broad range of Contracts of Insurance and based its decision on an adequate analysis of those contracts.
2. Insurance Brokers act for Clients who are Policyholders. In doing so, they may claim under Rule 7.5.3(3) that they act ‘independently’ for the Clients.
3. The DFSA expects an Insurance Broker which holds itself out to a Client as acting ‘independently’ for the Client to be able to demonstrate its independence to the DFSA. Factors that the DFSA would take into account when assessing if an Insurance Broker has acted independently include whether that broker:
  - (a) has assessed a sufficiently large number of insurance products available on the market, and those products are sufficiently diverse in terms of their types and the issuers, to be able to suit the Client’s needs and objectives;
  - (b) is free to select insurance products from a sufficiently large number of insurers – for example, if a broker has close links with insurers, or exclusivity clauses in arrangements with insurers whose products they can select, the broker may not be able to claim it is independent; and
  - (c) has disclosed clearly to the Client all commissions and other economic benefits it or a Group member receives from insurers with whom it places insurance.

## **7.6 Disclosure of costs and remuneration**

- 7.6.1** An Insurer, Insurance Intermediary or Insurance Manager must provide details of the costs of each Contract of Insurance or Insurance Intermediation service or Insurance Management service offered to a Client.

**Guidance**

- 1 The disclosure required by this Rule should include any premiums, fees, charges or taxes payable by the Client, whether or not these are payable to the Authorised Firm.
- 2 The disclosure should be made in terms readily understandable by the Client, taking into account the knowledge held by that Client in relation to the type of insurance in question.

- 7.6.2** An Insurer or Insurance Intermediary must, where any premium is payable through a Credit Facility made available to a Retail Client, disclose any interest, profit rate or charges payable by the Client for using that facility.

**7.6.3** An Insurer, Insurance Intermediary or Insurance Manager must ensure that it does not impose any new costs, fees or charges without first disclosing the amount and the purpose of those charges to the Client.

**7.6.4** (1) An Insurer, Insurance Intermediary or Insurance Manager must, on the request of any Client, disclose to that Client all commissions and other economic benefits accruing to the Authorised Firm or any member of the same Group from:

- (a) any Insurance Intermediation business;
- (b) any Insurance Management business; or
- (c) any other business connected to or related to the provision of such business;

transacted by the Authorised Firm on behalf of that Client.

(2) The requirement to disclose the information under (1) does not apply where an Insurance Intermediary acts solely on behalf of a single insurer, and this fact has been disclosed to the Client.

## **7.7 Information about the proposed insurance**

**7.7.1** An Insurer or Insurance Intermediary must provide adequate information in a comprehensive and timely manner to enable a Client to make an informed decision about the Contract of Insurance that is being proposed.

**7.7.2** Without limiting the generality of the disclosure obligation under section 7.5, an Insurer or Insurance Intermediary must, for the purpose of complying with the obligation under that section:

- (a) provide to a Client information about the key features of any insurance proposed including the essential cover and benefits, any significant or unusual restrictions, exclusions, conditions or obligations, and the applicable period of cover; and
- (b) explain, except where the insurance cover is sourced from a single insurer, the differences in and the relative costs of similar types of insurance as proposed.

### **Guidance**

When deciding to what extent it is appropriate to explain the terms and conditions of a particular insurance the Insurer or Insurance Intermediary should take into consideration the knowledge held by the Client in relation to the type of insurance in question.

### **Specific disclosure for Long-Term Insurance**

**7.7.3** Where an Insurer or an Insurance Intermediary proposes Direct Long-Term Insurance to a Retail Client, the disclosure for the purposes of this section must include:

- (a) the method of calculation of any bonuses;

- (b) an indication of surrender values and paid-up values, and the extent to which any such values are guaranteed;
- (c) for unit-linked insurance contracts, definition of the units to which they are linked, and a description of the underlying assets;
- (d) the basis of any projections included in the information; and
- (e) any facts that are material to the decision to invest, including risks associated with the investment and factors that may adversely affect the performance of the investments.

**7.7.4** Deleted

## **7.8 Suitability**

**7.8.1** An Insurer or an Insurance Intermediary must comply with the suitability requirement set out in section 3.4 when conducting any Insurance or Insurance Intermediation Business with or for a Retail Client in respect of Direct Long-Term Insurance.

**7.8.2** (1) Subject to Rule 7.8.3, an Insurer or Insurance Intermediary must only make a recommendation to a Retail Client to enter into a Contract of Insurance that is General Insurance where it has taken reasonable steps to ensure that the recommended Contract of Insurance is suitable in light of the Client's demands and needs.

(2) The Insurer or Insurance Intermediary must obtain from a Retail Client such information as is necessary to identify the Client's circumstances and objectives, and consider whether the terms of the particular contract of General Insurance meet the requirements identified.

**7.8.3** An Insurer and an Insurance Intermediary may only recommend to a Client a contract of General Insurance that does not meet all the Client's requirements if it clearly explains to the Client, at the point of making the recommendation, that the contract does not fully meet the Client's requirements and the differences in the insurance recommended.

### **Guidance**

When deciding what level of explanation is appropriate for a Client to whom a contract of insurance that does not fully meet that Client's requirements is recommended, the Insurer or Insurance Intermediary should take into consideration the knowledge held by the Client in relation to the type of insurance in question.

**7.8.4** Where an Insurance Intermediary is instructed to obtain insurance which is contrary to the advice that it has given to a Client, the Insurance Intermediary must obtain from the Client written confirmation of the Client's instructions before arranging or buying the relevant insurance.

## **7.9 Managing conflicts of interest**

- 7.9.1** (1) An Insurance Intermediary or Insurance Manager must manage any conflict of interest to ensure that all its Clients are fairly treated and not prejudiced by any such interests.
- (2) An Insurance Intermediary or Insurance Manager must manage the conflict of interest by disclosing such conflict to the Clients in writing either generally or in relation to a specific Transaction.
- (3) If an Insurance Intermediary or Insurance Manager is unable to manage a conflict of interest, it must decline to act for the Client.

### **Guidance**

1. An Insurance Intermediary, when considering how it manages conflicts of interests, should clearly identify the capacity in which it acts and to whom it owes duties. For example, if it is acting as an Insurance Broker, it is acting as an agent for the policyholder and it has a duty to act in the best interests of the policyholder. If it is acting as an Insurance Agent, it has a duty to act in the best interests of its principal i.e. the insurer or insurers from whom it holds an authority to act as agent.
2. While the Rules do not prohibit an Insurance Intermediary from acting for both an insurer and policyholder in relation to the same risk, such an arrangement could result in conflicts of interest that are hard to manage. If an Insurance Intermediary proposes to act for both an insurer and policyholder in relation to the same risk, it should, under Rule 7.9.1(2), clearly disclose that information in a timely manner. The DFSA expects the firm to at least:
  - a. notify both parties about the procedures it will follow if acting in the interest of the policyholder or the insurer is likely to impair its ability to act in the interests of the other party; and
  - b. if one or both parties express concerns relating to the proposed process, decline to act for both parties under Rule 7.9.1(3) and instead act for only one party.
3. An Insurance Manager will also need to identify and manage conflicts of interest that arise in the course of carrying on its business, for example, in the course of settling claims.

## **7.10 Placement of Insurance**

### **Instructions**

- 7.10.1** An Insurance Intermediary or Insurance Manager must not place a Contract of Insurance with or on behalf of an insurer unless it has satisfied itself on reasonable grounds that the insurer may lawfully effect that contract under the laws of the jurisdictions in which the insurer and the risk are located.

### **Quotations**

- 7.10.2** When giving a quotation, an Insurance Intermediary or Insurance Manager must take due care to ensure the accuracy of the quotation and its ability to obtain the insurance at the quoted terms.



**Confirmation of cover**

- 7.10.3** (1) An Insurer, in Effecting Contracts of Insurance, must promptly document the principal economic and coverage terms and conditions agreed upon under any Contract of Insurance and finalise such contract in a timely manner.
- (2) An Insurer, Insurance Intermediary or Insurance Manager must, as soon as reasonably practicable, provide a Client with written confirmation and details of the insurance which it has effected for the Client or has obtained on behalf of the Client, including any changes to an existing Contract of Insurance.
- (3) An Insurer, Insurance Intermediary or Insurance Manager must, as soon as reasonably practicable, provide the Client with the full policy documentation where this was not included with the confirmation of cover.
- (4) In (2) and (3), a Client of an Insurance Manager is any Policyholder with whom the Insurance Manager interacts when carrying on its Insurance Management activities.

**7.11 Providing an ongoing service****Amendments to and renewal of insurance**

- 7.11.1** (1) An Insurer or Insurance Intermediary must deal promptly with a Client's request for an amendment to the insurance cover and provide the Client with full details of any premium or charges to be paid or returned.
- (2) An Insurer or Insurance Intermediary must provide a Client with written confirmation when the amendment is made and remit any return premium or charges due to the Client without delay.
- 7.11.2** An Insurer or Insurance Intermediary must give adequate advance notification to a Client of the renewal or expiration date of an existing insurance policy so as to allow the Client sufficient time to consider whether continuing cover is required.
- 7.11.3** On expiry or cancellation of the insurance, at the request of the Client, an Insurer or Insurance Intermediary must promptly make available all documentation and information to which the Client is entitled.

**Claims**

- 7.11.4** Where an Insurance Intermediary handles insurance claims it must:
- (a) on request, give the Client reasonable guidance in pursuing a claim under the relevant policy;
- (b) handle claims fairly and promptly and keep the Client informed of progress;
- (c) inform the Client in writing, with an explanation, if it is unable to deal with any part of a claim; and

- (d) forward settlement of any claim, as soon as reasonably practicable, once it has been agreed.

**7.11.5** An Insurer must:

- (a) handle claims fairly and promptly;
- (b) keep the Client informed of the progress of the claim;
- (c) not reject a claim unreasonably;
- (d) if only part of a claim is accepted:
  - (i) provide a clear statement about the part of the claim that is accepted; and
  - (ii) give clear reasons for rejecting that part of the claim that has not been accepted; and
- (e) settle the claim promptly.

**7.12 Insurance monies****Application**

- 7.12.1** This section applies to an Insurance Intermediary and an Insurance Manager, in respect of activities carried on in or from the DIFC.

**General**

- 7.12.2** (1) Insurance Monies are, subject to (2), any monies arising from Insurance Intermediation or the Insurance Management business which are any of the following:
- (a) premiums, additional premiums and return premiums of all kinds;
  - (b) claims and other payments due under Contracts of Insurance;
  - (c) refunds and salvages;
  - (d) fees, charges, taxes and similar fiscal levies relating to Contracts of Insurance;
  - (e) discounts, commissions and brokerage; or
  - (f) monies received from or on behalf of a Client of an Insurance Manager, in relation to his Insurance Management business.
- (2) Monies are not Insurance Monies where there is a written agreement in place between the Insurance Intermediary or Insurance Manager and the insurer to whom the relevant monies are to be paid (or from whom they have been received) under which the insurer agrees that:

- (a) the Insurance Intermediary or Insurance Manager, as the case may be, holds as agent for the insurer all monies received by it in connection with Contracts of Insurance effected or to be effected by the insurer;
- (b) insurance cover is maintained for the Client once the monies are received by the Insurance Intermediary or the Insurance Manager, as the case may be; and
- (c) the insurer's obligation to make a payment to the Client is not discharged until actual receipt of the relevant monies by the Client.

**Guidance**

If an Insurance Manager does not have in place risk transfer arrangements referred to in Rule 7.12.2(2), the Insurance Manager holds Insurance Monies, so far as they belong to Policyholders, at the risk of those Policyholders.

**Insurance money segregation**

- 7.12.5** (1) An Insurance Intermediary or Insurance Manager when dealing with Insurance Monies must:
- (a) maintain one or more separate Insurance Bank Accounts with an Eligible Bank;
  - (b) ensure that each Insurance Bank Account contains in its title the name of the Authorised Firm, together with the designation Insurance Bank Account (or IBA);
  - (c) prior to operating an Insurance Bank Account, give written notice to, and request written confirmation from, the Eligible Bank that the bank is not entitled to combine the Insurance Bank Account with any other account unless that account is itself an Insurance Bank Account held by the Authorised Firm, or to any charge, encumbrance, lien, right of set-off, compensation or retention against monies standing to the credit of the Insurance Bank Account;
  - (d) pay all Insurance Monies directly and without delay into an Insurance Bank Account;
  - (e) use an Insurance Bank Account only for the following purposes:
    - (i) the receipt of Insurance Monies;
    - (ii) the receipt of such monies as may be required to be paid into the Insurance Bank Account to ensure compliance by the Authorised Firm with any conditions or requirements prescribed by the DFSA;
    - (iii) the payment to Clients or to insurers of monies due under Insurance Intermediation Business transactions;

- (iv) the payment of all monies payable by the Authorised Firm in respect of the acquisition of or otherwise in connection with Approved Assets;
  - (v) the withdrawal of brokerage, management fees and other income related to Insurance Intermediation Business, either in cash or by way of transfer to an account in the name of the Intermediary which is not an Insurance Bank Account, provided that no such sum may be withdrawn from the Insurance Bank Account before the time at which that amount may be brought into account as income of the Insurance Intermediary;
  - (vi) the withdrawal of monies that are required to be transferred under (2) or Rule 7.12.9A;
  - (vii) the withdrawal of monies paid into the Insurance Bank Account in error; and
  - (viii) the withdrawal of any monies credited to the Insurance Bank Account in excess of those required by any conditions and requirements prescribed by the DFSA;
- (f) ensure that any amount held in the Insurance Bank Account or other Approved Assets, together with any amount due and recoverable from insurance debtors, is equal to, or greater than the amount due to insurance creditors; and
- (g) take immediate steps to restore the required position if at any time it becomes aware of any deficiency in the required segregated amount.
- (2) If an Eligible Bank has not provided the written confirmation referred to in (1)(c) within 40 business days after the Authorised Firm made the request, the Authorised Firm must as soon as possible withdraw Insurance Monies held in the Insurance Bank Account with that Eligible Bank and deposit them in an Insurance Bank Account with another Eligible Bank.
- (3) An Insurance Intermediary or Insurance Manager is not required to comply with the requirement in (1)(c) if it has no account, other than one or more Insurance Bank Accounts, with the Eligible Bank.

**7.12.6** An Insurance Intermediary or Insurance Manager may not obtain a loan or overdraft for any purpose relating to an Insurance Bank Account unless that advance:

- (a) is on a bank account which is designated as an Insurance Bank Account, and the loan or overdraft is used for payment to Clients or to insurers of monies due under Insurance Intermediation transactions;
- (b) does not give rise to a breach of the requirements of Rule 7.12.5(e); and
- (c) is of a temporary nature and is repaid as soon as reasonably practicable.

**7.12.7** An Insurance Intermediary or Insurance Manager must hold Insurance Monies either in an Insurance Bank Account or in Approved Assets.

**7.12.8** An Insurance Intermediary or Insurance Manager must ensure that Approved Assets are:

- (a) registered in the name of the Insurance Intermediary or Insurance Manager and designated as being an 'Insurance Bank Account'; or
- (b) held for the Insurance Bank Account of the Insurance Intermediary or Insurance Manager at the bank at which such Insurance Bank Account is held.

**7.12.9** An Insurance Intermediary or Insurance Manager must ensure that monies, other than interest, arising from Approved Assets or their realisation, sale or disposal are paid into an Insurance Bank Account.

**7.12.9A** (1) An Insurance Intermediary or Insurance Manager must not hold Insurance Monies for a Client in an Insurance Bank Account with an Eligible Bank outside the State, unless it has previously disclosed in writing to the Client:

- (a) that the money may be held in an Insurance Bank Account outside the State;
- (b) that in such circumstances, the legal and regulatory regime applying to the Eligible Bank may be different from that in the State;
- (c) in the event of failure of the Eligible Bank, the money may be treated in a different way to that which would apply if the money were held by a bank in the State;
- (d) if it is the case, that the particular Eligible Bank has not accepted that it has no right of set-off or counterclaim against money held in the Insurance Bank Account in respect of any sum owed on any other account of the Authorised Firm; and
- (e) that the Client may notify the Authorised Firm if he does not wish the money to be held in an Insurance Bank Account outside the State or in a particular jurisdiction.

(2) If a Client notifies an Insurance Intermediary or Insurance Manager in writing that he does not wish the Insurance Monies to be held in an Insurance Bank Account outside the State or in a particular jurisdiction, the Insurance Intermediary or Insurance Manager must ensure that, no later than 20 days after receiving the notice, either:

- (a) the Insurance Monies are transferred into an Insurance Bank Account with an Eligible Bank in the State, or in a jurisdiction to which the Client has not objected, as the case may be; or
- (b) if no such alternative arrangement can be made, the Insurance Monies are returned to the Client.

- 7.12.10** An Insurance Intermediary or Insurance Manager may not hold Insurance Monies in Approved Assets until it has given written notice to and received written notice from the bank referred to in Rule 7.12.8(b) that the bank is not entitled to any charge, encumbrance, lien, right of set-off, compensation or retention against Approved Assets held for the Insurance Intermediary's or Insurance Manager's Insurance Bank Account.
- 7.12.11** An Insurance Intermediary or Insurance Manager may only use Approved Assets as security for a loan or overdraft where that loan or overdraft is for a purpose relating to an Insurance Bank Account as permitted by Rule 7.12.6.
- 7.12.12** Where Insurance Monies are held in Approved Assets whose rating drops below the minimum stipulated within the definitions, that investment or asset will cease to be an Approved Asset and the Insurance Intermediary or Insurance Manager must dispose of the investment or asset as soon as possible and no later than within 30 days of the rating change.
- 7.12.13** An Insurance Intermediary or Insurance Manager may not use derivatives in the management of Insurance Monies except for the prudent management of foreign exchange risks.
- 7.12.14** An Insurance Intermediary who has a credit balance for a Client who cannot be traced should not take credit for such an amount except where:
- (a) he has taken reasonable steps to trace the Client and to inform him that he is entitled to the money;
  - (b) at least six years from the date the credit was initially notified to the Client; and
  - (c) Rule 7.12.5(f) will continue to be satisfied after the withdrawal of such money.
- 7.12.15** An Insurance Intermediary must keep records of all sums withdrawn from the Insurance Bank Account or realised Approved Assets as a result of credit taken under Rule 7.12.14 for at least six years from the date of withdrawal or realisation.

## **8 SPECIFIC RULES – OPERATING A CREDIT RATING AGENCY**

### **8.1 Application**

- 8.1.1** (1) This chapter applies to every Person who carries on, or intends to carry on, the Financial Service of Operating a Credit Rating Agency in or from the DIFC.
- (2) In this chapter, where a reference is made to a Rating Subject which is a credit commitment, a debt or a debt-like Investment referred to in GEN Rule 2.27.1(3)(b) or (c), that reference is to be read, where the context requires, as a reference to the Person responsible for obtaining the Credit Rating.

#### **Guidance**

1. The Financial Service of Operating a Credit Rating Agency is defined in GEN Rule 2.27.1. This chapter contains the specific conduct requirements that apply to Persons carrying on the Financial Service of Operating a Credit Rating Agency.

#### **Code of conduct/ethics**

2. The outcome intended by some of the specific conduct requirements in this chapter can be achieved by adopting a code of conduct/ethics. Whilst not proposing to prescribe that a Credit Rating Agency must have a code of conduct/ethics, a Credit Rating Agency should consider, particularly where noted in relation to specific Rules, adopting such a code as a means of achieving the outcome intended by the relevant requirements. However, where a Credit Rating Agency does not adopt such a code, the onus is on the Credit Rating Agency to demonstrate how it achieves compliance with the relevant requirements through other means.

#### **Persons responsible for obtaining a Credit Rating**

3. Not all Rating Subjects are bodies corporate. For example, Credit Ratings can be provided in respect of a credit commitment given by a Person, or a debt or debt-like Investment. In such instances, where a Rule in this chapter requires the Rating Subject to carry out some activity, such a reference is to be read, pursuant to Rule 8.1.1(2), as a reference to the Person who is responsible for obtaining the Credit Rating. Such a Person would generally be the originator, arranger or sponsor of the relevant financial product which is being rated. The Credit Rating Agency should clearly identify the Person responsible for a Rating Subject before proceeding with its Credit Rating Activities relating to that Rating Subject.
4. However, there is no restriction against more than one Person being identified as Persons responsible for obtaining a Credit Rating relating to a Rating Subject. In such cases, a Credit Rating Agency should clearly identify those Persons as responsible Persons relating to the relevant Rating Subject.

### **8.2 Additional Principles for Credit Rating Agencies**

#### **Guidance**

Credit Rating Agencies are required to comply with, in addition to the Principles in GEN sections 4.1 and 4.2, three further Principles set out in this section.

**Principle 1 – Quality and integrity**

- 8.2.1** A Credit Rating Agency must take all reasonable steps to ensure that its Credit Ratings are well founded and are based on a fair and thorough analysis of all relevant information which is reasonably known or available to the Credit Rating Agency.

**Principle 2 – Independence and conflicts of interest**

- 8.2.2** A Credit Rating Agency must take all reasonable steps to ensure that its decisions relating to Credit Ratings are independent and free from political or economic pressures and not affected by conflicts of interest arising due to its ownership structure or business or other activities or conflicts of interest of its Employees.

**Principle 3 – Transparency and disclosure**

- 8.2.3** A Credit Rating Agency must take all reasonable steps to ensure that it conducts its Credit Rating Activities in a transparent and responsible manner.

**Guidance**

Acting in a responsible manner means that a Credit Rating Agency undertakes the level of due diligence and care expected of an entity undertaking similar business in conducting its Credit Rating Activities. What is reasonable would depend on the nature, scale and complexity of its operations, including models and methodologies it has adopted in order to formulate Credit Ratings.

**8.3 Quality of the rating process****Policies and procedures**

- 8.3.1** (1) A Credit Rating Agency must adopt, implement and enforce policies, procedures and controls that are adequate to ensure that:
- (a) its Credit Ratings are based on a thorough and fair analysis of all the Relevant Information;
  - (b) it has clearly defined methodologies and models for the purposes of preparing and reviewing Credit Ratings; and
  - (c) its Rating Analysts, in preparing and reviewing Credit Ratings, adhere to the relevant methodologies and models adopted by the Credit Rating Agency, including any updates of such methodologies and models.
- (2) For the purposes of (1)(a), Relevant Information is information which is:
- (a) reasonably known or available to the Credit Rating Agency; and
  - (b) required, pursuant to the established rating methodologies and models adopted by the Credit Rating Agency.
- (3) For the purposes of (1)(c), a Rating Analyst means an Employee of a Credit Rating Agency who performs analytical functions in relation to the preparation or review of a Credit Rating.
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- (4) A Credit Rating Agency must have adequate mechanisms to monitor whether its policies, procedures and controls are implemented in such a way so as to ensure that they operate, on an on-going basis, effectively and as intended.

**Guidance**

## Application to Groups and Branches

1. Where a Credit Rating Agency is a member of a Group, the Credit Rating Agency may rely on the policies, procedures and controls adopted at the group-wide level. Where this is the case, the Credit Rating Agency should ensure that the group-wide policies, procedures and controls are consistent with the requirements applicable to it and do not constrain its ability to comply with the applicable requirements in the DIFC.
2. In the case of Branch operations, the DFSA will only grant an authorisation to conduct the Financial Service of Operating a Credit Rating Agency where it is satisfied with the adequacy of the home jurisdiction regulation of the relevant legal entity.
3. Considerations set out in Guidance No 1 and 2 are equally relevant to the other requirements applicable to CRAs which are set out in this chapter.

**Periodic review**

4. A Credit Rating Agency should ensure that there is a formal and rigorous periodic review (at least annually) of the effectiveness of its systems and controls, including the methodologies and models it uses, to ensure that they remain effective and adequate in light of factors such as changing market conditions and practices and matters that have a material impact on the users of Credit Ratings.
5. Such a review should be carried out by individuals who are not involved in the day-to-day management or operations of the Credit Rating Agency. Taking into account the nature, scale and complexity of its business, a Credit Rating Agency may undertake such a review through a designated function at the group-wide level, or using external consultants. The DFSA expects the findings of such a review to be made available to the Governing Body and the senior management of the Credit Rating Agency, and that any inadequacies identified are promptly and effectively addressed.

**Analysts**

6. By definition, the Employees of a Credit Rating Agency include Rating Analysts who are either employed by the Credit Rating Agency or appointed under a contract for services to perform analytical functions in relation to the preparation of Credit Ratings. Such appointed Rating Analysts may, in the case of a Credit Rating Agency which is part of a Group, be employed by another entity within the Group. In that case, the Credit Rating Agency should ensure that such Rating Analysts comply with the applicable DFSA Rules when conducting Credit Rating Activities on its behalf.

**Relevant Information**

7. See Guidance under Rule 8.3.4.

**Methodologies and models**

**8.3.2** For the purposes of producing and reviewing Credit Ratings, a Credit Rating Agency must adopt and use rating methodologies and models, including any key rating assumptions, which:

- (a) are rigorous and systematic;

- (b) to the extent possible, result in Credit Ratings that can be subjected to some form of objective validation based on historical experience;
- (c) are subject to periodic review as appropriate; and
- (d) are made public, including any changes made to such methodologies and models.

**Guidance**

1. A Credit Rating Agency will need to establish proper procedures for the regular review of its methodologies and models, including any key rating assumptions used in such methodologies and models, in order to be able to properly assess the Relevant Information and prepare credible and high quality Credit Ratings. Any changes to the methodologies and models should incorporate cumulative experience gained through on-going market surveillance.
2. Where any material modifications are made to the methodologies or models used by the Credit Rating Agency, it should make prior disclosure to the public of such modifications before applying the modified methodologies and models, especially to existing Credit Ratings.
3. A Credit Rating Agency should assess whether existing methodologies and models for providing a Credit Rating in respect of structured financial products remain appropriate where the risk characteristics of the assets underlying a structured product change materially.

**Rating Analysts****8.3.3** A Credit Rating Agency must ensure that its Rating Analysts:

- (a) have adequate and appropriate knowledge and experience to carry out Credit Rating Activities assigned to them;
- (b) have access to, and use, all the Relevant Information;
- (c) apply the relevant methodologies and models in a transparent and consistent manner;
- (d) act without bias in carrying out their functions; and
- (e) observe high standards of integrity.

**Guidance**

1. See GEN Rules 5.3.18 and 5.3.19 with regard to the assessment that a Credit Rating Agency, as an Authorised Firm, needs to undertake to ensure that its Employees (including Rating Analysts) are fit and proper and have adequate competencies in order to carry out their functions.
2. A Credit Rating Agency should structure its rating teams in such a way so as to promote continuity of adequate skills and expertise within a relevant team, and avoidance of bias in the preparation or review of a Credit Rating. For the purpose of promoting objectivity and lack of bias in preparing or reviewing Credit Ratings, measures such as periodic rotation of Rating Analysts, as appropriate, should be considered.

**Credit Ratings**

- 8.3.4** A Credit Rating Agency must ensure that:
- (a) the role and responsibility of assigning a Credit Rating rests clearly on the Credit Rating Agency and not on any of its Rating Analysts;
  - (b) the information it uses for the purposes of preparing or reviewing a Credit Rating is of sufficient quality to support a credible Credit Rating;
  - (c) its Credit Ratings:
    - (i) reflect all the Relevant Information;
    - (ii) do not contain any misrepresentations, and are not misleading in respect of the creditworthiness of the Rating Subject; and
    - (iii) contain clear and prominent statements if they are premised on limited historical data, are not subject to on-going surveillance or are subject to any other limitation which has or may have a material impact on the relevant Credit Rating; and
  - (d) it does not produce a Credit Rating where it has reasonable doubts as to whether a credible Credit Rating can be produced due to the complexity of, or the lack of adequate information relating to, a potential Rating Subject.

**Guidance**

Relevant Information is defined in Rule 8.3.1(2). A Credit Rating Agency should adopt adequate measures to ensure that the quality of information it uses is reliable to support a credible Credit Rating. Such measures may include:

- a. relying on independently audited financial statements and public disclosures where available;
- b. conducting random sampling examination of the information received; and
- c. having contractual arrangements with Persons who request a Credit Rating, or any third party source from whom information is obtained, that render such Persons liable if they knowingly provide materially false or misleading information, or fail to conduct due diligence they are reasonably expected to carry out to verify the accuracy of the Relevant Information.

**On-going monitoring and review of the Credit Ratings**

- 8.3.5** (1) Unless a Credit Rating clearly states that it will not be subject to on-going review, a Credit Rating Agency must:
- (a) have adequate personnel and financial resources committed for the on-going surveillance of the creditworthiness of the Rating Subject;
  - (b) ensure a review of a Credit Rating is undertaken regularly, and in any case, promptly upon becoming aware of information reasonably likely to result in a Rating Action; and
  - (c) take any appropriate Rating Action promptly.

- (2) For the purposes of (1), a Rating Action is an upward or downward move of a Credit Rating, a confirmation of an existing Credit Rating or a withdrawal of a Credit Rating.
- (3) Following the review in (1)(b), a Credit Rating Agency must issue a notice of its Rating Action. Such a notice must:
  - (a) be promptly disseminated to the public or distributed by subscription, as applicable; and
  - (b) contain a clear and prominent statement specifying:
    - (i) the date on which the Credit Rating was last updated; and
    - (ii) the date on which the new Credit Rating is effective; or
    - (iii) if the Credit Rating is withdrawn, the effective date from which it is withdrawn and the reasons for such withdrawal.
- (4) Without prejudice to the obligation to conduct on-going surveillance and review of a Credit Rating, where a Credit Rating Agency forms an opinion on reasonable grounds that it does not have adequate or credible Relevant Information, it must not support an existing Credit Rating, and must withdraw such a Credit Rating immediately. Where it does so, it must issue a notice of withdrawal of the Credit Rating in accordance with (3).

#### **Guidance**

1. A Credit Rating Agency may use separate teams of Rating Analysts for determining initial Credit Ratings and subsequent review of such ratings. It should ensure that each team has the requisite level of expertise and resources to perform its functions effectively.
2. A Credit Rating Agency should undertake both periodic and ad hoc reviews of its Credit Ratings as appropriate to the nature of the Rating Subject, the market conditions and reasonable expectations of users of such Credit Ratings. Such reviews should apply any changes in its rating methodologies and models, including rating assumptions.
3. A Credit Rating Agency should have clear and published parameters relating to the review of Credit Ratings, including, to the extent possible, when it will undertake any ad hoc reviews. Such parameters should include any material change in the risk characteristics of the Rating Subject or significant changes in the markets which relate to, or affect, the Rating Subject.
4. A Credit Rating Agency may place under surveillance a Rating Subject upon becoming aware of any material changes relating to, or affecting, it. A Credit Rating Agency should consider whether, in such circumstances, it is appropriate to give any prior notice that the relevant Rating Subject is under surveillance.

## **8.4 Integrity of the credit rating process**

### **Policies and procedures**

- 8.4.1** To promote integrity of its credit rating process, a Credit Rating Agency must implement adequate policies, procedures and controls to ensure that it and its Employees:

- (a) comply with all the applicable legal and other requirements, including those relating to its Credit Rating Activities, regardless of where such activities are carried on;
- (b) deal fairly and honestly with Rating Subjects and Persons using or relying on its Credit Ratings, such as investors and other market participants, including the public; and
- (c) do not, either expressly or implicitly, give any assurances or guarantees of a particular rating outcome before undertaking a full analysis of the Relevant Information in accordance with the applicable methodologies and models.

**Guidance**

1. Where a Credit Rating Agency undertakes activities in a number of jurisdictions, the effect of Rule 8.4.1 is that it will need to ensure that respective obligations arising in all those jurisdictions are effectively met as appropriate. In doing so, it will need to take account of the application of the DFSA regime to Group and Branch operations (see Guidance 1 and 2 under Rule 8.3.1).
2. A Credit Rating Agency is required, under GEN Rule 7.5.1(2), to have an Authorised Individual as its Compliance Officer. It is the responsibility of the Compliance Officer to ensure proper observance by the Credit Rating Agency and its Employees, particularly Rating Analysts, of the applicable legal and other obligations, including any code of conduct/ethics adopted by the Credit Rating Agency. Such a code should generally set out matters relating to unacceptable and unethical behaviour which should be avoided by its Employees. See also Guidance 2 under section 8.1.1.

## 8.5 Conflicts of interest and independence

**Guidance**

1. There is a significant overlap between conflicts of interest and lack of independence of Employees (who include Rating Analysts). Therefore, some of the requirements set out in this section, while promoting independence of Credit Rating Agencies, are equally relevant for the purpose of addressing conflicts of interest. For convenience, they are set out under distinct headings.
2. The more detailed requirements set out in this section are designed to enable a Credit Rating Agency to meet the requirements set out under COB Rule 8.2.2 (Principle 2 – Independence and transparency). For this purpose, a Credit Rating Agency should have a detailed code of conduct/ethics that sets out its policies and procedures for meeting the requirements including those in this module covering aspects relating to conflicts of interest, as well as independence, of its Employees. See also Guidance 2 under section 8.1.1.

**Policies and procedures**

### 8.5.1 A Credit Rating Agency must have adequate, clear and well documented policies, procedures and controls to:

- (a) promote high standards of care, independence and objectivity in decision making by its Employees;
- (b) ensure that its Credit Ratings are not influenced by any considerations other than those which are relevant in accordance with its published

methodologies and models as applicable to the particular Rating Subject;  
and

- (c) identify, and eliminate or manage, as appropriate, including through disclosure, any conflicts of interest that may influence its Credit Ratings, including those conflicts of interest which may influence its Employees who are involved in producing or reviewing Credit Ratings.

**Guidance**

1. A Credit Rating Agency should neither take, nor forbear or refrain from taking, any Rating Action based on its potential effect (economic, political or otherwise) on the Credit Rating Agency, its Rating Subjects, investors or any other market participants (for example, the existence or non-existence of business relationship between the Credit Rating Agency or a member of its Group and the Rating Subject).
2. The determination of a Credit Rating should be influenced only by factors relevant to the credit assessment in accordance with its published methodologies and models as applicable to the particular Rating Subject.
3. A Credit Rating Agency should, at a minimum, set out clearly when conflicts of interest arise and, in relation to what type of business or commercial dealings or transactions, and between whom, such conflicts of interest can arise.
4. Where the Rating Subject (such as a government) has, or is simultaneously pursuing, any oversight function relating to the Credit Rating Agency, the Credit Rating Agency should avoid assigning Employees involved in the Credit Rating of the Rating Subject for also discharging any function relating to the Credit Rating Agency's oversight.

**Provision of consultancy and ancillary services**

- 8.5.2** (1) A Credit Rating Agency must not provide to a Rating Subject or a Related Party of a Rating Subject consultancy or advisory services relating to the corporate or legal structure, assets, liabilities or activities of such Rating Subject or Related Party.
- (2) For the purposes of (1), a Related Party of a Rating Subject is:
- (a) an undertaking which is in the same Group as the Rating Subject;
  - (b) any Person who interacts with the Credit Rating Agency in respect of the Credit Rating; or
  - (c) any Person who has a significant business or other relationship with the Rating Subject or any Person referred to in (a) or (b).
- (3) Without prejudice to (1), a Credit Rating Agency may provide services which are ancillary to its Credit Rating Activities to a Rating Subject or a Related Party of the Rating Subject where it:
- (a) has a clear definition of what services it considers as ancillary services;
  - (b) documents why such services are considered not to raise any conflicts of interest with its Credit Rating Activities; and

- (c) has in place adequate mechanisms to minimise the potential for any conflicts of interest arising.
- (4) If a member of the Group in which the Credit Rating Agency is also a member provides services of the kind referred to in (1) to a Rating Subject of the Credit Rating Agency or a Related Party of such a Rating Subject, such services must be operationally and functionally separated from the business of the Credit Rating Agency.

**Guidance**

1. The prohibition in Rule 8.5.2(1) includes, for example, making proposals or recommendations regarding the design or structure of Rating Subjects, including suggestions as to how a desired rating could be achieved. Therefore, such services cannot be provided.
2. Some of the activities which are prohibited under Rule 8.5.2(1) may constitute a Financial Service other than Operating a Credit Rating Agency. Even if a Credit Rating Agency has an authorisation to provide such a Financial Service, it is prevented from providing such services to a Rating Subject or a Related Party because of the prohibition in Rule 8.5.2(1).
3. Ancillary services referred to in Rule 8.5.2(3) include, for example, market forecasts, estimates of economic trends, pricing analysis and other general data analysis as well as related distribution services. These services can be provided to Rating Subjects and their Related Parties where the requirements in Rule 8.5.2(3) are met. These services are also unlikely to constitute other Financial Services.
4. A Credit Rating Agency should separate operationally its Credit Rating Activities from any ancillary services it provides in accordance with Rule 8.5.2(3). For example, Rating Analysts and other key individuals involved in Credit Rating Activities should not also be involved in the provision of such services.
5. Where a Group member provides to a Rating Subject of a Credit Rating Agency any ancillary services, the Credit Rating Agency and the Group member should not share Employees or premises to ensure operational separation.

**Credit Rating Agency fees**

- 8.5.3** A Credit Rating Agency must not enter into fee arrangements for providing Credit Ratings where the fee depends on the rating outcome or on any other result or outcome of the Credit Rating Activities.

**Other conflicts of interest**

- 8.5.4** A Credit Rating Agency must not engage in any securities or derivatives transactions with, relating to, or in respect of, a Rating Subject or its Related Party in circumstances where such a transaction would amount to, or pose a risk of, a conflict of interest with respect to its Credit Rating Activities.

**Guidance**

Examples of investments which would not present conflicts of interest include investments in collective investment funds which might contain investments in a Rating Subject or its Related Party.



## **8.6 Independence of Rating Analysts and other Employees**

### **Policies and procedures**

- 8.6.1** A Credit Rating Agency must have adequate policies, procedures and controls to ensure that its Employees, as far as practicable, avoid relationships which compromise or are reasonably likely to compromise the independence and objectivity of its Credit Rating Activities.
- 8.6.2** (1) A Credit Rating Agency must ensure that its Employees who are directly involved in preparing or reviewing a Credit Rating of a Rating Subject do not initiate, or participate in, discussions regarding fees or payments with the Rating Subject or a Related Party of the Rating Subject.
- (2) A Credit Rating Agency must ensure that its Employees who are directly involved in preparing or reviewing a Credit Rating of a Rating Subject, and their Close Relatives, do not engage in any securities or derivative transactions with, relating to, or in respect of, the Rating Subject or a Related Party of the Rating Subject in circumstances where such a transaction would amount to, or pose a risk of, a conflict of interest with respect to the activities of the relevant Employee.

### **Guidance**

This Rule should be read in conjunction with Rule 8.2.2, pursuant to which, Employees of a Credit Rating Agency need to be independent and free from conflicts of interest. Such conflicts of interest include the appearance of being compromised as result of a personal relationship which he or his Close Relatives have with a Rating Subject or a Related Party of a Rating Subject. The Credit Rating Agency's policies and procedures should clearly set out where a personal relationship should be considered to create the potential for any real or apparent conflicts of interest and therefore be subject to the conflicts of interest provisions.

- 8.6.3** (1) A Credit Rating Agency must ensure that its Employees who have a relevant material interest in a Rating Subject or its Related Party are not involved in the preparation or review of the relevant Credit Rating or able to influence that process.
- (2) For the purposes of Rule 8.6.3(1), an Employee of a Credit Rating Agency has a material interest in a Rating Subject if the Employee:
- (a) owns a security or a derivative relating to a Rating Subject or its Related Party, other than holdings in diversified collective investment funds;
  - (b) has had a recent employment or other significant business relationship with a Rating Subject or its Related Party which may cause, or may be perceived as causing, conflicts of interest; or
  - (c) has a Close Relative who is currently employed by a Rating Subject or its Related Party.



**Guidance**

A Credit Rating Agency should, where it has a code of conduct/ethics, set out unacceptable conduct for Employees, such as soliciting money, gifts, or favours from anyone with whom the Credit Rating Agency does business, or accepting gifts offered in the form of cash or any gifts which are reasonably capable of influencing their opinions or decisions relating to Credit Ratings. There should also be guidance relating to minimal value of gifts or benefits that may be accepted, and clearance and disclosure procedures relating to such gifts and benefits. See also Guidance 2 under Rule 8.1.1.

- 8.6.4** A Credit Rating Agency must establish policies and procedures for reviewing the past work of a Rating Analyst who leaves the employment of the firm to join a Rating Subject or its Related Party where the Rating Analyst had been involved in producing or reviewing the Credit Rating assigned to such Rating Subject or Related Party.

**Remuneration and reporting lines****Guidance**

A Credit Rating Agency is required, pursuant to GEN Rule 5.3.31, to have remuneration structures and strategies which, amongst other things, are consistent with the business objectives and identified risk parameters within which the firm operates, and provide for effective alignment of risk outcomes and the roles and functions of the relevant Employees. The requirements set out in this section are designed to augment those remuneration requirements set out in GEN.

- 8.6.5** A Credit Rating Agency must ensure that Employees involved in the provision of Credit Ratings have reporting lines and remuneration arrangements that are designed to eliminate, or effectively manage, actual and potential conflicts of interest.
- 8.6.6** A Credit Rating Agency must ensure that its Employees are not remunerated, or their performance evaluated, based on the amount of revenue generated or expected from the Credit Ratings in which the Employee was involved.

**Guidance**

The Employees intended to be covered by this Rule are Rating Analysts and other Employees who are directly involved in producing or reviewing a Credit Rating, or who are able to influence the credit rating process (such as the senior management).

- 8.6.7** A Credit Rating Agency must conduct formal and periodic reviews of its remuneration policies and practices relating to Employees who participate in, or who might otherwise have an effect on, the rating process to ensure that those policies and practices do not compromise the objectivity of the Credit Rating Activities.

**8.7 Transparency and disclosure****Policies and procedures**

- 8.7.1** (1) A Credit Rating Agency must, subject to (2), have adequate policies, procedures and controls to ensure that it discloses in a timely manner:
- (a) its Credit Ratings and any updates thereof;

- (b) its policies for distributing Credit Ratings and updates thereof;
  - (c) the methodologies and models used and key assumptions made in preparing its Credit Ratings and any updates thereof; and
  - (d) any other significant element relating to (a), (b) or (c) above.
- (2) A Credit Rating Agency is not required to disclose information where the information is subject to confidentiality requirements.

**Guidance**

1. The level of detail required in the disclosure of information concerning methodologies, models and key assumptions should be such as to give adequate information to the users of Credit Ratings to enable them to perform their own due diligence when assessing whether, or to what extent, reliance can be placed on those Credit Ratings (see Rule 8.8.1). Disclosure of information must not, however, reveal confidential information of, or relating to, the Rating Subject or its Group pursuant to Rule 8.9.1.
2. The information referred to in Guidance No. 1 should generally include the meaning of each rating category and the definition of default or recovery, and the time horizon the Credit Rating Agency used when making a Credit Rating.
3. A Credit Rating Agency should adequately and clearly disclose applicable risks which may affect a Credit Rating, including a sensitivity analysis of the relevant assumptions and an explanation of how various market developments affect the parameters built into the methodologies and models and may influence or impinge on the Credit Rating (for example volatility).
4. If the nature of a Credit Rating or other circumstances make a historical default rate inappropriate or otherwise likely to mislead investors, the Credit Rating Agency should provide appropriate clarifications.
5. A Credit Rating Agency should provide information to assist users of its Credit Ratings to develop a greater understanding of what a Credit Rating is, and the limitations on the use of Credit Ratings with respect to the particular type of financial product that the Credit Rating Agency rates. A Credit Rating Agency should clearly indicate the attributes and limitations of each Credit Rating, and the limits to which the firm verifies information provided to it by the Rating Subject, its Related Party or any external source.

**Communication of information**

- 8.7.2** A Credit Rating Agency must ensure that its communications relating to its Credit Ratings, Credit Rating Activities and its other business are clear, fair and not misleading.

**Guidance**

1. A Credit Rating Agency should, taking into account the nature, scale and complexity of its operations, have a function within its organisation charged with the responsibility for communicating with market participants and the public on questions, concerns or complaints it receives.
2. The objective of this function should be to help ensure that the Credit Rating Agency's officers and management are informed of those issues that such officers and management would reasonably need to be informed about when setting and implementing the Credit Rating Agency's systems and controls.

## **8.8 Disclosure and presentation of Credit Ratings**

### **General Disclosure**

- 8.8.1** (1) Subject to the confidentiality requirements applicable to a Credit Rating Agency, it must ensure that its Credit Ratings:
- (a) are published promptly, and as far as practicable, on a non-selective basis and free of charge;
  - (b) contain sufficient information to enable users of such Credit Ratings to understand how the Credit Rating was reached, including information relating to the methodologies, models and key underlying assumptions used;
  - (c) contain a clear statement if the Credit Rating is initiated by the Credit Rating Agency on its own initiative (unsolicited), and information relating to the Credit Rating Agency's policy relating to providing unsolicited Credit Ratings;
  - (d) contain sufficient information about the historical default rates of its Credit Ratings which are of the same category as the Credit Rating being published so that interested parties can understand the historical performance of its Credit Ratings; and
  - (e) include any other information relevant to the particular Credit Rating, as specified in this module.
- (2) A Credit Rating Agency must ensure that any press release which accompanies a Credit Rating contains key elements underlying the Credit Rating.
- (3) Before publishing a new or an updated Credit Rating or withdrawing a Credit Rating, the Credit Rating Agency must, to the extent practicable and appropriate, give to the Rating Subject sufficient advance notice to enable that Person to draw to the attention of the Credit Rating Agency any factual errors on which the Credit Rating Agency may have based the relevant Credit Rating.
- (4) Subject to the confidentiality requirements applicable to a Credit Rating Agency, any information which the Credit Rating Agency is required to publish pursuant to any Rules must also be made available on the website of the relevant Credit Rating Agency.

### **Guidance**

In relation to Rule 8.8.1(3), a Credit Rating Agency should inform the Rating Subject at least 12 hours before publication of a new Credit Rating or an update or withdrawal of an existing Credit Rating of the principal grounds on which such Credit Rating is based in order to give the Rating Subject an opportunity to draw to the attention of the Credit Rating Agency any factual errors. The Rating Subject has the meaning given to it in GEN Rule 2.27.1(3) and should be read in conjunction with Rule 8.1.1(2).

**Specific Disclosure - Fees and Charges**

- 8.8.2** (1) A Credit Rating Agency must include in its announcements relating to Credit Ratings and its annual report the general nature of its arrangements relating to fees and charges with, or relating to, the Rating Subject including:
- (a) whether the Credit Rating Agency or any member of its Group receives any fees, charges or other monetary benefits which are unrelated to the provision by the Credit Rating Agency of its Credit Ratings, and if so, the proportion of such benefits relating to the aggregate fees and charges in respect of the provision of Credit Ratings; and
  - (b) if the Credit Rating Agency receives 10% or more of its aggregate annual revenue from a single Rating Subject or its Related Party, information about that source.
- (2) Where a Credit Rating Agency is a member of a Group, the 10% aggregate annual income referred to in (1)(b) may be calculated by aggregating the net revenue of all Credit Rating Agencies within the Group.

**Specific Disclosure – Structured financial products**

- 8.8.3** A Credit Rating Agency must, where the Rating Subject is a structured financial product disclose in its Credit Ratings whether the Relevant Information is made publicly available by the Rating Subject, or whether all, or some of, such information remains non-public.

**Guidance**

1. The information which a Credit Rating Agency provides relating to structured financial products should include sufficient information such as information relating to the profit and loss statement and cash flow analysis to enable users of the Credit Ratings to understand the basis of the Credit Rating. Such information should also include the degree to which, in accordance with its analysis, the Credit Rating is sensitive to changes in market conditions.
2. A Credit Rating Agency should differentiate ratings of structured finance products from traditional corporate bond ratings, preferably through a different rating symbology. A Credit Rating Agency must also disclose how this differentiation operates.
3. A Credit Rating Agency should use reasonable efforts to encourage the Rating Subject to disclose to the public all Relevant Information to enable investors and users of the Credit Ratings to conduct their own due diligence relating to that product.

**8.9 Confidential information**

- 8.9.1** A Credit Rating Agency must have policies, procedures and controls to ensure that it and its Employees do not:
- (a) use any information given to or obtained by the Credit Rating Agency on a confidential basis (“Confidential Information”) for a purpose other than that for which it was given or obtained;

- (b) disclose the Confidential Information to any other Person, except:
  - (i) in accordance with (a);
  - (ii) with the prior written consent of the Person to whom a duty of confidentiality in respect of such Confidential Information is owed; or
  - (iii) where obliged to do so by any legislation applicable to the Credit Rating Agency; and
- (c) disclose any pending Rating Action except to the Rating Subject or as agreed with the Rating Subject.

**8.9.2** Subject to Rule 8.9.1(b), a Credit Rating Agency and its Employees must not disclose Confidential Information in any manner, including in press releases, through research conferences, to future employers, or in conversations with investors, other issuers, other persons, or by other means.

**8.9.3** A Credit Rating Agency must have adequate measures to ensure that it and its Employees:

- (a) take all reasonable steps to protect all property and records belonging to or in possession of the Credit Rating Agency against fraud, theft or misuse; and
- (b) do not share Confidential Information entrusted to the Credit Rating Agency with any third parties except where permitted under Rule 8.9.1(b).

## **8.10 Record keeping**

**8.10.1** (1) A Credit Rating Agency must, for a minimum of six years, maintain sufficient records in relation to each activity and function of the Credit Rating Agency and, where appropriate, audit trails of its Credit Rating Activities. These must include, where applicable, the following:

- (a) for each Credit Rating:
  - (i) the identity of the Rating Analysts participating in the determination of the Credit Rating;
  - (ii) the identity of the individuals who have approved the Credit Rating;
  - (iii) information as to whether the Credit Rating was solicited or unsolicited;
  - (iv) information to support the Credit Rating;
  - (v) the Accounting Records relating to fees and charges received from or in respect of the Rating Subject;

- (vi) the internal records and files, including non-public information and working papers, used to form the basis of any Credit Rating; and
  - (vii) credit analysis and credit assessment reports including any internal records and non-public information and working papers used to form the basis of the opinions expressed in such reports;
  - (b) the Accounting Records relating to fees received from any person in relation to services provided by the Credit Rating Agency;
  - (c) the Accounting Records for each subscriber to the Credit Rating Agency's services;
  - (d) the records documenting the established procedures, methodologies, models and assumptions used by the Credit Rating Agency to determine Credit Ratings; and
  - (e) copies of internal and external communications, including electronic communications, received and sent by the Credit Rating Agency and its Employees that relate to Credit Rating Activities.
- (2) For the purposes of (1), the six year period commences from the date the Credit Rating is disclosed to the public or distributed by subscription.

**Guidance**

1. Information to support a Credit Rating includes information received from the Rating Subject or information obtained through publicly available sources or third parties and verification procedures adopted in relation to information such as those obtained from public sources or third parties. In accordance with GEN Rule 5.3.24, records should be kept in such a manner as to be readily accessible.
2. Where a Credit Rating is subject to on-going surveillance and review, the Credit Rating Agency should retain records required under Rule 8.10.1 in relation to the initial Credit Rating as well as subsequent updates where such records are required to support the latest Credit Rating.

## **9 ADDITIONAL RULES: OPERATING AN ALTERNATIVE TRADING SYSTEM**

### **9.1 Application and interpretation**

**9.1.1** This chapter applies to an Authorised Firm which Operates an Alternative Trading System (ATS Operator).

#### **Guidance**

The Financial Service of Operating an Alternative Trading System can be either operating a Multilateral Trading Facility (MTF) or operating an Organised Trading Facility (OTF). See GEN Rule 2.22.1.

**9.1.2** In this chapter:

- (a) a reference to a “member” is a reference to a Client of the ATS Operator who has been granted access to its facilities in accordance with the requirements in this chapter;
- (b) a reference to a “facility” is a reference to a Multilateral Trading Facility (MTF) and an Organised Trading Facility (OTF), except where specific reference is made only to an MTF or OTF;
- (c) a reference to an “ATS Operator” is a reference to a Person operating an MTF and a Person operating an OTF, except where specific reference is made only to a Person operating an MTF or a Person operating an OTF; and
- (d) where a Rule in this chapter conflicts with any other provision in the DFSA Rulebook, the Rule in this chapter prevails over those other provisions.

### **9.2 Main requirements relating to trading on the facility**

- 9.2.1** (1) An ATS Operator must, at the time a Licence is granted and at all times thereafter, have:
- (a) transparent and non-discriminatory rules and procedures to ensure fair and orderly trading of Investments on its facility (“Operating Rules”);
  - (b) objective criteria governing access to its facility (“Access Criteria”);
  - (c) objective and transparent criteria for determining the Investments that can be traded on its facility (“Investment Criteria”);
  - (d) adequate technology resources (“Technology Resources”); and
  - (e) rules and procedures to ensure only Investments in which there is a Proper Market are traded on its facilities (“Proper Markets”).

- (2) A breach of the Operating Rules of an ATS Operator is a prescribed matter for the purposes of Article 67(1)(b) of the Regulatory Law 2004.

**Guidance**

Pursuant to Article 67(1) of the Regulatory Law 2004, an Authorised Firm is required to disclose to the DFSA anything which reasonably tends to show breaches or likely breaches of requirements as prescribed in Rules. Rule 9.2.1(2) prescribes a breach of Operating Rules as a the matter which is reportable to the DFSA by an ATS Operator.

**Operating Rules**

- 9.2.2** (1) The Operating Rules of an ATS Operator must be:
- (a) based on objective criteria;
  - (b) non-discriminatory;
  - (c) clear and fair;
  - (d) legally binding and enforceable against each member and where relevant, any other Person who has been allowed access to the facility through the member; and
  - (e) in the case of a Person operating an MTF, non-discretionary and made publicly available.
- (2) The Operating Rules of an ATS Operator must place obligations upon Persons who are admitted to trading on its facility (“members”):
- (i) when undertaking transactions on its facilities; and
  - (iii) relating to professional standards applicable to staff and other Persons allowed access to the facility through such a member.
- (3) Without limiting the generality of (1) and (2), the Operating Rules of an ATS Operator must contain:
- (a) criteria for admission of members to its facility, in accordance with Rule 9.3.1;
  - (b) criteria relating to Investments traded on its facility, in accordance with Rule 9.4.1;
  - (c) the rules and procedures governing trading on the facility;
  - (d) default rules;
  - (e) the rules and procedures for the clearing and settlement of transactions executed on the facility; and
  - (f) any other matters necessary for the proper functioning of its facility.



**Material changes to Current Arrangements**

- 9.2.3** (1) An ATS Operator may only make material changes to its existing arrangements to meet the requirements in this chapter in accordance with the requirements in this Rule.
- (2) The reference to “Existing Arrangements” in (1) is a reference to both the arrangements which were in place at the time of the initial grant of the Licence and any changes made to such arrangements in accordance with the requirements in this Rule.
- (3) For the purposes of obtaining the DFSA approval, an ATS Operator must provide to the DFSA, at least 30 days before the proposed change is intended to come into effect, a notice setting out:
- (a) the proposed change;
  - (b) the reasons for the proposed change; and
  - (c) what impact the proposed change would have on its members and its ability to operate the facility.
- (4) The DFSA must, upon receipt of a notice referred to in (1), approve or disapprove the proposed change as soon as practicable and in any event within 30 days of the receipt of the notice, unless that period has been extended by notification to the applicant.
- (5) The DFSA may, in circumstances where a material change to Current Arrangements is shown on reasonable grounds to be urgently needed, accept an application for approval of such a change on shorter notice than 30 days.
- (6) The procedures in Schedule 3 to the Regulatory Law apply to a decision of the DFSA to reject a proposed change under this Rule.
- (7) Where the DFSA decides to reject a proposed change, the ATS Operator may refer the matter to the FMT for review.

**Guidance**

1. The period of 30 days will commence to run from the time the DFSA has received all the relevant information to assess the application.
2. An ATS Operator should consider submitting its application for the DFSA approval well in advance of the date on which a proposed amendment is intended to come into effect, especially in the case of significant material changes to its existing arrangements, to allow the DFSA sufficient time to consider the application. If additional time is reasonably required to properly assess the impact of a proposed change due to its nature, scale and complexity, the DFSA may make an appropriate extension of time beyond 30 days. Such an extension would be made in consultation with the applicant.

### **9.3 Member access criteria**

- 9.3.1** (1) An ATS Operator may, subject to (2) and (3), only accept as a member a Person if that Person:
- (a) is an Authorised Firm;
  - (b) is a Recognised Member;
  - (c) meets the criteria in GEN Rule 2.3.2(2); or
  - (d) is classified as a Professional Client pursuant to COB Rule 2.3.4(1)(g), (h) and (i).
- (2) An ATS Operator must not admit a Person referred to in (1)(c) or (d), unless such Person:
- (a) agrees in writing to submit unconditionally to the jurisdiction of the DFSA in relation to any matters which arise out of or which relate to its use of the facility;
  - (b) agrees in writing to submit unconditionally to the jurisdiction of the DIFC Courts in relation to any proceedings in the DIFC, which arise out of or relate to its use of the facility;
  - (c) agrees in writing to subject itself to the DIFC laws and the jurisdiction of the DIFC Courts in relation to its use of the facility; and
  - (d) appoints and maintains at all times an agent for service of process in the DIFC and requires such agent to accept its appointment for service of process.
- (3) Prior to admitting a Person referred to in (1)(c) or (d) as a member, an ATS Operator must undertake due diligence to ensure that such a Person:
- (a) is of sufficiently good repute;
  - (b) has a sufficient level of competence and experience; and
  - (c) has adequate organisational arrangements, including financial and technological resources, which are no less than those required of an Authorised Firm appropriate to the nature of its operations.

#### **Direct electronic access**

- 9.3.2** An ATS Operator must have adequate rules and procedures to ensure that its members do not allow any other Person to have Direct Electronic Access to the facility unless such other Person meets the requirements in Rule 9.3.1(1).
- 9.3.3** An ATS Operator must, where it permits its members to provide to another Person Direct Electronic Access to its facilities, have adequate systems and controls including:

- (a) appropriate standards regarding risk controls and thresholds on trading through Direct Electronic Access;
- (b) mechanisms to identify and distinguish orders placed by those Persons who are allowed to place orders through Direct Electronic Access; and
- (c) if necessary, the ability to stop orders of, or trading by, the Persons allowed Direct Electronic Access.

### **Monitoring of compliance**

**9.3.4** An ATS Operator must establish and maintain adequate and effective systems and controls, including policies and procedures, to ensure that its members and other Persons to whom access to its facility is provided through members comply with its Operational Rules and where any gaps or deficiencies are identified, they are promptly addressed.

## **9.4 Investment criteria**

**9.4.1** An ATS Operator must ensure in respect of every Investment traded on its facility that:

- (a) only Investments which meet the requirements in (i) or (ii) are permitted to be traded on its facility:
  - (i) in the case of Securities, only Securities which are admitted to trading on an Authorised Market Institution or other Regulated Exchange; or
  - (ii) in the case of Derivatives, only instruments that meet the contract specification criteria set out in AMI Rule 6.3.2;
- (b) there is sufficient information relating to the Investments traded on the facility available to members and other Persons having access to the facility through such members to enable such Persons to make informed decisions relating to such Investments; and
- (c) if it is an Investment that references to an underlying benchmark or index provided by a Price Information Provider, the requirements in Rule 9.4.2 are met.

### **Use of price information providers**

- 9.4.2** (1) An ATS Operator may only trade Investments that reference to an underlying benchmark or index provided by a Price Information Provider where it has undertaken appropriate due diligence to ensure that the Price Information Provider, on an on-going basis, meets the requirements set out in (3).
- (2) A Price Information Provider is a price reporting agency or an index provider which constructs, compiles, assesses or reports, on a regular and systematic basis, prices of Investments, rates, indices, commodities or figures, which are made available to users.

- (3) For the purposes of (1), the Price Information Provider must:
- (a) have fair and non-discriminatory procedures for establishing prices of Investments which are made public.
  - (b) demonstrate adequate and appropriate transparency over the methodology, calculation and inputs to allow users to understand how the benchmark or index is derived and its potential limitations;
  - (c) where appropriate, give priority to concluded transactions in making assessments and adopt measures to minimise selective reporting;
  - (d) be of good standing and repute as an independent and objective price reporting agency or index provider;
  - (e) have a sound corporate governance framework;
  - (f) have adequate arrangements to avoid its staff having any conflicts of interest where such conflicts have, or are likely to have, a material adverse impact on price establishment process; and
  - (g) adequate complaint resolution mechanisms to resolve any complaints about the Price Information Provider's assessment process and methodology.

**Guidance**

An ATS Operator, when assessing the suitability of a Price Information Provider (the provider), should take into account factors such as:

- a. the provider's standing and reliability in the relevant physical or derivatives markets as a credible price reporting agency;
- b. the quality of corporate governance adopted, covering areas such as independent members of the board, independence of its internal audit and risk management function;
- c. whether the methodologies and processes (including any material changes to such methodologies and processes) adopted by the provider for the purposes of pricing are made publicly available;
- d. whether there are adequate procedures adopted to ensure that conflicts between the provider's commercial interests and those of users of its services, including those of its Employees involved in pricing process, are adequately addressed, including through codes of ethics;
- e. whether there is a clear conveyance to its users of the economic realities of the underlying interest the Price Information Provider seeks to measure; and,
- f. the degree to which the Price Information Provider has given consideration to the characteristics of the underlying interests measured, such as:
  - **the size and liquidity:** Whether the size of the market informs the selection of an appropriate compilation mechanism and governance processes. For example, a benchmark or index that measures a smaller market may be impacted by single trades and therefore be more prone to potential manipulation, whereas a benchmark for a larger market may not be well represented by a small sample of participants;

- **the relative market size.** Where the size of a market referencing a benchmark is significantly larger than the volume of the underlying market, the potential incentive for benchmark manipulation to increase; and
- **Transparency:** Where there are varying levels of transparency regarding trading volumes and positions of market participants, particularly in non-regulated markets and instruments, whether the benchmark represents the full breadth of the market, the role of specialist participants who might be in a position to give an overview of the market, and the feasibility, costs and benefits of providing additional transparency in the underlying markets.

## 9.5 Technology resources

### 9.5.1 (1) An ATS Operator must:

- (a) have sufficient technology resources to operate, maintain and supervise the facility it operates;
- (b) be able to satisfy the DFSA that its technology resources are established and maintained in such a way as to ensure that they are secure and maintain the confidentiality of the data they contain; and
- (c) ensure that its members and other participants on its facility have sufficient technology resources which are compatible with its own.

### (2) For the purposes of meeting the requirement in (1)(c), an ATS Operator must have adequate procedures and arrangements for the evaluation, selection and on-going monitoring of information technology systems. Such procedures and arrangements must, at a minimum, provide for:

- (a) problem management and system change;
- (b) adequate procedures for testing information technology systems before live operations, which are in conformity with the requirements that would apply to an Authorised Market Institution under App 1 of AMI;
- (c) monitoring and reporting on system performance, availability and integrity; and
- (d) adequate measures to ensure:
  - (i) the information technology systems are resilient and not prone to failure;
  - (ii) business continuity in the event that an information technology system fails;
  - (iii) protection of the information technology systems from damage, tampering, misuse or unauthorised access; and
  - (iv) the integrity of data forming part of, or being processed through, information technology systems.

**Guidance**

1. In assessing the adequacy of an ATS Operator's systems and controls used to operate and carry on its functions, the DFSA will consider:
  - a. the organisation, management and resources of the information technology department of the firm;
  - b. the arrangements for controlling and documenting the design, development, implementation and use of technology systems; and
  - c. the performance, capacity and reliability of information technology systems.
  
2. The DFSA will also, during its assessment of technology systems, have regard to the:
  - a. procedure for the evaluation and selection of information technology systems;
  - b. procedures for problem management and system change;
  - c. arrangements for testing information technology systems before live operations;
  - d. arrangements to monitor and report system performance, availability and integrity;
  - e. arrangements made to ensure information technology systems are resilient and not prone to failure;
  - f. arrangements made to ensure business continuity in the event that an information technology system fails;
  - g. arrangements made to protect information technology systems from damage, tampering, misuse or unauthorised access;
  - h. arrangements made to ensure the integrity of data forming part of, or being processed through, information technology systems; and
  - i. third party outsourcing arrangements.
  
3. In particular, when assessing whether an ATS Operator has adequate information technology resourcing, the DFSA will consider:
  - a. whether its systems have sufficient electronic capacity to accommodate reasonably foreseeable volumes of messaging and orders, and
  - b. whether such systems are adequately scalable in emergency conditions that might threaten the orderly and proper operations of its facility.

**Regular review of systems and controls**

- 9.5.2** (1) An ATS Operator must undertake regular review and updates of its systems and controls as appropriate to the nature, scale and complexity of its operations.

- (2) For the purposes of (1), an ATS Operator must adopt well defined and clearly documented development and testing methodologies which are in line with internationally accepted testing standards.

**Guidance**

Through the use of such testing methodologies, the ATS Operator should be able to ensure, amongst other things, that:

- a. its systems and controls are compatible with its operations and functions;
- b. compliance and risk management controls embedded in its system operate as intended (for example by generating error reports automatically); and
- c. it can continue to work effectively in stressed market conditions.

## **9.6 Proper Markets**

- 9.6.1** (1) Without limiting the generality of the other requirements in this chapter, an ATS Operator must, for the purposes of meeting the requirement in Rule 9.2.1(e) relating to Proper Markets, ensure that:
- (a) if Derivatives are traded on its facilities, such Derivatives meet the contract design specifications in AMI Rule 6.3.2;
  - (b) relevant market information is made available to Persons engaged in dealing on an equitable basis, including pre-trade and post-trade orders, in accordance with Rules 9.6.2 and 9.6.3;
  - (c) there are adequate mechanisms to discontinue, suspend or remove from trading on its facilities any Investments in circumstances where the requirements in this chapter are not met;
  - (d) there are controls to prevent volatility in the markets that is not caused by market forces, in accordance with Rule 9.6.4;
  - (e) error trades are managed, in accordance with Rule 9.6.5;
  - (f) Short Selling and position concentration are monitored and managed, in accordance with Rule 9.6.5;
  - (g) there are fair and non-discretionary algorithm operating in respect of matching of orders on its facilities;
  - (h) there are adequate controls to monitor and manage any foreign ownership restrictions applying to Investments traded on its facilities, in accordance with Rule 9.6.7;
  - (i) liquidity incentive schemes are offered only in accordance with Rule 9.6.8; and
  - (j) there are adequate rules and procedures to address Market Abuse and financial crime, in accordance with Rules 9.6.9 and 9.6.10.

**Pre-trade transparency**

- 9.6.2** (1) An ATS Operator must disclose the information specified in (2) relating to trading of Investments on its facility in the manner prescribed in (3).
- (2) The information required to be disclosed pursuant to (1) includes:
- (a) the current bid and offer prices and volume;
  - (b) the depth of trading interest shown at the prices and volumes advertised through its systems for the Investments; and
  - (c) any other information relating to Investments which would promote transparency relating to trading.
- (3) The information referred to in (2) must be made available to members and the public as appropriate on a continuous basis during normal trading.

**Guidance**

1. When making disclosure, an ATS Operator should adopt a technical mechanism by which the public can differentiate between transactions that have been transacted in the central order book and transactions that have been reported to the facility as off-order book transactions. Any transactions that have been cancelled pursuant to its rules should also be identifiable.
2. An ATS Operator should use appropriate mechanisms to enable pre-trade information to be made available to the public in an easy to access and uninterrupted manner at least during business hours. An ATS Operator may charge a reasonable fee for the information which it makes available to the public.
3. An ATS Operator may seek a waiver or modification from the disclosure requirement in Rule 9.6.1(1) in relation to certain transactions where the order size is pre-determined, exceeds a pre-set and published threshold level and the details of the exemption are made available to its members and the public.
4. In assessing whether an exemption from pre-trade disclosure should be allowed, the DFSA will take into account factors such as:
  - a. the level of order threshold compared with normal market size for the Investment;
  - b. the impact such an exemption would have on price discovery, fragmentation, fairness and overall market quality;
  - c. whether there is sufficient transparency relating to trades executed without pre-trade disclosure as a result of dark orders, whether or not they are entered in transparent markets;
  - d. whether the ATS Operator supports transparent orders by giving priority to transparent orders over dark orders, for example, by executing such orders at the same price as transparent orders; and
  - e. whether there is adequate disclosure of details relating to dark orders available to members and other participants on the facility to enable them to understand the manner in which their orders will be handled and executed on the facility.
5. Dark orders are orders executed on execution platforms without pre-trade transparency.



### Post-trade transparency requirements

- 9.6.3** (1) An ATS Operator must disclose the information specified in (2) in the manner prescribed in (3).
- (2) The information required to be disclosed pursuant to (1) is the price, volume and time of the transactions executed in respect of Investments.
- (3) The information referred to in (2) must be made available to the public as close to real-time as is technically possible on reasonable commercial terms and on a non-discretionary basis.

#### Guidance

An ATS Operator should use adequate mechanism to enable post-trade information to be made available to the public in an easy to access and uninterrupted manner at least during business hours. An ATS Operator may charge a reasonable fee for the information which it makes available to the public.

### Volatility controls

- 9.6.4** (1) An ATS Operator's Operating Rules must include effective systems, controls and procedures to ensure that its trading systems:
- (a) are resilient;
  - (b) have adequate capacity to deal with peak orders and message volumes; and
  - (c) are able to operate in an orderly manner under conditions of market stress.
- (2) Without limiting the generality of its obligations arising under (1) or any other Rule, an ATS Operator must be able under its rules, systems, controls and procedures to:
- (a) reject orders that exceed its pre-determined volume and price thresholds, or are clearly erroneous;
  - (b) temporarily halt trading of Investments traded on its facility if there is a significant price movement in relation to those Investments on its market or a related market during a short period; and
  - (c) where appropriate, cancel, vary or correct any transaction.

#### Guidance

An ATS Operator should test its trading systems to ensure that they are resilient and capable of operating orderly trading under conditions of market stress and other contingencies.

### Error Trade policy

- 9.6.5** (1) An ATS Operator must be able to cancel, amend or correct any error trades.

- (2) An “Error Trade” is the execution of an order resulting from:
  - (a) an erroneous order entry;
  - (b) malfunctioning of the system of a member or of the ATS Operator;  
or
  - (c) a combination of (a) and (b).
- (3) For the purposes of (1), an ATS Operator must include a comprehensive error trade policy in its Operating Rules, which sets out clearly the extent to which transactions can be cancelled by it at its sole discretion, at the request of a member or by mutual consent of members involved.
- (4) An ATS Operator must have adequate systems and controls to:
  - (a) prevent or minimise error trades;
  - (b) promptly identify and rectify error trades where they occur; and
  - (c) identify whether error trades are related to disorderly market activity.

**Guidance**

When assessing whether an ATS Operator has an appropriate and adequate error trade policy, the DFSA will consider whether the rules and procedures included in its Operating Rules:

- a. are adequate to minimise the impact of error trades where prevention of such trades is not possible;
- b. are sufficiently flexible in the design to address varying scenarios;
- c. establish a predictable and timely process for dealing with Error Trades, including measures specifically designed to detect and identify Error Trade messages to market users;
- d. promote transparency to market users with regard to any cancellation decisions involving material transactions resulting from the invocation of the Error Trade policy;
- e. include adequate surveillance conducted in the markets to detect Error Trades;
- f. promote predictability, fairness and consistency of actions taken under the Error Trade policy;  
and
- g. enable sharing of information with other markets when possible concerning the cancellation of trades.

**Short Selling**

- 9.6.6** (1) An ATS Operator must have in place effective systems, controls and procedures to monitor and manage:
- (a) Short Selling in Securities; and
  - (b) position concentrations.

- (2) For the purposes of (1), an ATS Operator must have adequate powers over its members to address risks to an orderly functioning of its facility arising from unsettled positions in Investments.
- (3) Short Selling for the purposes of this Rule constitutes the sale of a Security by a Person who does not own the Security at the point of entering into the contract to sell.

**Guidance**

1. An ATS Operator should, when developing its controls and procedures with regard to short selling and position management, have regard to:
  - a. its own settlement cycle, so that any short selling activities on its facilities do not result in any delay or prevent effective settlement within such cycle; and
  - b. orderly functioning of its facilities, so that any long or short position concentration on Investments that remain unsettled does not interrupt such functioning;
2. Examples of circumstances that would not be treated as short selling in Rule 6.7.1(3) include where the seller:
  - a. has entered into an unconditional contract to purchase the relevant Securities but has not received their delivery at the time of the sale;
  - b. has title to other securities which are convertible or exchangeable for the Securities to which the sale contract relates;
  - c. has exercised an option to acquire the Securities to which the sale contract relates;
  - d. has rights or warrants to subscribe and receive Securities to which the sale contract relates; and
  - e. is making a sale of Securities that trades on a “when issued” basis and has entered into a binding contract to purchase such Securities, subject only to the condition of issuance of the relevant Securities.

**Foreign ownership restrictions**

- 9.6.7** An ATS Operator must not permit its facility to be used for trading Investments which are subject to foreign ownership restrictions unless it has adequate and effective arrangements to:
- (a) monitor applicable foreign ownership restrictions;
  - (b) promptly identify and take appropriate action where any breaches of such restrictions occur without any undue interruption or negative impact to its trading activities; and
  - (c) suspend trading in the relevant Investments where the ownership restrictions are, or are about to be, breached and reinstate trading when the breaches are remedied.

**Guidance**

The kind of arrangements an ATS Operator should implement to meet the requirements in Rule 9.6.7 are such as those specified in AMI Rule 6.8.1(2).

**Liquidity providers**

- 9.6.8** (1) An ATS Operator must not introduce a liquidity incentive scheme unless:
- (a) participation of such a scheme is limited to:
    - (i) a member as defined in Rule 9.3.1(1); or
    - (ii) any other Person where:
      - (A) it has undertaken due diligence to ensure that the Person is of sufficient good repute and has adequate competencies and organisational arrangements; and
      - (B) the Person has agreed in writing to comply with its Operating Rules so far as those rules are applicable to that Person's activities; and
  - (b) it has obtained the prior approval of the DFSA.
- (2) For the purposes of this section, a "liquidity incentive scheme" means an arrangement designed to provide liquidity to the market in relation to Investments traded on the facility.
- (3) Where an ATS Operator proposes to introduce or amend a liquidity incentive scheme, it must lodge with the DFSA, at least 10 days before the date by which it expects to obtain the DFSA approval, a statement setting out:
- (a) the details of the relevant scheme, including benefits to the ATS and members arising from that scheme; and
  - (b) the date on which the scheme is intended to become operative.
- (4) The DFSA must within 10 days of receiving the notification referred to in (3), approve a proposed liquidity incentive scheme unless it has reasonable grounds to believe that the introduction of the scheme would be detrimental to the facility or markets in general. Where the DFSA does not approve the proposed liquidity incentive scheme, it must notify the ATS Operator of its objections to the introduction of the proposed liquidity incentive scheme, and its reasons for that decision.
- (5) An ATS Operator must, as soon practicable, announce the introduction of the liquidity incentive scheme, including the date on which it becomes operative and any other relevant information.
- (6) If the DFSA decides not to approve a liquidity incentive scheme, the ATS Operator may refer the decision to the FMT for review.

### Prevention of Market Abuse

- 9.6.9** (1) An ATS Operator must:
- (a) implement and maintain appropriate measures to identify, deter and prevent Market Abuse on and through its facility; and
  - (b) report promptly to the DFSA any Market Abuse.
- (2) For the purposes of (1)(a), an ATS Operator must:
- (a) include in its Operating Rules a regime to prevent Market Abuse, which is applicable to its members and their Clients; and
  - (b) implement and maintain adequate measures to ensure that its members comply with that regime.
- (3) The regime to prevent Market Abuse referred to in (2)(a) must, at a minimum, include rules and procedures in relation to compliance with the applicable requirements in Part 6 of the Market Law, including adequate compliance arrangements applicable to its members and staff and the clients of members, record keeping, transaction monitoring, risk assessment and appropriate training.

#### Guidance

1. An ATS Operator should have an effective surveillance system in place for:
  - a. the coordinated surveillance of all activity on or through its facilities and activity in related Investments conducted elsewhere; and
  - b. communicating information about Market Abuse or suspected abuse, to the DFSA or appropriate regulatory authorities.
2. In determining whether an ATS Operator is ensuring that business conducted on its facilities is conducted in an orderly manner, the DFSA will consider:
  - a. arrangements for pre and post trade transparency taking into account the nature and liquidity of the Investments traded; and
  - b. the need to provide anonymity for trading participants.
3. An ATS Operator will also have appropriate procedures allowing it to influence trading conditions, suspend trading promptly when required, and to support or encourage liquidity when necessary to maintain an orderly market. The DFSA will consider the transparency of such procedures and the fairness of their application and potential application.

- 9.6.10** (1) An ATS Operator must:
- (a) before accepting a prospective member, ensure that the applicant has in place adequate arrangements, including systems and controls to comply with its regime for preventing Market Abuse;
  - (b) monitor and regularly review compliance by its members with that regime; and

- (c) take appropriate measures to ensure that its members rectify to the extent feasible any contraventions of its regime without delay.
- (2) An ATS Operator must promptly notify the DFSA of any:
- (a) material breach of its regime to prevent Market Abuse by a member, or by staff or clients of the member; and
  - (b) circumstances in which a member will not or cannot rectify a breach of its regime.

**Guidance**

1. An Authorised Firm is subject to the requirements in the DFSA's AML module. Members of an Authorised Firm which are themselves Authorised Firms are also subject, by virtue of being Authorised Firms, to the requirements in the DFSA's AML module.
2. In determining whether an ATS Operator's measures are adequate and appropriate to reduce the extent to which its facilities can be used for Market Abuse, the DFSA will consider:
  - a. whether the ATS Operator has appropriate staff, surveillance systems, resources and procedures for this purpose;
  - b. the monitoring conducted for possible patterns of normal, abnormal or improper use of those facilities;
  - c. how promptly and accurately information is communicated about Market Abuse to the DFSA and other appropriate organisations; and
  - d. how the ATS Operator co-operates with relevant bodies in the prevention, investigation and pursuit of Market Abuse.
3. An ATS Operator must have regard to Part 6 of the Markets Law in relation to forms of Market Abuse. Practices that amount to market manipulation (which is Market Abuse) in an automated trading environment which an ATS should be able to identify and prevent in order to promote proper markets include the following:
  - a. entering small orders in order to ascertain the level of hidden orders, particularly used to assess what is resting on a dark platform, called Ping Orders;
  - b. entering large numbers of orders and/or cancellations/updates to orders to create uncertainty for other market participants, to slow down their process and to camouflage the ATS Operator's own strategy, called Quote Stuffing;
  - c. entry of orders or a series of orders intended to start or exacerbate a trend, and to encourage other participants to accelerate or extend the trend in order to create an opportunity to unwind/open a position at a favourable price, called Moment Ignition; and
  - d. submitting multiple orders often away from one side of the order book with the intention of executing a trade on the other side of the order book, where once that trade has taken place, the manipulative orders will be removed, called Layering and Spoofing.

## Clearing and settlement arrangements

- 9.6.11** (1) An ATS Operator must:
- (a) ensure that there are satisfactory arrangements in place for securing the timely discharge of the rights and liabilities of the parties to transactions conducted on or through its facility; and
  - (b) inform its members and other Persons having access to its facility through members of details relating to such arrangements.
- (2) For the purposes of (1)(a), an ATS Operator must ensure that:
- (a) the Person who provides clearing and settlement services to a member is either:
    - (i) an Authorised Person appropriately licensed to carry on clearing or settlement services; or
    - (ii) an entity which is authorised and supervised by a Financial Services Regulator acceptable to the DFSA for the activity of clearing and settlement services and is operating under broadly equivalent standards as defined under Chapter 7 of the AMI module; and
  - (b) notification of such arrangements (including any changes thereto) is provided to the DFSA at least 30 days before making the arrangements and the DFSA has not objected to such arrangements within that period.

### Guidance

An ATS Operator is not authorised under its Licence to provide clearing and settlement services. Therefore, it must make suitable arrangements relating to clearing and settlement of transactions that are undertaken on its facility. For this purpose, it may arrange for its members to obtain such services from an appropriately licensed Person.

## 9.7 Specific requirements applicable to Persons operating an OTF

- 9.7.1** A Person operating an OTF must not execute any orders made on the facility against its own proprietary capital.

## **10 CUSTODY PROVIDERS ACTING AS A CENTRAL SECURITIES DEPOSITORY (“CSD”)**

### **10.1 Application and interpretation**

- 10.1.1** (1) This chapter applies to an Authorised Firm which operates a Central Securities Depository (CSD).
- (2) Such an Authorised Firm is referred to in this chapter as a CSD.

#### **Guidance**

The Financial Service of Providing Custody includes the activity of operating a CSD. See GEN Rule 2.13.1(1)(c) and (3).

### **10.2 Additional requirements for CSDs**

- 10.2.1** (1) A CSD must have rules and procedures, including robust accounting practices and controls that:
- (a) ensure the integrity of the securities issues; and
  - (b) minimise and manage risks associated with the safekeeping and transfer of securities.
- (2) A CSD must ensure that securities referred to in (1)(a) are recorded in book-entry form prior to the trade date.
- (3) For the purposes of (1)(a), a CSD's systems and controls must ensure that:
- (a) the unauthorised creation or deletion of securities is prevented;
  - (b) appropriate intraday reconciliation is conducted to verify that the number of securities making up a securities issue or part of a securities issue submitted to the CSD is equal to the sum of securities recorded on the securities accounts of the Members and other participants of the CSD;
  - (c) where entities other than the CSD are involved in the reconciliation process for a securities issue, such as the issuer, registrars, issuance agents, transfer agents or other CSDs, the CSD has adequate arrangements for cooperation and information exchange between all involved parties so that the integrity of the issue is maintained; and
  - (d) there are no securities overdrafts or debit balances in securities accounts.



**CSD links**

- 10.2.2** (1) A CSD must not establish any link with another CSD (CSD link) unless it:
- (a) has, prior to establishing the CSD link, identified and assessed potential risks, for itself and its members and other participants using its facilities, arising from establishing such a link;
  - (b) has adequate systems and controls to effectively monitor and manage, on an on-going basis, the risks identified under (a) above; and
  - (c) is able to demonstrate to the DFSA, prior to the establishment of the CSD link, that the CSD link satisfies the requirements referred to in (2).
- (2) The requirements referred to in (1)(c) are that:
- (a) the link arrangement between the CSD and all linked CSDs contains adequate mitigants against possible risks taken by the relevant CSDs, including credit, concentration and liquidity risks, as a result of the link arrangement;
  - (b) each linked CSD has robust daily reconciliation procedures to ensure that its records are accurate;
  - (c) if it or another linked CSD uses an intermediary to operate a link with another CSD, the CSD or the linked CSD has adequate systems and controls to measure, monitor, and manage the additional risks arising from the use of the intermediary;
  - (d) to the extent practicable and feasible, linked CSDs provide for Delivery Versus Payment (DVP) settlement of transactions between participants in linked CSDs, and where such settlement is not practicable or feasible, reasons for non-DVP settlement are notified to the DFSA; and
  - (e) where interoperable securities settlement systems and CSDs use a common settlement infrastructure, there are:
    - (i) identical moments established for the entry of transfer orders into the system;
    - (ii) irrevocable transfer orders; and
    - (iii) finality of transfers of securities and cash.

**Guidance**

A CSD should include in its notification to the DFSA relating to the establishment of CSD links the results of due diligence undertaken in respect of the matters specified in Rule 10.2.2(2) to demonstrate that those requirements are met. Where a CSD changes any existing CSD arrangements, fresh notification relating to such changes, along with its due diligence relating to the new CSD link, should be provided to the DFSA in advance of the proposed change.

## **11 CROWDFUNDING**

### **11.1 Overview**

#### **Guidance**

1. This chapter applies to an Authorised Firm that Operates a Crowdfunding Platform (an ‘operator’).
2. A Crowdfunding Platform may be a Loan Crowdfunding Platform or an Investment Crowdfunding Platform. The key distinction is whether the Person providing funding on the platform enters into a loan agreement with the Person to whom it is providing funding or purchases an Investment (such as a Share, Debenture or Sukuk) issued by that Person.
3. The terminology used in this chapter varies according to the type of Crowdfunding:
  - (a) ‘borrower’, ‘lender’ and ‘loan’ for Loan Crowdfunding; and
  - (b) ‘Issuer’, ‘investor’ and ‘Investment’ for Investment Crowdfunding.
4. In this chapter, sections 1, 2 and 3 apply to all Crowdfunding Platforms (unless specified otherwise); section 4 sets out additional requirements for Loan Crowdfunding; and section 5 sets out additional requirements for Investment Crowdfunding.
5. In addition to the Rules in this section, an operator is required to comply with other parts of COB such as chapters 1, 2 and 3 and, if it holds or controls Client Assets, sections 6.11 to 6.14.
6. Both borrowers and lenders (in the case of Loan Crowdfunding) and Issuers and investors (in the case of Investment Crowdfunding) will be Clients of the operator. COB requirements will apply in relation to both types of Clients. Under section 3.3 and App 2, additional terms are required to be included in Client Agreements between a Crowdfunding Operator and its Clients (see Rules A2.1.5 and A2.1.6).
7. An operator will need to comply with relevant AML requirements, such as carrying out customer due diligence on Clients who are borrowers or lenders or Issuers or investors.
8. In the case of Investment Crowdfunding, the issue of Investments may result in the application of requirements under the Markets Law such as Market Abuse provisions or, if an offer is not an Exempt Offer, Prospectus requirements.

### **11.2 Application and interpretation**

#### **Application**

- 11.2.1** This chapter applies to an Authorised Firm with respect to the Operation of a Crowdfunding Platform.

**Interpretation****11.2.2** In this chapter:

- (a) “borrower” means a Person that has borrowed or is seeking to borrow money using a Loan Crowdfunding Platform;
- (b) “commitment period” means the period specified by the operator during which lenders may commit to lending money to a particular borrower or investors may commit to investing with a particular Issuer;
- (c) “cooling-off period”, for Investment Crowdfunding, means the period referred to in Rule 11.5.2 when an investor may withdraw his commitment to invest with an Issuer;
- (d) “investor” means an investor or potential investor using an Investment Crowdfunding Platform;
- (e) “lender” means a Person who:
  - (i) lends money under a loan agreement; or
  - (ii) by assignment has assumed the rights and obligations of a Person who has lent money under a loan agreement;
- (f) “loan agreement” means a loan agreement between a borrower and lender referred to in Rule 11.4.1;
- (g) “operator” means a Crowdfunding Operator;
- (h) “platform” means the website or other electronic media used to provide the service;
- (i) “service” means Operating a Crowdfunding Platform; and
- (j) “transfer”, in relation to a loan agreement, means the assignment by the lender of his rights and obligations under the agreement to another Person.

**11.3 Requirements for Crowdfunding Platforms****Crowdfunding risk disclosure****11.3.1** An operator must disclose prominently on its website the main risks to lenders or investors of using a Crowdfunding Platform, including that:

- (a) the lender or investor may lose all or part of their money or may experience delays in being paid;
- (b) borrowers or Issuers on the platform may include new businesses and, as many new businesses fail, a loan to such a borrower or an investment with such an Issuer may involve high risks;
- (c) the lender may not be able to transfer their loan, or the investor may not be able to sell their Investment, when they wish to, or at all; and

- (d) if for any reason the operator ceases to carry on its business, the lender or investor may lose their money, incur costs or experience delays in being paid.

### **Information about default or failure rates**

- 11.3.2** (1) An operator must disclose prominently on its website:
- (a) for Loan Crowdfunding, the actual and expected default rates for loans entered into on the platform; and
  - (b) for Investment Crowdfunding, the actual and expected failure rate of Issuers who use the platform.
- (2) The information referred to in (1) must:
- (a) for actual default or failure rates, cover the period since the operator began providing the service;
  - (b) for expected default or failure rates, set out a summary of the assumptions used in determining those expected rates; and
  - (c) be presented in a way that is fair, clear and not misleading.

### **Guidance**

1. Rule 11.3.2 requires a Loan Crowdfunding Operator to disclose historical information about the default rates of loans entered into on the platform. It also requires the operator to set out expected default rates in the future for loans entered into on the platform.
2. An Investment Crowdfunding Operator is required to disclose similar information about the failure rates of Issuers on its platform. In this context, failure of an Issuer should include where an Issuer defaults on payments, becomes insolvent, is wound up or ceases to carry on business.
3. Information about default and failure rates is intended to assist potential lenders or investors to assess the risks of lending or investing using the platform.
4. If an operator is a start-up entity, it may base the information on crowdfunding services provided by other members of the Group, provided it states clearly the basis for the information it provides.

### **Information about the service**

- 11.3.3** An operator must disclose prominently on its website key information about how its service operates, including:
- (a) details of how the platform functions;
  - (b) details of how and by whom the operator is remunerated for the service it provides, including fees and charges it imposes;
  - (c) any financial interest of the operator or a Related Person that may create a conflict of interest;

- (d) the eligibility criteria for borrowers or Issuers that use the service;
- (e) the minimum and maximum amounts, if any, of loans or Investments that may be sought by a borrower or an Issuer using the service;
- (f) what, if any, security is usually sought from borrowers or Issuers, when it might be exercised and any limitations on its use;
- (g) the eligibility criteria for lenders or investors that use the service;
- (h) any limits on the amounts a lender may lend or an investor may invest using the service, including limits for individual loans or investments and limits that apply over any 12 month period;
- (i) when a lender or an investor may withdraw a commitment to provide funding, and the procedure for exercising such a right;
- (j) what will happen if loans sought by a borrower or funds sought by an Issuer either fail to meet, or exceed, the target level;
- (k) steps the operator will take if there is a material change in a borrower's or an Issuer's circumstances and the rights of the lender and borrower or Issuer and investor in that situation;
- (l) how the operator will deal with overdue payments or a default by a borrower or an Issuer;
- (m) which jurisdiction's laws will govern the loan agreement between the lender and borrower;
- (n) arrangements and safeguards for Client Assets held or controlled by the operator, including details of any legal arrangements (such as nominee companies) that may be used to hold Client Assets;
- (o) any facility it provides to facilitate the transfer of loans or the sale of Investments, the conditions for using the facility and any risks relating to the use of that facility;
- (p) measures it has in place to ensure the platform is not used for money-laundering or other unlawful activities;
- (q) measures it has in place for the security of information technology systems and data protection; and
- (r) contingency arrangements it has in place to ensure the orderly administration of loans or Investments if it ceases to carry on business.

**Operator not to provide both regulated and unregulated crowdfunding services**

- 11.3.4** An operator must ensure that it does not provide both regulated and unregulated crowdfunding services.

**Guidance**

Some crowdfunding services may not need to be authorised e.g. reward or donation crowdfunding that do not involve an Investment or loan or other services carried on with Persons in certain jurisdictions. An operator needs to ensure that it does not provide both regulated and unregulated crowdfunding services from the same legal entity. If it wishes to provide unregulated crowdfunding services, it should do so using a separate legal entity. This removes any risk that Clients of the Authorised Firm will not understand that parts of the service are unregulated.

**Due diligence on borrowers or Issuers**

**11.3.5** An operator must not permit a borrower or an Issuer to use its service unless the borrower or Issuer is a Body Corporate.

**11.3.6** (1) An operator must conduct due diligence on each borrower or Issuer before allowing it to use its service.

(2) The due diligence under (1) must include, as a minimum, taking reasonable steps to verify in relation to the borrower or Issuer:

- (a) its identity, including details of its incorporation and business registration;
- (b) the identity and place of domicile of each of its directors, officers and controllers;
- (c) its fitness and propriety and that of each of the Persons referred to in (b);
- (d) its financial strength, including checking financial statements;
- (e) its financial history and past performance and its credit history, including checking with external credit agencies;
- (f) any credentials or expertise it claims to have;
- (g) the valuation of its business, current borrowing or funding levels (if any) and the source of any existing borrowing or funding;
- (h) its business proposal;
- (i) its commitment and that of its directors, officers and controllers to the business, including how much capital they have provided and any potential flight risk; and
- (j) that its business is being carried on in accordance with applicable laws in the jurisdiction where it is based.

**Guidance**

1. The type of background checks the DFSA expects an operator to conduct under Rule 11.3.6(2)(c) include, for example, whether the Person has been:
  - a. found guilty of a criminal offence;

- b. the subject of any finding in a civil proceeding of fraud, misfeasance or other misconduct;
  - c. the subject of a judgment or agreed settlement in a civil proceeding exceeding \$10,000;
  - d. disqualified from acting as a director or taking part in the management of a company; or
  - e. bankrupt or the director, or a person concerned in the management, of a company which has gone into liquidation or administration.
2. The purpose of the due diligence under Rule 11.3.6(2)(j) is to check that the business itself is lawful in the place in which it is being carried on i.e. that the owner has the necessary permits and that the activity is lawful. The borrower or Issuer should certify these matters and provide relevant documents where appropriate.

**Disclosure of information about the borrower or Issuer**

**11.3.7** An operator must disclose prominently on its website relevant information about each borrower or Issuer, including as a minimum:

- (a) the name of the borrower or Issuer, the full name and position of each of its directors and officers and the full name of each controller;
- (b) the place of incorporation of the borrower or Issuer and the place of domicile of each director, officer and controller;
- (c) a description of the borrower's or Issuer's business;
- (d) the most recent financial statements, if any, of the borrower or Issuer and a warning that the operator gives no assurances about their accuracy;
- (e) the valuation of the borrower's or Issuer's business, its current borrowing levels and the source of its borrowing and its liquidity;
- (f) a detailed description of the proposal for which it is seeking funding including:
  - (i) the total funding sought;
  - (ii) how the funds will be used; and
  - (iii) the target level of funding sought and what will happen if that level is not met or is exceeded;
- (g) the results of the due diligence carried out by the operator on the borrower or Issuer and any limits on the due diligence that could be carried out;
- (h) any grading or rating by the operator of the borrower's or Issuer's creditworthiness, including:
  - (i) how the grading or rating has been assessed;
  - (ii) an explanation of what the different grading or rating levels mean; and

- (iii) a clear statement that this should not be taken as advice about whether money should be lent to the borrower or invested with the Issuer;
- (i) for a loan or Debenture, the duration of the loan or Debenture, details of interest payable and any other rights attaching to the loan or Debenture;
- (j) for a Share issue, any rights attaching to the Share, such as dividend, voting or pre-emption rights;
- (k) whether any security is being provided and, if so, the circumstances in which it might be exercised and any limitations on its use;
- (l) if applicable, any other reward or benefit attaching to the loan or Investment and the terms on which it is available;
- (m) for a Share issue, whether investors have any protection from their shareholding being diluted by the issue of further Shares; and
- (n) that the borrower or Issuer, and information provided about the borrower or Issuer, are not checked or approved by the DFSA.

#### **Proposals not to be advertised outside platform**

##### **11.3.8** An operator must:

- (a) not advertise a specific lending or Investment proposal that is available on its platform; and
- (b) take reasonable steps to ensure that borrowers and Issuers that use its platform do not advertise the lending or Investment proposal,

unless the advertisement is made on the platform and is accessible only to existing Clients who use the platform.

#### **Guidance**

1. Rule 11.3.8 does not prevent a Person such as a borrower or an Issuer from referring other Persons to the operator or providing a link to the operator's website homepage. However, a link to a specific lending or investment proposal should not be displayed outside the platform if it is accessible to Persons who are not Clients of the operator.
2. If an Investment proposal is advertised to Persons who are not Clients of the operator, in addition to breaching Rule 11.3.8, this may constitute an Offer of Securities to the Public that requires a Prospectus, as the offer may no longer meet the conditions of the Exempt Offer exclusion for Crowdfunding Platforms in MKT Rule 2.3.1(m).
3. Rule 11.3.8 does not prevent an operator from generally promoting its crowdfunding service to potential Clients, provided it does not advertise a specific proposal.

#### **Material changes affecting a borrower or Issuer**

- ##### **11.3.9** (1) This Rule applies if a material change occurs relating to a borrower or Issuer, its business, its proposal or the carrying out of its proposal.



- (2) In this Rule, a “material change” means any change or new matter that may significantly affect the borrower’s ability to meet its payment obligations under the loan agreement or that may significantly affect an Issuer’s business or its ability to carry out its proposal.
- (3) If the material change occurs during the commitment period, the operator must:
  - (a) disclose prominently on its website details of the material change;
  - (b) notify committed lenders or investors of the material change and require them to reconfirm their commitment within 5 business days; and
  - (c) if reconfirmation is not provided within the period specified in (b), cancel the commitment.
- (4) If the material change occurs after the commitment period, the operator must disclose prominently on its website:
  - (a) details of the material change;
  - (b) any change in the rights of the lenders and the borrower, or the investors and the Issuer, arising from the material change; and
  - (c) what steps, if any, the operator is proposing to take as a result of the change.
- (5) A disclosure or notification under (3) or (4) must be made as soon as practicable after the operator becomes aware of the material change.

**Guidance**

1. Rule 11.3.9 sets out the requirements that an operator must comply with if there is a material change affecting a borrower or Issuer, either during the commitment period or at a later time. A material change might include, for example, a change in the management, control or structure of the business, an event affecting its profitability, a change relating to its assets or a default in meeting another obligation.
2. A borrower or an Issuer is required, under its Client Agreement, to give reasonable advance notice to the operator of any material change in its circumstances (see Rule A2.1.6).
3. The DFSA expects that it would be only in limited circumstances that a material change would occur during the commitment period. This is because full information about the borrower or Issuer will only recently have been verified and published (see Rules 11.3.6 and 11.3.7). As a material change during the commitment period could significantly affect a lender or investor’s decision, in addition to notifying investors or lenders, the operator must require anyone who has already committed to lend or invest to reconfirm their commitment. This reconfirmation is separate from the cooling-off period for investors under Rule 11.5.2 which starts when the commitment period ends.
4. If a material change occurs after the commitment period, in addition to notifying lenders or investors of the details, the operator is required to inform lenders or

investors whether this affects their rights and whether the operator is proposing to take further steps e.g. to clarify the situation or to take action for a default.

### **Borrower or Issuer not to use other platforms**

**11.3.10** An operator must take reasonable steps to restrict a borrower or an Issuer from seeking funding on another crowdfunding platform during the commitment period.

#### **Guidance**

Allowing a borrower or an Issuer to use different platforms at the same time creates the risk that the borrower or Issuer might offer different terms and information about the proposal, causing potential confusion for lenders or investors and creating the potential for arbitrage by a borrower or an Issuer. This restriction only applies during the commitment period i.e. the period during which lenders may commit to making loans to the borrower or investors may commit to investing with the Issuer.

### **Equal treatment of lenders and investors**

**11.3.11** An operator must ensure that lenders or investors who use its service are able to have access to the same information on its website about a borrower or an Issuer or a lending or investment proposal, and that access to the information is provided at the same time.

**11.3.12** If an operator provides an auto-lending system or auto-investing system, or any other facility that provides some lenders or investors with the opportunity to lend or invest money ahead of other lenders or investors, it must disclose prominently on its website that some lenders or investors may have preferential access to better proposals.

#### **Guidance**

1. An 'auto-lending system' or 'auto-investing system' is a facility that automatically allocates certain loans or Investments to a lender or investor according to parameters chosen by the lender or investor. The availability of this type of facility creates the risk that other lenders may not be aware that the best lending or investment opportunities have already been allocated and that remaining lending or investment opportunities may be of lower quality.
2. Further, if an operator permits some lenders or investors using its service to lend or invest on terms that are better than those offered to other lenders or investors on the platform, a potential conflict of interest may arise between the interests of the different lenders or investors. The operator will need to consider under Rule 3.5.1 what steps it should take to ensure that other Clients are not prejudiced by the conflict of interest.

### **No suitability disclosure**

**11.3.13** If an operator provides an auto-lending system or auto-investing system, it must disclose prominently to lenders or investors who use the facility that no assessment is made that any loan or Investment selected by the system is suitable for the lender or investor.

### Operator not to permit staff to use the platform

**11.3.14** An operator must take reasonable steps to ensure that its officers and employees and their family members do not:

- (a) lend money or provide finance to a borrower or an Issuer;
- (b) borrow money from a lender or receive funding from an investor; or
- (c) hold any direct or indirect interest in the capital or voting rights of a borrower or lender or an Issuer or investor.

#### Guidance

1. Rule 11.3.14 is intended to ensure that staff of an operator do not enter into transactions with clients of the operator. This is because staff may have access to additional confidential information about a borrower or Issuer that is not available to clients. Such transactions may also create other conflicts of interest.
2. The Rule does not prohibit an operator itself from lending money to a borrower, or investing in an Issuer, that uses the platform. However, if it does so, it is likely to be carrying on a separate Financial Service of Providing Credit or Dealing in Investments as Principal and require an additional authorisation for that activity. As well as complying with additional Rules relating to capital and the conduct of that business, it would need to take reasonable steps to prevent or manage conflicts of interests that may arise between its interests and those of its Clients (see Rule 3.5.1). If the operator discloses conflicts of interests to Clients under Rule 3.5.1, it should disclose details of each specific transaction that creates a potential conflict of interest.

#### Forums

**11.3.15** If an operator provides a means of communication (a “forum”) for lenders and borrowers or Issuers and investors to discuss funding proposals made using the service, it must:

- (a) refer lenders or investors to the forum as a place where they can find, or take part in, further discussion about proposals, while clearly stating that the operator does not conduct due diligence on information on the forum;
- (b) restrict posting of comments on the forum to Persons who are Clients using the service;
- (c) ensure that all Clients using the forum have equal access to information posted on the forum;
- (d) require a Person posting a comment on the forum to disclose clearly if he is affiliated in any way with a borrower or an Issuer or is being compensated, directly or indirectly, to promote a proposal by a borrower or an Issuer;
- (e) take reasonable steps to monitor and prevent posts on the forum that are potentially misleading or fraudulent;
- (f) immediately take steps to remove a post, or to require a post to be deleted or amended, if the operator becomes aware that (d) or (e) have not been complied with; and

- (g) not participate in discussions on the forum except to moderate posts or to take steps referred to in (f).

### **Facility for transfer of loans or Investments**

**11.3.16** If an operator provides a facility that assists the transfer of rights or obligations under a loan agreement or the sale of Investments, it must ensure that:

- (a) the facility relates only to loans or Investments originally facilitated using its service;
- (b) transfers can take place only between lenders or investors who are already Clients using the service and have initially lent money under loan agreements or initially subscribed for Investments using the service;
- (c) in the case of a loan agreement, the facility allows only a lender (and not the borrower) to transfer rights and obligations under the agreement;
- (d) in the case of a loan agreement, a lender must transfer the rights and obligations relating to the whole of a loan made (and not just a part of the loan);
- (e) potential transferees or buyers have access to all information on the website about the borrower or Issuer that was available to earlier lenders or investors; and
- (f) fees it charges for the use of the facility are designed to recover its costs of providing the facility, rather than generating additional income.

### **Guidance**

1. A facility for the transfer of rights and obligations under loan agreements or for the sale of Investments should exist mainly to provide an exit route for lenders or investors rather than being a facility for the active trading of loans or Investments. For example, the operator should ensure that transferees or buyers are Clients who already initially lent money to either the particular borrower or another borrower, or initially invested funds in the Issuer or another Issuer, using the platform. That is, the facility should not be used by persons who are only involved in secondary trading of loans or Investments.
2. The conditions in Rule 11.3.16 apply only to a transfer or sale using the facility provided by the operator. They do not affect transfers of rights and obligations or sales of Investments that may occur outside that facility, for example, by operation of law such as under a will or by a Court order.

### **Information technology**

- 11.3.17** (1) An operator must have adequate measures in place to ensure:
- (a) its information technology systems are resilient and not prone to failure;
  - (b) business continuity in the event that an information technology system fails;

- (c) protection of its information technology systems from damage, tampering, misuse or unauthorised access; and
  - (d) the integrity of data forming part of, or being processed through, its information technology systems.
- (2) An operator must review the measures referred to in (1) at least annually to ensure they are adequate.

### **Business cessation plan**

**11.3.18** The operator must:

- (a) maintain a business cessation plan that sets out appropriate contingency arrangements to ensure the orderly administration of loan agreements or Investments in the event that it ceases to carry on its business; and
- (b) ensure, as far as reasonably practicable, that the contingency arrangements can be implemented if necessary.

### **Guidance**

The business cessation plan may, for example, set out arrangements for another appropriately regulated third party to take over the administration of existing loans or Investments. The operator should put in place measures that, as far as reasonably practicable, ensure that the contingency arrangements can be implemented if necessary e.g. by entering into an agreement with a third party to provide certain services. The operator will need to disclose the contingency arrangements it has in place (see Rule 11.3.3 (r)).

## **11.4 Loan Crowdfunding – extra requirements**

### **Written loan agreement**

**11.4.1** A Loan Crowdfunding Operator must ensure that, when a loan is made using its service, there is a written loan agreement in place between the borrower and lender that is legally enforceable and sets out sufficient details of the loan, the terms of repayment and the rights and obligations of the borrower and lender.

### **Lending limits**

**11.4.2** A Loan Crowdfunding Operator must maintain effective systems and controls to ensure that a Retail Client does not lend more than:

- (a) US\$5,000 to any single borrower using its service; and
- (b) US\$50,000 in total in any calendar year using its service.

## **11.5 Investment Crowdfunding – extra requirements**

### **Risk acknowledgement form**

- 11.5.1** (1) An Investment Crowdfunding Operator must ensure that a Retail Client provides a signed risk acknowledgement form for each Investment that it makes using the platform.
- (2) The risk acknowledgement form under (1) must:
- (a) set out clearly the risks referred to in Rule 11.3.1;
  - (b) require the Retail Client to confirm that he understands those risks; and
  - (c) be provided before, or at the same time as, the Retail Client commits to making the Investment.

#### **Cooling-off period**

- 11.5.2** (1) An Investment Crowdfunding Operator must ensure that investors who have committed to providing funding to a particular Issuer may withdraw that commitment, without any penalty and without giving a reason, during the cooling-off period.
- (2) In (1), “cooling-off period” means the period of at least 48 hours starting at the end of the commitment period.

#### **Guidance**

An operator may provide investors with a cooling-off period that is longer than the period specified in Rule 11.5.2(2).

#### **Investment limit**

- 11.5.3** An Investment Crowdfunding Operator must maintain effective systems and controls to ensure that a Retail Client does not invest more than US\$50,000 in total in any calendar year using its service.

## **APP1 RECORDS OF ORDERS AND TRANSACTIONS**

### **A1.1 Minimum contents of transaction records**

#### **Receipt of client order or discretionary decision to transact**

**A1.1.1** An Authorised Firm must, pursuant to Rule 6.7.4(1), make a record of the following:

- (a) the identity and account number of the Client;
- (b) the date and time in the jurisdiction in which the instructions were received or the decision was taken by the Authorised Firm to deal;
- (c) the identity of the Employee who received the instructions or made the decision to deal;
- (d) the Investment, including the number of or its value and any price limit; and
- (e) whether the instruction relates to a purchase or sale.

#### **Executing a transaction**

**A1.1.2** An Authorised Firm must, pursuant to Rule 6.7.4(2), make a record of the following:

- (a) the identity and account number of the Client for whom the Transaction was Executed, or an indication that the Transaction was an Own Account Transaction;
- (b) the name of the counterparty;
- (c) the date and time in the jurisdiction in which the Transaction was Executed;
- (d) the identity of the Employee executing the Transaction;
- (e) the Investment, including the number of or its value and price; and
- (f) whether the Transaction was a purchase or a sale.

#### **Passing a client order to another person for execution**

**A1.1.3** An Authorised Firm must, pursuant to Rule 6.7.4(3), make a record of the following:

- (a) the identity of the Person instructed;
- (b) the terms of the instruction; and
- (c) the date and time that the instruction was given.

## **APP2 KEY INFORMATION AND CLIENT AGREEMENT**

### **A2.1 Key Information and content of the Client Agreement**

#### **General**

**A2.1.1** The key information which an Authorised Firm is required to provide to a Client and include in the Client Agreement with that Client pursuant to Rule 3.3.2 must include:

- (a) the core information set out in:
  - (i) Rule A2.1.2 (1) if it is a Retail Client; and
  - (ii) Rule A2.1.2(2) if it is a Professional Client;
- (b) where relevant, the additional information required under Rule A2.1.3 for Investment Business and Rule A2.1.4 for Investment Management; and
- (c) the additional terms set out in Rules A2.1.5 and A2.1.6 if the Client Agreement relates to the use of a Crowdfunding Platform.

#### **Core information**

**A2.1.2** (1) In the case of a Retail Client, the core information for the purposes of A2.1.1(a) is:

- (a) the name and address of the Authorised Firm, and if it is a Subsidiary, the name and address of the ultimate Holding Company;
- (b) the regulatory status of the Authorised Firm;
- (c) when and how the Client Agreement is to come into force and how the agreement may be amended or terminated;
- (d) sufficient details of the service that the Authorised Firm will provide, including where relevant, information about any product or other restrictions applying to the Authorised Firm in the provision of its services and how such restrictions impact on the service offered by the Authorised Firm. If there are no such restrictions, a statement to that effect;
- (e) details of fees, costs and other charges and the basis upon which the Authorised Firm will impose those fees, costs and other charges;
- (f) details of any conflicts of interests for the purposes of disclosure under Rule 3.5.1(2)(b);
- (g) details of any Soft Dollar Agreement required to be disclosed under Rules 3.5.6 and 3.5.7; and



- (h) key particulars of the Authorised Firm's Complaints handling procedures and a statement that a copy of the procedures is available free of charge upon request in accordance with GEN Rule 9.2.11.
- (2) In the case of a Professional Client, the core information for the purposes of A2.1.1(a) is the information referred to in (1)(a), (b), (c) and (e).

**Additional information for Investment Business**

**A2.1.3** The additional information required under A2.1.1(b) for Investment Business is:

- (a) the arrangements for giving instructions to the Authorised Firm and acknowledging those instructions;
- (b) information about any agreed investment parameters;
- (c) the arrangements for notifying the Client of any Transaction Executed on his behalf;
- (d) if the Authorised Firm may act as principal in a Transaction, when it will do so;
- (e) the frequency of any periodic statements and whether those statements will include some measure of performance, and if so, what the basis of that measurement will be;
- (f) when the obligation to provide best execution can be and is to be waived, a statement that the Authorised Firm does not owe a duty of best execution or the circumstances in which it does not owe such a duty; and
- (g) where applicable, the basis on which assets comprised in the portfolio are to be valued.

**Additional information for investment management activities**

**A2.1.4** The additional information required under A2.1.1(b) where an Authorised Firm acts as an Investment Manager is:

- (a) the initial value of the managed portfolio;
- (b) the initial composition of the managed portfolio;
- (c) the period of account for which periodic statements of the portfolio are to be provided in accordance with section 6.10; and
- (d) in the case of discretionary investment management activities:
  - (i) the extent of the discretion to be exercised by the Authorised Firm, including any restrictions on the value of any one Investment or the proportion of the portfolio which any one Investment or any particular kind of Investment may constitute; or that there are no such restrictions;

- (ii) whether the Authorised Firm may commit the Client to supplement the funds in the portfolio, and if it may include borrowing on his behalf:
  - (A) the circumstances in which the Authorised Firm may do so;
  - (B) whether there are any limits on the extent to which the Authorised Firm may do so and, if so, what those limits are;
  - (C) any circumstances in which such limits may be exceeded; and
  - (D) any margin lending arrangements and terms of those arrangements;
- (iii) that the Authorised Firm may enter into Transactions for the Client, either generally or subject to specified limitation; and
- (iv) where the Authorised Firm may commit the Client to any obligation to underwrite or sub-underwrite any issue or offer for sale of Securities:
  - (A) whether there are any restrictions on the categories of Securities which may be underwritten and, if so, what these restrictions are; and
  - (B) whether there are any financial limits on the extent of the underwriting and, if so, what these limits are.

#### **Additional terms for Crowdfunding Platforms**

**A2.1.5** The following terms must be included in a Client Agreement between a Crowdfunding Operator and a Client that is a lender or an investor:

- (a) the operator's obligations to administer the loan or Investment, including:
  - (i) how payments made by the borrower or Issuer will be transferred to the lender or investor; and
  - (ii) steps that will be taken if payments by a borrower or an Issuer are overdue or the borrower or Issuer is in default;
- (b) if the Client is a Retail Client, the steps that will be taken by the operator and lender or investor to ensure that the lender or investor complies with any applicable limits relating to the amounts of loans or investments that may be made using the platform;
- (c) for Investment Crowdfunding, if the Client is a Retail Client, that the Client agrees to sign a risk acknowledgement form each time before he makes an Investment using the platform; and
- (d) the contingency arrangements that the operator will put in place to deal with a platform failure or if the operator ceases to carry on its business.

- A2.1.6** The following terms must be included in a Client Agreement between a Crowdfunding Operator and a Client that is a borrower or an Issuer:
- (a) a restriction on the borrower or Issuer using any other crowdfunding service to raise funds during the commitment period;
  - (b) a restriction on the borrower or Issuer or any Person that is Connected to the borrower or Issuer, lending or financing, or arranging lending or finance for a lender or an investor using the service;
  - (c) a restriction on the borrower or Issuer advertising its proposal, or soliciting potential lenders or investors, outside the platform during the commitment period;
  - (d) a requirement on the borrower or Issuer to give reasonable advance notice to the operator of any material change affecting the borrower or Issuer, its business or the carrying out of its proposal;
  - (e) the obligations of the borrower or Issuer if there is any material change after funds have been provided; and
  - (f) an obligation on the borrower or Issuer to produce financial statements at least annually.

## **APP3 CONFIRMATION OF TRANSACTIONS**

### **A3.1 Content of confirmation notes**

#### **General information**

- A3.1.1** (1) For the purposes of Rule 6.9.2, an Authorised Firm must include the following general information:
- (a) the Authorised Firm's name and address;
  - (b) whether the Authorised Firm Executed the Transaction as principal or agent;
  - (c) the Client's name, account number or other identifier;
  - (d) a description of the Investment or Fund, including the amount invested or number of units involved;
  - (e) whether the Transaction is a sale or purchase;
  - (f) the price or unit price at which the Transaction was Executed;
  - (g) if applicable, a statement that the Transaction was Executed on an Execution-Only basis;
  - (h) the date and time of the Transaction;
  - (i) the total amount payable and the date on which it is due;
  - (j) the amount of the Authorised Firms charges in connection with the Transaction, including Commission charges and the amount of any Mark-up or Mark-down, Fees, taxes or duties;
  - (k) the amount or basis of any charges shared with another Person or statement that this will be made available on request; and
  - (l) for Collective Investment Funds, at statement that the price at which the Transaction has been Executed is on a Historic Price or Forward Price basis, as the case may be.
- (2) An Authorised Firm may combine items (f) and (j) in respect of a Transaction where the Client has requested a note showing a single price combining both of these items.

#### **Additional information: derivatives**

- A3.1.2** For the purposes of Rule 6.9.2, and in relation to Transactions in Derivatives, an Authorised Firm must include the following additional information:

- (a) the maturity, delivery or expiry date of the Derivative;

- (b) in the case of an Option, the date of exercise or a reference to the last exercise date;
- (c) whether the exercise creates a sale or purchase in the underlying asset;
- (d) the strike price of the Option; and
- (e) if the Transaction closes out an open Futures position, all essential details required in respect of each contract comprised in the open position and each contract by which it was closed out and the profit or loss to the Client arising out of closing out that position (a difference account).

## **APP4 PERIODIC STATEMENTS**

### **A4.1 Content of periodic statements: investment management**

#### **General information**

**A4.1.1** Pursuant to section 6.10, a periodic statement, as at the end of the period covered, must contain the following general information:

- (a) the number, description and value of each Investment;
- (b) the amount of cash held;
- (c) the total value of the portfolio; and
- (d) a statement of the basis on which the value of each Investment has been calculated.

#### **Additional information: discretionary investment management activities**

**A4.1.2** In addition to Rule A4.1.1, where an Authorised Firm acts as an Investment Manager on a discretionary basis, the periodic statement must also include the following additional information:

- (a) a statement of which Investments, if any, were at the closing date loaned to any third party and which Investments, if any, were at that date charged to secure borrowings made on behalf of the portfolio;
- (b) the aggregate of any interest payments made and income received during the account period in respect of loans or borrowings made during that period;
- (c) details of each Transaction which have been entered into for the portfolio during the period;
- (d) the aggregate of Money and details of all Investments transferred into and out of the portfolio during the period;
- (e) the aggregate of any interest payments, including the dates of their application and dividends or other benefits received by the Authorised Firm for the portfolio during that period;
- (f) a statement of the aggregate Charges of the Authorised Firm and its Associates; and
- (g) a statement of the amount of any Remuneration received by the Authorised Firm or its Associates or both from a third party.

#### **Additional information: contingent liability investments**

**A4.1.3** In addition to Rules A4.1.1 and A4.1.1.2, in the case where Contingent Liability Investments are involved, an Authorised Firm must include the following additional information:

- (a) the aggregate of Money transferred into and out of the portfolio during the valuation period;
- (b) in relation to each open position in the account at the end of the account period, the unrealised profit or loss to the Client (before deducting or adding any Commission which would be payable on closing out);
- (c) in relation to each Transaction Executed during the account period to close out a Client's position, the resulting profit or loss to the Client after deducting or adding any Commission;
- (d) the aggregate of each of the following in, or relating to, the Client's portfolio at the close of business on the valuation date:
  - (i) cash;
  - (ii) Collateral value;
  - (iii) management fees; and
  - (iv) commissions; and
- (e) Option account valuations in respect of each open Option contained in the account on the valuation date stating:
  - (i) the Share, Future, index or other Investment involved;
  - (ii) the trade price and date for the opening Transaction, unless the valuation statement follows the statement for the period in which the Option was opened;
  - (iii) the market price of the contract; and
  - (iv) the exercise price of the contract.

## **APP5 CLIENT MONEY PROVISIONS**

### **A5.1 Application**

**A5.1.1** This appendix applies to an Authorised Firm, in accordance with Rule 6.12.2

### **A5.2 General requirements**

**A5.2.1** (1) The provisions of this appendix are referred to as the Client Money Provisions.

(2) The types of Client described in Rule 6.12.2 are referred to in this appendix as Segregated Clients.

**A5.2.2** An Authorised Firm which holds or controls Client Money for a Segregated Client must:

- (a) comply with the Client Money Provisions in relation to that Client Money; and
- (b) have systems and controls in place to be able to evidence compliance with the Client Money Provisions.

### **A5.3 Payment of client money into client accounts**

**A5.3.1** Where an Authorised Firm holds or controls Client Money it must ensure, except where otherwise provided in section A5.5 that the Client Money is paid into one or more Client Accounts within one day of receipt.

**A5.3.2** Subject to Rule A5.3.3, an Authorised Firm must not deposit its own Money into a Client Account.

- A5.3.3** (1) An Authorised Firm may deposit its own Money in a Client Account where:
- (a) it is a minimum sum required to open the account, or to keep it open;
  - (b) the Money is received by way of mixed remittance provided the Authorised Firm transfers out that part of the payment which is not Client Money within one day of the day on which the Authorised Firm would normally expect the remittance to be cleared;
  - (c) interest credited to the account exceeds the amount payable to Segregated Clients, provided that the Money is removed within twenty five days; or
  - (d) it is to meet a shortfall in Client Money.



- (2) Where an Authorised Firm deposits any Money into a Client Account such Money is Client Money until such time as the Money is withdrawn from the Client Account in accordance with the Client Money Provisions.

**A5.3.4** An Authorised Firm must maintain systems and controls for identifying Money which must not be in a Client Account and for transferring it without delay.

**A5.3.5** Where an Authorised Firm is aware that a Person may make a payment of Client Money to the Authorised Firm, it must take reasonable steps:

- (a) to ensure that such payment of Client Money is directed to a Client Account; and
- (b) to ensure that the Authorised Firm is notified by that Person of such payment as soon as reasonably practicable.

**Guidance**

An Authorised Firm should have procedures for identifying Client Money received by the Authorised Firm, and for promptly recording the receipt of the Money either in the books of account or a register for later posting to the Client cash book and ledger accounts. The procedures should cover Client Money received by the Authorised Firm through the mail, electronically or via agents of the Authorised Firm or through any other means.

## **A5.4 Client accounts**

**A5.4.1** A Client Account in relation to Client Money is an account which:

- (a) is held with a Third Party Agent;
- (b) is established to hold Client Assets;
- (c) is maintained in the name of;
- (i) if a Domestic Firm, the Authorised Firm; or
- (ii) if a non-Domestic Firm, a Nominee Company controlled by the Authorised Firm; and
- (d) includes the words 'Client Account' in its title.

**A5.4.2** (1) An Authorised Firm must maintain a master list of all Client Accounts.

- (2) The master list must detail:
- (a) the name of the account;
- (b) the account number;
- (c) the location of the account;
- (d) whether the account is currently open or closed; and
- (e) the date of opening or closure.

- (3) The details of the master list must be documented and maintained for at least six years following the closure of an account.

**Guidance**

1. An Authorised Firm may hold or control Client Money belonging to a Segregated Client in a Client Account solely for that Client. Alternatively, an Authorised Firm may choose to pool that Client Money in a Client Account containing Client Money of more than one Segregated Client.
2. The purpose of controlling or holding Client Money in a Client Account is to ensure that Money belonging to Segregated Clients is readily identifiable from Money belonging to the Authorised Firm such that, following a Distribution Event, Segregated Clients will rank highest in line in terms of any subsequent distribution of Client Money in proportion to each Client's valid claim over that that Money.
3. Following a Distribution Event, a Segregated Client may not have a valid claim over Client Money held or controlled in a Client Account if that Client Account was not established to hold or control Client Money for that Client or a pool of Clients of which that Client was a part.

## **A5.5 Exceptions to holding client money in client accounts**

**A5.5.1** The requirement for an Authorised Firm to pay Client Money into a Client Account does not, subject to Rule A5.5.2, apply with respect to such Client Money:

- (a) received in the form of cheque, or other payable order, until the Authorised Firm, or a Person or account controlled by the Authorised Firm, is in receipt of the proceeds of that cheque;
- (b) temporarily held by an Authorised Firm before forwarding to a Person nominated by the Client;
- (c) in connection with a Delivery Versus Payment Transaction where:
  - (i) in respect of a Client purchase, Client Money from the Client will be due to the Authorised Firm within one day upon the fulfilment of a delivery obligation; or
  - (ii) in respect of a Client sale, Client Money will be due to the Client within one day following the Client's fulfilment of a delivery obligation; or
- (d) held in the Client's own name where the Authorised Firm has a mandate to manage the Money on a discretionary basis.

**A5.5.2** An Authorised Firm must pay Client Money of the type described in Rule A5.5.1(b) or (c) into a Client Account where it has not fulfilled its delivery or payment obligation within three days of receipt of the Money or Investments unless in the case of the type of Client Money referred to in Rule A5.5.1(c)(ii) it instead safeguards Client Investments at least equal to the value of such Client Money.

- A5.5.3** (1) An Authorised Firm must maintain adequate records of all cheques and payment orders received in accordance with Rule A5.5.1(a) including, in respect of each payment, the:
- (a) date of receipt;
  - (b) name of the Client for whom payment is to be credited; and
  - (c) date when the cheque or payment order was presented to the Authorised Firm's Third Party Agent.
- (2) The records must be kept for a minimum of six years.

## **A5.6 Appointment of a third party agent**

- A5.6.1** (1) An Authorised Firm may only pay, or permit to be paid, Client Money to a Third Party Agent in accordance with Rule A5.7.1 where it has undertaken a prior assessment of the suitability of that agent and concluded on reasonable grounds that the Third Party Agent is suitable to hold that Client Money in a Client Account.
- (2) When assessing the suitability of the Third Party Agent, the Authorised Firm must ensure that the Third Party Agent will provide protections equivalent to the protections conferred by this appendix.
- (3) An Authorised Firm must have systems and controls in place to ensure that the Third Party Agent remains suitable.
- A5.6.2** An Authorised Firm must be able to demonstrate to the DFSA's satisfaction the grounds upon which the Authorised Firm considers the Third Party Agent to be suitable to hold that Client Money.

### **Guidance**

When assessing the suitability of a Third Party Agent, an Authorised Firm should have regard to:

- a. its credit rating;
- b. its capital and financial resources in relation to the amount of Client Money held;
- c. the insolvency regime of the jurisdiction in which it is located;
- d. its regulatory status and history;
- e. its Group structure; and
- f. its use of agents and service providers.

## **A5.7 Payment of client money to a third party agent**

- A5.7.1** (1) Subject to Rule A5.7.3, an Authorised Firm may only pass, or permit to be passed, a Segregated Client's Money to a Third Party Agent if:

- (a) the Client Money is to be used in respect of a Transaction or series of Transactions for that Client;
  - (b) the Client Money is to be used to meet an obligation of that Client; or
  - (c) the Third Party Agent is a bank or a Regulated Financial Institution which is authorised to accept or take Deposits.
- (2) In respect of (1)(a) and (b), an Authorised Firm must not hold any excess Client Money with the Third Party Agent longer than necessary to effect a Transaction or satisfy the Client's obligation.

**A5.7.2** When an Authorised Firm opens a Client Account with a Third Party Agent it must obtain, within a reasonable period, a written acknowledgement from the Third Party Agent stating that:

- (a) all Money standing to the credit of the account is held by the Authorised Firm as agent and that the Third Party Agent is not entitled to combine the account with any other account or to exercise any charge, mortgage, lien, right of set-off or counterclaim against Money in that account in respect of any sum owed to it on any other account of the Authorised Firm; and
- (b) the title of the account sufficiently distinguishes that account from any account containing Money that belongs to the Authorised Firm, and is in the form requested by the Authorised Firm.

**Guidance**

The DFSA would consider twenty days as being a reasonable period for an Authorised Firm to receive a written acknowledgement from the Third Party Agent.

**A5.7.3** If the Third Party Agent does not provide the acknowledgement referred to in Rule A5.7.2 within a reasonable period, the Authorised Firm must refrain from making further deposits of Client Money with that Third Party Agent and withdraw any Client Money standing to the credit of that Client Account.

**A5.8 Payment of client money from client accounts**

**A5.8.1** An Authorised Firm must have procedures for ensuring all withdrawals from a Client Account are authorised.

**A5.8.2** Subject to Rule A5.8.3, a Segregated Client's Client Money must remain in a Client Account until it is:

- (a) due and payable to the Authorised Firm;
- (b) paid to the Client on whose behalf the Client Money is held;
- (c) paid in accordance with a Client instruction on whose behalf the Client Money is held;
- (d) required to meet the payment obligations of the Client on whose behalf the Client Money is held; or

(e) paid out in circumstances that are otherwise authorised by the DFSA.

**A5.8.3** Money paid out by way of cheque or other payable order under Rule A5.8.2 must remain in a Client Account until the cheque or payable order is presented to the Client's bank and cleared by the paying agent.

**A5.8.4** An Authorised Firm must not use Client Money belonging of one Client to satisfy an obligation of another Client.

**Guidance**

The effect of Rule A5.8.4 is that an Authorised Firm would be required to deposit its own Money into a Client Account to remedy a shortfall arising from a client debit balance.

**A5.8.5** An Authorised Firm must have a system for ensuring no off-setting or debit balances occur on Client Accounts.

**A5.9 Client disclosure**

**A5.9.1** Before, or as soon as reasonably practicable after, an Authorised Firm receives Client Money belonging to a Segregated Client, it must disclose to the Client on whose behalf the Client Money is held:

- (a) the basis and any terms governing the way in which the Client Money will be held;
- (b) that the Client is subject to the protection conferred by the DFSA's Client Money Provisions and as a consequence:
  - (i) this Money will be held separate from Money belonging to the Authorised Firm; and
  - (ii) in the event of the Authorised Firm's insolvency, winding up or other Distribution Event stipulated by the DFSA, the Client's Money will be subject to the DFSA's Client Money Distribution Rules;
- (c) whether interest is payable to the Client and, if so, on what terms;
- (d) if applicable, that the Client Money may be held in a jurisdiction outside the DIFC and the market practices, insolvency and legal regime applicable in that jurisdiction may differ from the regime applicable in the DIFC;
- (e) if applicable, details about how any Client Money arising out of Islamic Financial Business are to be held;
- (f) if applicable, that the Authorised Firm holds or intends to hold the Client Money in a Client Account with a Third Party Agent which is in the same Group as the Authorised Firm; and
- (g) details of any rights which the Authorised Firm may have to realise Client Money held on behalf of the Client in satisfaction of a default by the Client or otherwise, and of any rights which the Authorised Firm may have to close out or liquidate contracts or positions in respect of any of the Client's Investments.

## **A5.10 Client reporting**

- A5.10.1** (1) In relation to a Client to whom the Client Money Provisions are applicable, an Authorised Firm must send a statement to a Retail Client at least monthly or in the case of a Professional Client, at other intervals as agreed in writing with the Professional Client.
- (2) The statement must include:
- (a) the Client's total Client Money balances held by the Authorised Firm reported in the currency in which the Client Money is held, or the relevant exchange rate if not reported in the currency in which the Money is held;
  - (b) the amount, date and value of each credit and debit paid into and out of the account since the previous statement; and
  - (c) any interest earned or charged on the Client Account since the previous statement.
- (3) The statement sent to the Client must be prepared within 25 days of the statement date.

## **A5.11 Reconciliation**

- A5.11.1** (1) An Authorised Firm must maintain a system to ensure that accurate reconciliations of the Client Accounts are carried out at least every 25 days.
- (2) The reconciliation must include:
- (a) a full list of individual Segregated Client credit ledger balances, as recorded by the Authorised Firm;
  - (b) a full list of individual Segregated Client debit ledger balances, as recorded by the Authorised Firm;
  - (c) a full list of unpresented cheques and outstanding lodgements;
  - (d) a full list of Client Account cash book balances; and
  - (e) formal statements from Third Party Agents showing account balances as at the date of reconciliation.
- (3) An Authorised Firm must:
- (a) reconcile the individual credit ledger balances, Client Account cash book balances, and the Third Party Agent Client Account balances;
  - (b) check that the balance in the Client Accounts as at the close of business on the previous day was at least equal to the aggregate

balance of individual credit ledger balances as at the close of business on the previous day; and

- (c) ensure that all shortfalls, excess balances and unresolved differences, other than differences arising solely as a result of timing differences between the accounting systems of the Third Party Agent and the Authorised Firm, are investigated and, where applicable, corrective action taken as soon as possible.
- (4) An Authorised Firm must perform the reconciliations in (3) within 10 days of the date to which the reconciliation relates.

**Guidance**

When performing the reconciliations, an Authorised Firm should:

- a. include in the credit ledger balances:
  - i. unallocated Client Money;
  - ii. dividends received and interest earned and allocated;
  - iii. sale proceeds which have been received by the Authorised Firm and the Client has delivered the Investments or the Authorised Firm holds or controls the Investment; and
  - iv. Money paid by the Client in respect of a purchase where the Authorised Firm has not remitted the Money to the counterparty or delivered the Investment to the Client; and
- b. deduct from the credit ledger balances:
  - i. Money owed by the client in respect of unpaid purchases by or for the Client if delivery of those Investments has been made to the Client; and
  - ii. Money remitted to the Client in respect of sales transactions by or for the Client if the Client has not delivered the Investments.

**A5.11.2** An Authorised Firm must ensure that the process of reconciliation does not give rise to a conflict of interest.

**Guidance**

When performing reconciliations, an Authorised Firm should maintain a clear separation of duties to ensure that an employee with responsibility for operating Client Accounts, or an employee that has the authority to make payments, does not perform the reconciliations under Rule A5.11.1

**A5.11.3** (1) Reconciliation performed in accordance with Rule A5.11.1 must be reviewed by a member of the Authorised Firm who has adequate seniority.

(2) The individual referred to in (1) must provide a written statement confirming the reconciliation has been undertaken in accordance with the requirements of this section.

**A5.11.4** The Authorised Firm must notify the DFSA where there has been a material discrepancy with the reconciliation which has not been rectified.

**Guidance**

A material discrepancy includes discrepancies which have the cumulative effect of being material, such as longstanding discrepancies.

**A5.12 Auditor's reporting requirements****Guidance**

In accordance with GEN chapter 8, an Authorised Firm which holds or controls Client Money for Segregated Clients must arrange for a Client Money Auditor's Report to be submitted to the DFSA on an annual basis.

**A5.13 Client money distribution rules**

**A5.13.1** This section is referred to as the Client Money Distribution Rules and to the extent that these Rules are inconsistent with part 5.52 of the DIFC Insolvency Regulations, and the DIFC Preferential Creditor Regulations, these Rules will prevail.

**A5.13.2** Following a Distribution Event, the Authorised Firm must distribute Money in the following order of priorities:

- (a) firstly, in relation to Client Money held in a Client Account on behalf of Segregated Clients, claims relating to that Money must be paid to each Segregated Client in full or, where insufficient funds are held in a Client Account, proportionately, in accordance with each Segregated Client's valid claim over that Money;
- (b) secondly, where the amount of Client Money in a Client Account is insufficient to satisfy the claims of Segregated Clients in respect of that Money, or not being immediately available to satisfy such claims, all other Money held by the Authorised Firm must be used to satisfy any outstanding amounts remaining payable to Segregated Clients but not satisfied from the application of (a) above;
- (c) thirdly, upon resolution of claims in relation to Segregated Clients, any Money remaining with the Authorised Firm must be paid to each Client in full or, where insufficient funds are held by the Authorised Firm, proportionately, in accordance with each Client's valid claim over that Money; and
- (d) fourthly, upon satisfaction of all claims in (a), (b) and (c) above, in the event of:
  - (i) the appointment of a liquidator, receiver or administrator, or trustee in bankruptcy over the Authorised Firm, payment must be made in accordance with the Insolvency Law 2009; or
  - (ii) all other Distribution Events, payment must be made in accordance with the direction of the DFSA.



**Guidance**

A Segregated Client would not have a valid claim over Client Money held in a Client Account if that Client Account was not established to hold Client Money for that Client.

**A5.13.3** Following a Distribution Event, an Authorised Firm must sell all Collateral and use the proceeds of the sale to satisfy claims made in accordance with Rule A5.13.2

**A5.14 Failure to comply with this appendix**

**A5.14.1** An Authorised Firm which becomes aware that it does not comply with any Rule in this appendix must, within one day, give notice of that fact to the DFSA.

## **APP6 SAFE CUSTODY PROVISIONS**

### **A6.1 Application**

**A6.1.1** This appendix applies to an Authorised Firm in accordance with Rule 6.13.3.

### **A6.2 General requirements**

**A6.2.1** The provisions of this appendix are referred to as the Safe Custody Provisions.

**A6.2.2** An Authorised Firm must:

- (a) comply with the Safe Custody Provisions; and
- (b) have adequate systems and controls in place to be able to evidence compliance with the Safe Custody Provisions.

### **A6.3 Recording, registration and holding requirements**

**A6.3.1** An Authorised Firm which Provides Custody or holds or controls Client Investments must ensure that Safe Custody Investments are recorded, registered and held in an appropriate manner to safeguard and control such property.

**A6.3.2** Subject to Rule A6.4.1, an Authorised Firm which Provides Custody or holds or controls Client Investments must record, register and hold Safe Custody Investments separately from its own Investments.

### **A6.4 Client accounts in relation to Client Investments**

**A6.4.1** An Authorised Firm which Provides Custody or holds or controls Client Investments must register or record all Safe Custody Investments in the legal title of:

- (a) a Client Account; or
- (b) the Authorised Firm where, due to the nature of the law or market practice, it is not feasible to do otherwise.

**A6.4.2** A Client Account in relation to Client Investments is an account which:

- (a) is held with a Third Party Agent or by an Authorised Firm which is authorised under its Licence to provide Custody;
- (b) is established to hold Client Assets;
- (c) when held by a Third Party Agent, is maintained in the name of:
  - (i) if a Domestic Firm, the Authorised Firm; or

- (ii) if not a Domestic Firm, a Nominee Company controlled by the Authorised Firm; and
- (d) includes the words 'Client Account' in its title.

**A6.4.3** (1) An Authorised Firm must maintain a master list of all Client Accounts.

- (2) The master list must detail:
  - (a) the name of the account;
  - (b) the account number;
  - (c) the location of the account;
  - (d) whether the account is currently open or closed; and
  - (e) the date of opening or closure.
- (3) The details of the master list must be documented and maintained for a minimum period of six years following the closure of an account.

**Guidance**

1. An Authorised Firm may record, register or hold a Client's Investment in a Client Account solely for that Client. Alternatively, an Authorised Firm may choose to pool that Client's Investment in a Client Account containing Investments of more than one Client.
2. The purpose of recording, registering or holding Investments in a Client Account is to ensure that Investments belonging to Clients are readily identifiable from Investments belonging to the Authorised Firm such that, following a Distribution Event, any subsequent distribution of Investments may be made in proportion to each Client's valid claim over those Investments.
3. Following a Distribution Event, a Client may not have a valid claim over Investments registered, recorded or held in a Client Account if that Client Account was not established to register, record or hold Investments for that Client or a pool of Clients of which that Client was a part.

**A6.4.4** An Authorised Firm must not use a Client's Safe Custody Investment for its own purpose or that of another Person without that Client's prior written permission.

**A6.4.5** An Authorised Firm which intends to use a Client's Safe Custody Investments for its own purpose or that of another Person, must have systems and controls in place to ensure that:

- (a) it obtains that Client's prior written permission;
- (b) adequate records are maintained to protect Safe Custody Investments which are applied as collateral or used for stock lending activities;
- (c) the equivalent assets are returned to the Client Account of the Client; and
- (d) the Client is not disadvantaged by the use of his Safe Custody Investments.

## **A6.5 Holding or arranging custody with third party agents**

- A6.5.1** (1) Before an Authorised Firm holds a Safe Custody Investment with a Third Party Agent, it must undertake an assessment of that Third Party Agent and have concluded on reasonable grounds that the Third Party Agent is suitable to hold those Safe Custody Investments.
- (2) An Authorised Firm must have systems and controls in place to ensure that the Third Party Agent remains suitable.
- (3) When assessing the suitability of the Third Party Agent, the Authorised Firm must ensure that the Third Party Agent will provide protections equivalent to the protections conferred in this appendix.
- A6.5.1A** (1) Before an Authorised Firm arranges custody with a non-DIFC custodian authorised and supervised by a Financial Services Regulator, it must undertake an assessment of that custodian and have concluded, on reasonable grounds, that it is suitable to hold the Safe Custody Investments.
- (2) When assessing the suitability of a non-DIFC custodian, the Authorised Firm must ensure that the non-DIFC custodian will provide protections equivalent to the protections conferred in this appendix.
- A6.5.2** An Authorised Firm must be able to demonstrate to the DFSA's satisfaction the grounds upon which the Authorised Firm considers the Third Party Agent or a non-DIFC custodian to be suitable to hold Safe Custody Investments.

### **Guidance**

When assessing the suitability of a Third Party Agent, an Authorised Firm should have regard to:

- a. its credit rating;
- b. its capital and financial resources in relation to the amount of Safe Custody Investments held;
- c. the insolvency regime of the jurisdiction in which it is located;
- d. its arrangements for holding the Investments;
- e. its regulatory status, expertise, reputation and history;
- f. its Group structure;
- g. its use of agents and service providers; and
- h. any other activities of the agent.

## **A6.6 Safe custody agreements with third party agents**

- A6.6.1** Before an Authorised Firm passes, or permits to be passed, Safe Custody Investments to a Third Party Agent it must have procured a written acknowledgement from the Third Party Agent stating:

- (a) that the title of the account sufficiently distinguishes that account from any account containing Investments belonging to the Authorised Firm, and is in the form requested by the Authorised Firm;
- (b) that the Client Investment will only be credited and withdrawn in accordance with the instructions of the Authorised Firm;
- (c) that the Third Party Agent will hold Client Investments separately from assets belonging to the Third Party Agent;
- (d) the arrangements for recording and registering Client Investments, claiming and receiving dividends and other entitlements and interest and the giving and receiving of instructions;
- (e) that the Third Party Agent will deliver a statement to the Authorised Firm (including the frequency of such statement), which details the Client Investments deposited to the account;
- (f) that all Investments standing to the credit of the account are held by the Authorised Firm as agent and that the Third Party Agent is not entitled to combine the account with any other account or to exercise any charge, mortgage, lien, right of set-off or counterclaim against Investments in that account in respect of any sum owed to it on any other account of the Authorised Firm; and
- (g) the extent of liability of the Third Party Agent in the event of default.

- A6.6.2** (1) An Authorised Firm must maintain records of all Safe Custody Agreements and any instructions given by the Authorised Firm to the Third Party Agent under the terms of the agreement.
- (2) The records must be maintained for at least of six years.

## **A6.7 Client disclosure**

- A6.7.1** (1) Before an Authorised Firm Arranges Custody for a Client it must disclose to that Client, if applicable, that the Client's Safe Custody Investments may be held in a jurisdiction outside the DIFC and the market practices, insolvency and legal regime applicable in that jurisdiction may differ from the regime applicable in the DIFC.
- (2) Before an Authorised Firm Provides Custody for a Client it must disclose to the Client on whose behalf the Safe Custody Investments will be held:
- (a) a statement that the Client is subject to the protections conferred by the Safe Custody Provisions;
  - (b) the arrangements for recording and registering Safe Custody Investments, claiming and receiving dividends and other entitlements and interest and the giving and receiving instructions relating to those Safe Custody Investments;

- (c) the obligations the Authorised Firm will have to the Client in relation to exercising rights on behalf of the Client;
- (d) the basis and any terms governing the way in which Safe Custody Investments will be held, including any rights which the Authorised Firm may have to realise Safe Custody Investments held on behalf of the Client in satisfaction of a default by the Client;
- (e) the method and frequency upon which the Authorised Firm will report to the Client in relation to his Safe Custody Investments;
- (f) if applicable, a statement that the Authorised Firm intends to mix Safe Custody Investments with those of other Clients;
- (g) if applicable, a statement that the Client's Safe Custody Investments may be held in a jurisdiction outside the DIFC and the market practices, insolvency and legal regime applicable in that jurisdiction may differ from the regime applicable in the DIFC;
- (h) if applicable, a statement that the Authorised Firm holds or intends to hold Safe Custody Investments in a Client Account with a Third Party Agent which is in the same Group as the Authorised Firm; and
- (i) the extent of the Authorised Firm's liability in the event of default by a Third Party Agent.

## **A6.8 Client reporting**

- A6.8.1** (1) An Authorised Firm which Provides Custody or which holds or controls Client Investments for a Client must send a statement to a Retail Client at least every six months or in the case of a Professional Client at other intervals as agreed in writing with the Professional Client.
- (2) The statement must include:
- (a) a list of that Client's Safe Custody Investments as at the date of reporting;
  - (b) a list of that Client's Collateral and the market value of that Collateral as at the date of reporting; and
  - (c) details of any Client Money held by the Authorised Firm as at the date of reporting.
- (3) The statement sent to the Client must be prepared within 25 business days of the statement date.

## **A6.9 Reconciliation**

- A6.9.1** An Authorised Firm must:

- (a) at least every 25 business days, reconcile its records of Client Accounts held with Third Party Agents with monthly statements received from those Third Party Agents;
- (b) at least every six months, count all Safe Custody Investments physically held by the Authorised Firm, or its Nominee Company, and reconcile the result of that count to the records of the Authorised Firm; and
- (c) at least every six months, reconcile individual Client ledger balances with the Authorised Firm's records of Safe Custody Investment balances held in Client Accounts.

**A6.9.2** An Authorised Firm must ensure that the process of reconciliation does not give rise to a conflict of interest.

**Guidance**

An Authorised firm should maintain a clear separation of duties to ensure that an employee with responsibility for operating Client Accounts, or an employee that has authority over Safe Custody Investments, should not perform the reconciliations under Rule A6.9.1.

- A6.9.3**
- (1) Reconciliation performed in accordance with section A6.9 must be reviewed by a member of the Authorised Firm who has adequate seniority.
  - (2) The individual referred to in (1) must provide a written statement confirming that the reconciliation has been undertaken in accordance with the requirements of this section.

**A6.9.4** The Authorised Firm must notify the DFSA where there have been material discrepancies with the reconciliation which have not been rectified.

**Guidance**

A material discrepancy includes discrepancies which have the cumulative effect of being material, such as longstanding discrepancies.

## **A6.10 Auditor's reporting requirements**

**Guidance**

In accordance with GEN chapter 8, an Authorised Firm to which this appendix applies must arrange for a Safe Custody Auditor's Report to be submitted to the DFSA on an annual basis.