

## **By Email**

20 April 2015

To the Senior Executive Officers of DFSA Authorised Firms

Dear SEO,

### **Supervisory Priorities and Issues**

Following the issuance of DFSA's Business Plan for 2015/16 earlier this year, we would like to take this opportunity to highlight certain key risks and related activities that we will prioritise this year and possibly beyond. These priorities take into consideration our assessment of the global and regional economic environment, international regulatory developments, trends among our regulated population and the DFSA's risk tolerance.

Our primary focus will be on conduct-related issues, across all types of regulated entities. We aim to ensure the appropriate level of protection to clients and counterparties given their knowledge, experience and understanding of financial products and services and related risks. Key areas of supervisory focus include:

#### **Client Classification and Suitability**

The vast majority of Firms in the DIFC are licensed to deal only with Professional Clients and Market Counterparties. In respect of an *individual* classified by a Firm as a Professional Client, apart from meeting the DFSA's "net asset" requirement, the Firm must be able to demonstrate the steps it has undertaken to assess whether the client has sufficient knowledge, experience and understanding of the relevant financial markets, products, and transactions as well as the associated risks. Importantly, neither significant wealth nor high income serve as proxy for an individual's knowledge or sophistication as an investor and do not, singly or collectively, support the classification of an individual as a Professional Client.

In 2014, the DFSA undertook a series of discussions with a cross-section of Firms and identified a range of concerns related to its client classification regime. In response, the DFSA issued Consultation Paper No.98: Proposed changes to the Client Classification regime. The new client classification regime came into force on 1 April 2015.

The suitability of products and services recommended to a client remains an important area of supervisory focus for the DFSA. Generally, a Firm must assess the suitability of a product or service against the client's needs and objectives, financial situation, knowledge, experience and understanding of the risks involved and any other relevant requirements and circumstances of the client.

Notwithstanding DFSA's requirements under COB Rule 3.4.2(2), which conditionally permits a Firm to limit the extent of its suitability assessment when dealing with a Professional Client, when making a recommendation or discretionary investment decision for a client, a Firm must

ensure that the advice is given with reasonable care and skill and that it is suitable based on the Firm's suitability assessment of the client. This is consistent with the principle in GEN Rule 4.2.8 which requires that a Firm take reasonable care to ensure the suitability of its advice and discretionary decisions for customers who are entitled to rely upon its judgement.

The DFSA proposes to review its policy on suitability, including the ability to limit suitability considerations for Professional Clients, to ensure it remains aligned with international standards and best practice.

### Communication of Information and Marketing Material

All Firms must take reasonable steps to ensure that communications and marketing materials regarding financial products or services are clear, fair and not misleading. Care must be taken around the use of terms that create a perception of safety in a manner that misrepresents or is otherwise inconsistent with the actual risk profile of a product. Firms must ensure that any claims are factually consistent with the features of the subject investments.

### Financial Crime (AML/ CTF and Sanctions Compliance)

Financial Crime related risks remain prominent on the DFSA's regulatory radar. We will continue to proactively monitor and interact with firms in respect of such risks. Supervision will continue to work with Firms to embed and ensure ongoing compliance with the AML Rulebook which was updated in July 2013. In particular, Supervision will focus on how Firms:

- apply a risk based approach *to their assessment* of Financial Crime risks in activities including the provision of trade finance. A risk-based approach must be proportionate to the risks to which a Firm is exposed as a result of the nature of its business, customers, products, services, geographical presence and any other relevant matters;
- maintain an effective internal escalation process for reporting suspicious activities and enhancing the quality of external Suspicious Activity Reports submitted to the Anti-Money Laundering and Suspicious Cases Unit of the Central Bank of the UAE; and
- comply with their obligations to conduct ongoing Customer Due Diligence including risk reviews and transaction monitoring.

We would like to remind Firms of the importance of maintaining accurate and up-to-date books and records not only to demonstrate rules compliance but also to support its client relations. Current books and records are essential to support, among other things, client classifications, client risk profiles, suitability assessments, and to ensure that the Firm's activities remain within the scope of its Licence. Firms should also ensure they have proper complaints handling processes. In particular, where complaints are handled at the head office or by another Group entity, the DIFC entity should ensure it has an adequate process for being notified of complaints related to the DIFC entity or its customers, and any outcomes relating to such complaints.

In addition to the items mentioned above, the DFSA also takes this opportunity to remind Firms of the following supervisory issues.

## Cyber Risks

Cyber security has become a critical concern for regulators and policy makers internationally, not least those charged with safe guarding the safety and soundness of their respective financial systems. The DFSA regards cyber security and resilience as an important consideration for the continued health and reputation of the DIFC. We therefore expect Firms to have continuous arrangements in place to adequately assess cyber threats, including how Firms prevent, detect and respond to a cyber security incident and the adequacy of its controls over third-party providers. Firms should establish appropriate governance, systems and controls to properly manage cyber security risks and benchmark themselves against internationally accepted cyber security practices.

## Notifications - Market Volatility

Under GEN Rule 11.10, an Authorised Firm has an obligation to advise the DFSA immediately if it becomes aware, or has reasonable grounds to believe, that a particular matter in relation to the Authorised Firm may have impacted, or may be about to impact, the Firm's reputation, the Firm's capital adequacy or solvency, the financial system or other Firms.

The recent rapid decline in commodity prices and volatility in currency markets, have had significant impacts on various financial institutions around the world. In light of these events, and any similar future events, the DFSA reminds Firms of its obligation to notify the DFSA of particular events. For example, such events should include, but are not limited to:

- a material impact from a deterioration in counterparty credit or collateral quality;
- a material increase in loss provisions;
- an extraordinary outflows of customer funds;
- a material impact from outstanding margin calls or customer margin credit defaults; or
- a material or extraordinary losses due to operational risk events.

The DFSA expects Firms to be proactive in its notifications and not wait until the consequences are fully quantifiable.

## New Regulatory Reporting Forms

The DFSA's regulatory reporting regime is a key tool through which we ensure the performance of effective supervision throughout the risk management cycle. The DFSA has recently completed a comprehensive review and update of that regime. It involved the enhancement of the quality, the amount and the nature of collected data, and the inclusion of the latest legislative changes to the PIB Module that came into effect on 21 August 2014 and 1 January 2015.

As a result a new set of regulatory reporting forms became applicable starting 1 January 2015 and a new version of the Prudential Returns Module (PRU), including instructional guidelines, was published on 4 March 2015 (*VER4/03-15*). Firms must prepare and submit returns in accordance with the Rules in the PIB Module, the instructional guidelines in the PRU Module, and the requirements of the DFSA's Electronic Prudential Reporting System (EPRS). The DFSA



would like to remind Firms that submitting data in a timely and accurate manner is imperative to our risk management cycle.

By signing Form B100 (Declaration by Authorised Firms), an Authorised Firm and its officers declare that the submitted regulatory reporting forms are complete and correct. Under Article 66 of the Regulatory Law 2004, it is an offence to provide to the DFSA any information which is false, misleading, deceptive, or to conceal information where the concealment of such information is likely to mislead or deceive the DFSA.

Yours sincerely,

**Bryan Stirewalt**  
Managing Director, Supervision