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Policy & Legal Update

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What is in the Pipeline?

FSAP, FATF Review

CP98: Code of Market Conduct

CP97: Client Classification

Policy & Legal
Update


Proposed Changes to the Client Classification Regime

Dhammika Amukotuwa
Director, Policy and Legal Services

What I will cover today?

- Why is client classification important?
- What does CP 97 cover?
- Why have we proposed changes?
- What are the main changes proposed?
- More details about the three main types of clients
- Each proposed change and the rationale
- What are the next steps?

Why is client classification important?



To ensure that firms provide an **appropriate level** of protection to their Clients, in line with the particular Client's:

Knowledge;

Experience; and

Resources.

What does CP 97 cover?

CP 97 contains proposals to revamp the current client classification regime in COB chapter 2

Client classification regime requires Authorised Firms to classify their clients as retail or non-retail

Firms have to make such a classification before providing any Financial Service to a Person

Why have we proposed changes to the classification regime?



CLIENTS

To ensure that the existing client classification regime:

- is in line with the current developments and practices in financial services industry;
- has no unintended gaps;
- remains true to international standards/MiFID;
- addresses practical issues raised by firms – some reflected in waivers/modifications granted; and
- is outcome-based to provide greater flexibility (where possible).



What are the main changes proposed?



More categories of Professional Clients – within the existing framework of three types of Clients (i.e. Retail Clients, Professional Clients and Market Counterparties)



Flexibility to use client classifications made elsewhere – i.e. by the firm's head office or another Branch, or a Group member

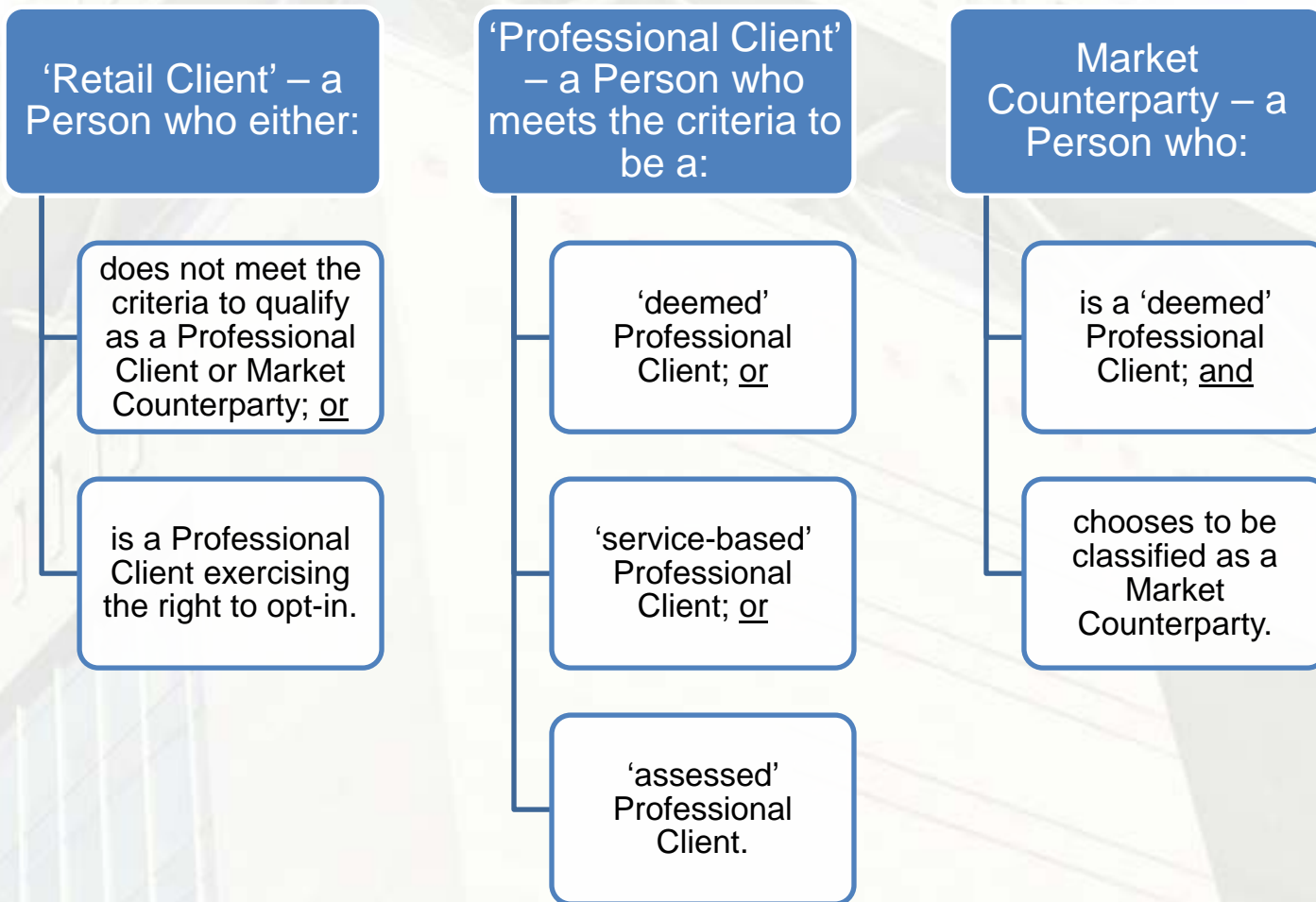


Recognition of the practice of providing 'group-based' financial services



More look-through arrangements to recognise professional status of a Client

More details about the three main types of Clients



Retail Clients

No
significant
change

A firm must
classify a Person
as a Retail Client
if that Person
cannot be
classified as a
Professional
Client or Market
Counterparty


A firm cannot classify a
Person as a
Professional Client or
Market Counterparty if:

the Person does not
meet the relevant
criteria; or


being a Person who
meets the relevant
criteria - exercises
the right to opt-in as
a Retail Client.

‘Deemed’ Professional Clients

The current list of institutional and wholesale Clients – with enhancements



Current list of COB 2.3.2(2) Clients to be called ‘deemed’ Professional Clients




Two new categories added – Large Undertakings and Single Family Office (SFO) Licensees



No need for an assessment of the net assets or expertise of a ‘deemed’ Professional Client

‘Service-based’ Professional Clients

Two new types of Professional Clients – based on the nature of the Financial Service



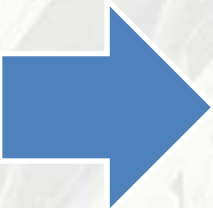
Credit provided to an Undertaking for its own, or that of a related party’s, business purposes – grandfathers existing waivers



‘Corporate structuring and financing’ related advice or arranging provided to an Undertaking – a new category reflecting risk-based approach

‘Assessed’ Professional Clients

Existing assessment approach – with enhancements



Need to undertake a detailed assessment against a two – pronged test (based on net assets and relevant expertise)



Bespoke look-through arrangements for individuals (eg joint accounts) and Undertakings (eg holding companies)



Increase of the net-assets test in one-year’s time – from current US\$ 500,000 to US\$ 1,000,000 (due to inflation etc.)

Market Counterparty

No significant change

A firm can only classify a 'deemed' Professional Client as a Market Counterparty

The firm must follow certain notification procedure before making such a classification

The notification procedures differ depending on the type of 'deemed' Professional Client

If it is a government, government agency, supranational or regulated firm – a written notification and no objection within the specified period would suffice

If not – a written notification and a written agreement of the Client are needed to classify a Client as a Market Counterparty

What are the procedures relating to client classification?

Procedures for a Professional Client to opt-in as a Retail Client (not available to a 'deemed' Professional Client)

How to assess 'net assets' – Primary residence, and any mortgages on assets excluded

How to assess knowledge and experience – Same as before

Procedures for relying on a client classification made elsewhere – This is new (more details to follow)

Procedures relating to Group-based financial services – This is new (more details to follow)

Relying on a client classification made elsewhere

Procedures provide flexibility:

- They reflect the DFSA's risk-based approach to regulation
- They are outcome based
- They are not the same procedures as for outsourcing

A Branch or a Group member can rely on a client classification made by either:

- its head office/another Branch; or
- a Group member

Some conditions must be met before reliance:

- Firm must make a gap analysis
- Firm must address any gaps identified effectively
- Firm must keep proper records (more details to follow)

Bundle of services provided by a Group

Group client concept:

- Recognises market practices – untested territory
- Greater flexibility through outcome-based procedures

What is a bundle of financial services?

- Where different parts of a bundle of financial services is provided by the Firm and other members of its Group to the same Client

What are the conditions to be met?

- The client classification must be appropriate for the services provided
- The nature of the arrangement must be clear to the Client – (i.e. who provides which service)
- Risks arising from the arrangement must be identified and effectively addressed
- Proper records must be kept (more details to follow)

Enhancements to record keeping

General record keeping requirements in GEN apply. These are enhanced under CP97 proposals to cater to client classification related changes

The firm must ensure that the DFSA has unrestricted access to firm's records to demonstrate its compliance with relevant procedures if it:

places reliance on a client classification made elsewhere; or

provides a bundle of financial service to a Client with other members of its Group

Enhancements relating to Client Agreements

Flexibility and greater alignment with the proposed changes

If a Branch is relying on a Client Agreement made by its head office/another branch, the agreement must:

- adequately and clearly cover the Financial Service provided by the Branch; and
- be available to the DFSA upon request.

If a firm is relying on a Client Agreement of a Group member for a **bundle** of financial services, the agreement must:

- state clearly those services provided by the firm;
- be enforceable against the firm for Financial Services provided by the firm (no exclusion clauses); and
- be available to the DFSA upon request.

What are the next steps?

Public consultation finishes on 15 October
2014

Rules, subject to any refinements, to be made
in December 2014

Rules to come into effect in January 2015; and

The proposed increase of the net asset
threshold from US\$500,000 to US\$ 1,000,000 to
be made in January 2016



Questions

A low-angle photograph of modern skyscrapers. The image is split horizontally into two panels by a thin gold line. The top panel shows the upper parts of the buildings against a blue sky with white clouds. The bottom panel shows the lower parts of the buildings, including a prominent glass-fronted skyscraper on the right and two other towers on the left. The text 'Thank You' is centered in the middle of the image, overlapping the gold line.

Thank You