

DFSA Annual Supervision Outreach Breakout Group #2 Conduct of Business Risks

3 May 2017

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Breakout Group 2 - Agenda

Opening Comments

- *Lawrence Paramasivam*

Client Classification Thematic Review

- *Hamda AlSarkal and Hend Al Budoor*

Suitability and General COB Issues -

- *Dean Miller*



What Are Some Of The Key Conduct Risks For 2017/18?

- Client Classification and Suitability
- Product Governance
- Safeguarding Client Assets
- Retail OTC Leveraged Products



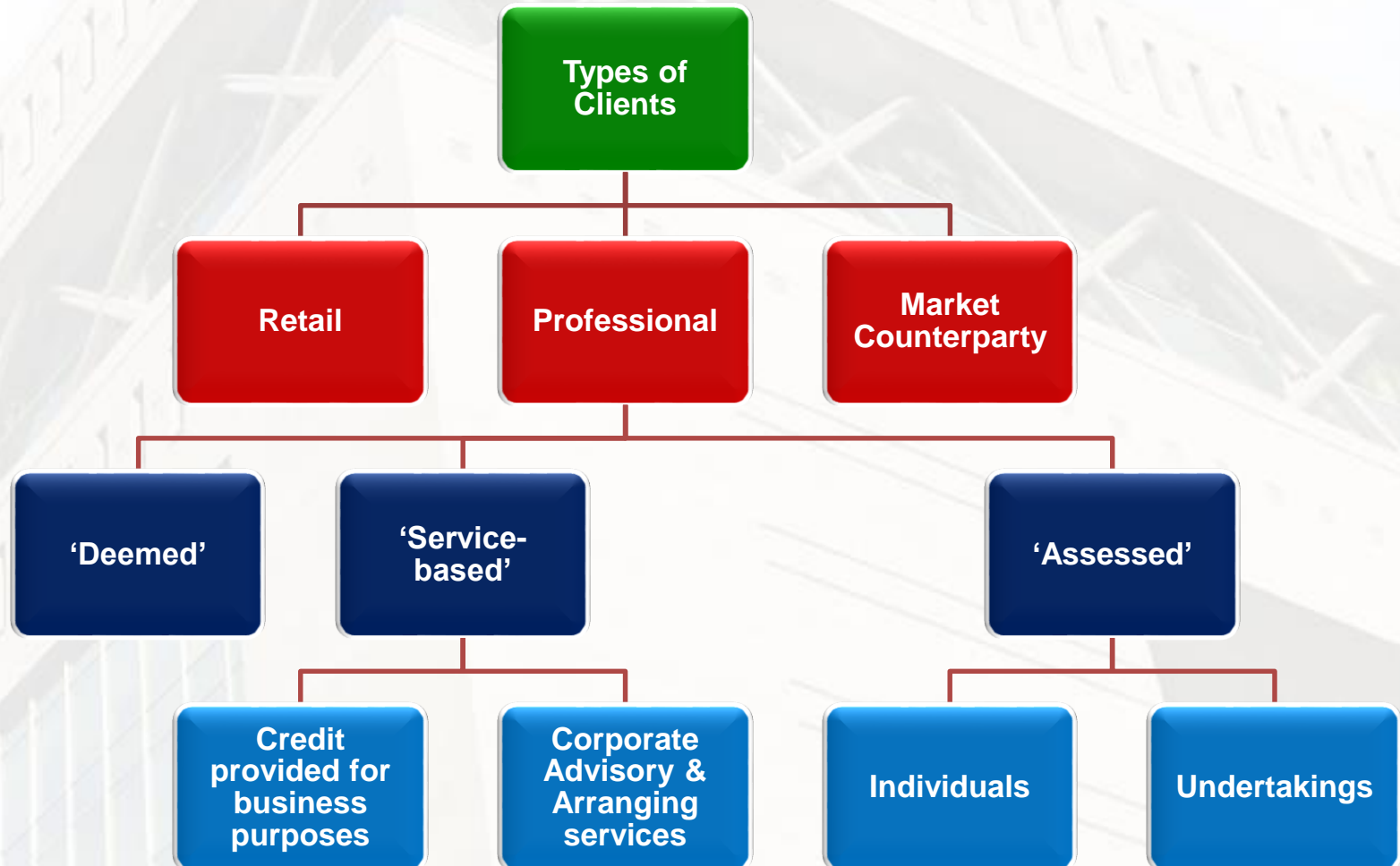
Client Classification and Suitability Thematic Review – Update

**Hamda AlSarkal and Hend Al Budoor,
Managers, Supervision**

Drivers and Objectives of the Thematic Review

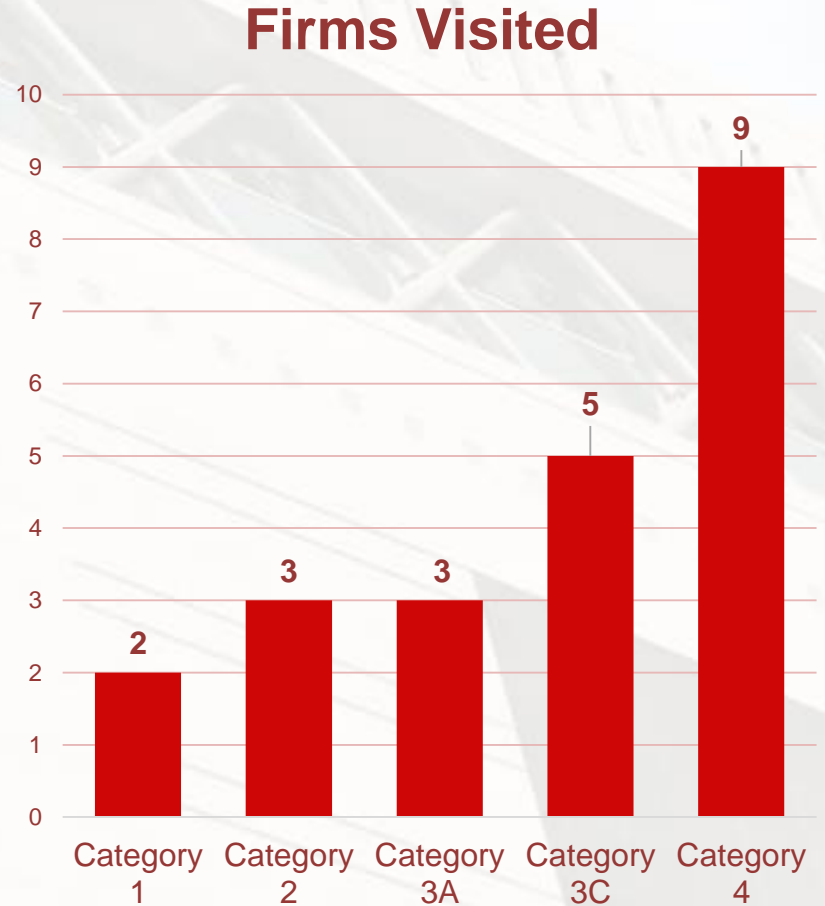
- Rule changes regarding Client Classification in 2015
- General findings of certain risk assessments since the rules came into effect
- Court findings in cases relating to Client Classification and Suitability
- International regulatory actions in relation to Client Classification and Suitability

DFSA's Client Classification Regime



Overview of Thematic Review

- Phase one
 - Online survey
 - 193 out of 217 Firms responded to the survey
- Phase two
 - Desk based review
- Phase Three
 - Onsite visits
 - 22 Firms

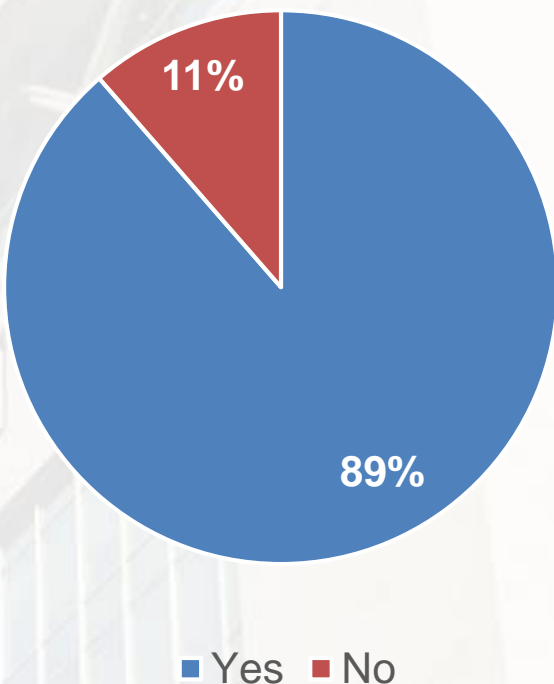


Client Classification - Guidance

- Person/s responsible for Client Classification
 - Half of the Firms visited rely on the Relationship Manager (“RM”) to classify the Client
 - However, it appears that some of these Firms do not provide adequate guidance to the RM
- Good practice
 - Verification of the Client Classification by independent person
- Room for improvement
 - Manner in which classification is conducted

Client Classification – Sub Categorisation

Survey Results Segregation of Professional Clients into the sub categories



- Trends
 - The classification of the Client is not adequately documented internally
 - As a result, inaccurate data was reported in the survey
- Importance of documenting the sub category of a Professional Client internally ('assessed', 'service-based', 'deemed')

Option to be treated as a Retail Client

- **COB 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

- **COB 2.4.1 (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

Grandfathered Clients – COB 2.6

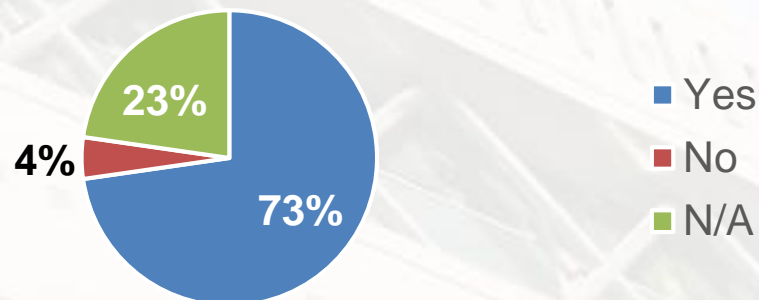
- **Grandfathered Clients should be reclassified in the following scenarios**
 - Client requests to opt-in as a Retail Client
 - Client obtains a new Financial Service from the Firm
 - Client no longer fulfils the requirements to remain classified as a Professional Client

Net Asset Assessment – COB

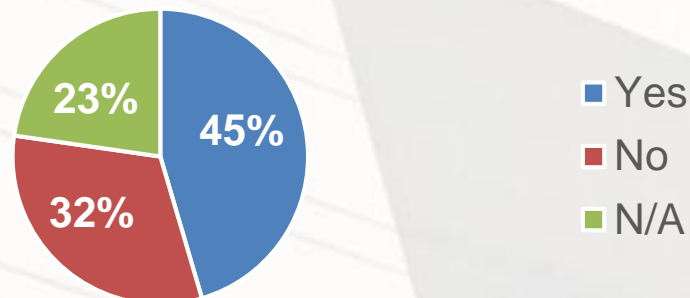
2.4.2

- Majority of Firms have obtained supporting documents regarding their Clients' net assets
- Some Firms do not adequately evidence the assessment of the Client's net assets

Onsite Visit
Supporting documents regarding
Clients' net assets



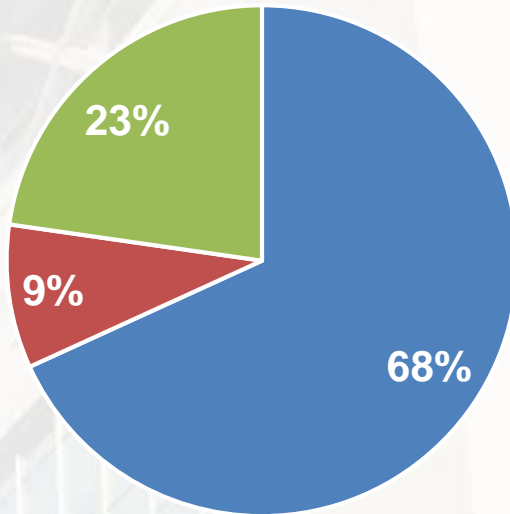
Onsite Visit
Assessments of Client's net assets
adequately evidenced



Knowledge & Experience Assessment – COB 2.4.3

Onsite Visit

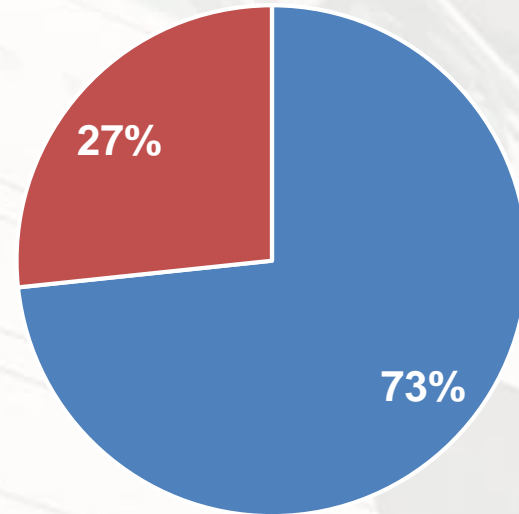
Is an assessment conducted regarding the Client's knowledge and experience?



■ Yes ■ No ■ N/A

Onsite Visit

Does the Firm adequately record the knowledge and experience assessment?



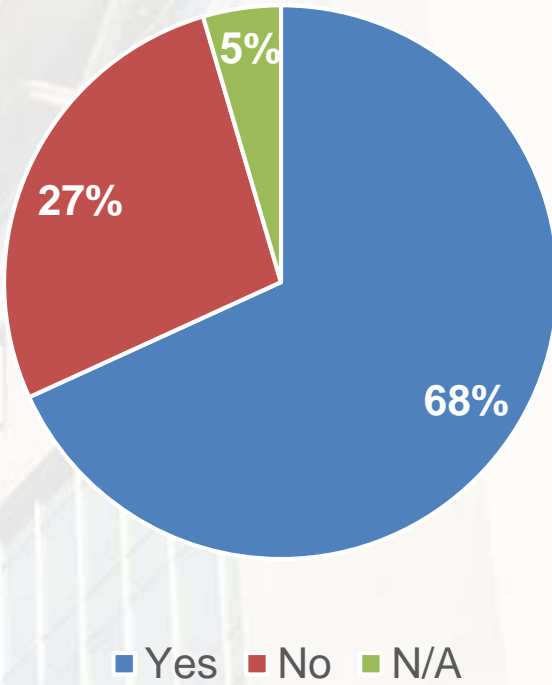
■ Yes ■ No

Knowledge & Experience Assessment – COB 2.4.3

- **Good practices**
 - An analysis of the Client's knowledge and experience across different product types and services is performed and documented
 - Reliance on statements regarding investment portfolio to support the assessment of the knowledge and experience
- **Weak Practices**
 - Insufficient records on file to show the Client's assessment properly conducted and appropriate supporting information obtained
 - Using mainly 'tick box' approach without further analysis

Suitability

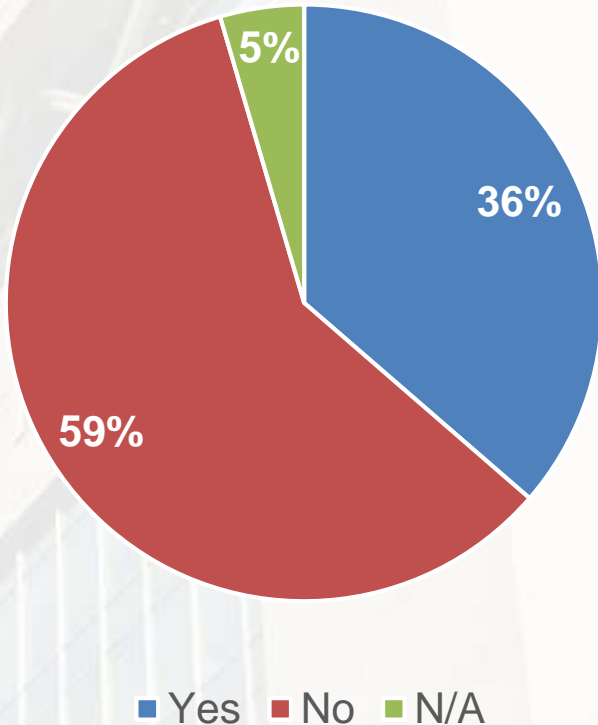
Onsite Visit
Suitability assessment
conducted and documented



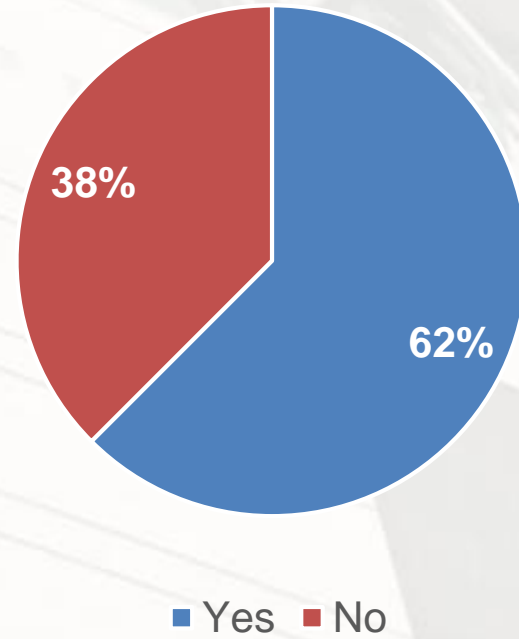
- In accordance with GEN 4.2.8 and the 2015 Dear SEO letter, Firms must, when making a recommendation or discretionary investment decision for a Client, ensure that the advice is given with reasonable care and skill and that it is suitable based on the Firm's Suitability assessment of the Client
- Majority of Firms visited conduct a Suitability assessment. However, the DFSA is concerned about the number of Firms who do not
- A good practice observed is certain Firms utilising Suitability assessment tools

Limitation of Suitability

Onsite Visit
Does the Firm limit Suitability?



Onsite Visit
Is a written warning regarding
the limitation of Suitability
provided to the Client?



Suitability and General Issues and Trends – Update

Dean Miller
Senior Manager, Supervision

Suitability Reminders

- Client Classification vs. Suitability
- Suitability Triggers and Suitability Documentation
- Limitations on Extent of Suitability Assessment - 20 April 2016 Dear SEO Letter
 - GEN 4.2.8 – Principle 8 of the Principles for Authorised Firms
 - An Authorised Firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for customers who are entitled to rely upon its judgment
 - COB 3.4.2 – Suitability Assessment
 - Ability to limit the extent of suitability assessment does not obviate the over-arching applicability of the principle



Supervisory Themes

- Roles of the Governing Body and Senior Management
 - Setting strategy and managing performance
 - Acting within scope of licence (RBP)
 - Monitoring and managing outsourced arrangements
- Reliance on Group for CDD and Client Classification
 - They may do, you must know
- Arranging vs. Providing Custody
 - CP 106 and recent rulebook changes
- Client Money and Client Investments (COB App 5&6)
- Product Governance



OTC Leveraged Products (Retail)

- Update on DFSA expectations forthcoming
 - Will supersede March 2015 SEO Letter
- Expand beyond FX to cover wider range of OTC derivatives including CFDs and binary options
- Will address:
 - Leverage limits
 - Product governance expectations
 - Appropriateness considerations
 - Disclosure



QUESTIONS



Thank You