

## By Email

22 January 2014

To the Senior Executive Officers  
of the DFSA Authorised Firms

Dear SEO

### ***THEMATIC REVIEW – CORPORATE GOVERNANCE***

In 2013, the DFSA carried out a Thematic Review of Authorised Firms focusing on director's duties and general corporate governance obligations (the Review). This letter sets out the findings made by the DFSA in the Review.

#### **1. The DFSA's Corporate Governance Remit**

The DFSA administered Laws and Rules impose corporate governance requirements on Authorised Firms. Many (though not all) of these requirements are contained in Chapter 5 of the *DFSA Rulebook, General Module (GEN)*.

The corporate governance requirements imposed on Authorised Firms by the DFSA administered Laws and Rules are based on principles established by standard-setters such as the Organisation for Economic Co-operation and Development (OECD), the Basel Committee on Banking Supervision (BCSB), and the International Association of Insurance Supervisors (IAIS).

#### **2. The Conduct of the Review**

Appendix 1 of this letter contains further details concerning the:

- Objectives of the Review;
- Scope of the Review;
- Questionnaire issued to all Authorised Firms in the DIFC on 18 February 2013 (the Questionnaire) which commenced the Review;
- Review Methodology;
- Two Stages of the Review; and
- Eleven Authorised Firms (the Firms) who participated in the second stage of the Review.

### 3. Findings

The following general observations are made by the DFSA:

- Documentation in relation to corporate governance policies, processes and procedures and systems and controls were generally adequate but, in a number of Firms, the actual practices did not match the documentation;
- Systems and controls established by a number of Firms remained untested because of the nature and volume of business conducted by the Firm;
- Some Firms made the decision not to implement systems and controls specified by GEN Chapter 5 without requesting a waiver of the requirement from the DFSA. The decision in each case was made because of the nature and volume of the business conducted by the Firm;
- Firms generally did not carry out structured, periodic reviews of their Governing Bodies and their effectiveness;
- The Governing Body of the Firms generally did not carry out structured, periodic reviews of their committees and their effectiveness;
- Firms generally did not carry out structured and periodic reviews of their systems and controls;
- Outsourced Compliance Officers reported greater difficulties than in-house Compliance Officers in being fully informed of all of their respective Firms' compliance issues;
- Some Firms did not have an internal audit function, despite this being a mandatory requirement, and did not disclose or discuss this issue with the DFSA;
- Managing the quantity and quality of information presented to the Firms' Governing Bodies is a challenge, even for Firms with high quality corporate governance structures; and
- Firms generally did not have a documented process for the escalation of matters to the Governing Body.

### 4. Recommendations

The DFSA makes the following general recommendations arising from the Review:

#### Corporate Governance – GEN Rule 5.3.30

- Firms have the right and obligation to structure their corporate governance framework in a way which is appropriate to the nature, scale and complexity of their business. However, the documentation in relation to the framework should match the Firm's practice.
- Firms should consider their structures and determine whether or not the structure puts too much decision-making power in the hands of an individual, or a small collection of individuals.

- A regular, formalised periodic review of the Governing Body and its effectiveness should be conducted by the Governing Body. The regularity of the review will be a decision for the respective Firms.
- Similarly, a regular, formalised periodic review of its committees and their effectiveness should be conducted by the Governing Body. The regularity of the review will be a decision for the respective Firms.
- A formal and documented process for the escalation of issues to the Governing Body should also be in place for each Firm.

#### Allocation of Significant Responsibilities – GEN Rule 5.2

- Organisation charts should be up-to-date and show clear reporting lines.
- Decision-making guidelines and/or authority matrices should be detailed as to the decisions which may be required, who can initiate the process to make the decision, who should be consulted and at what level the decision should be made.
- The approving body and the approval date of documents, such as Board Charters or the Terms of Reference of committees, should be clearly specified.

#### Systems and Controls – GEN Rule 5.3.1

- Firms should implement systems and controls which align with the requirements of the business activity conducted. If the business model has been changed or modified due to economic or other circumstances, then the systems and controls should be changed or modified accordingly.
- It is understandable that Firms will make changes to cope with harsh economic conditions. However, Firms should consider whether the savings gained by the omission of a control is worth the risk to which the Firm may become exposed because of its omission.
- Firms should have a regular, periodic process in place for their Governing Bodies to review the systems and controls, rather than any such review being conducted in an *ad hoc* manner.

#### Organisation – GEN Rule 5.3.2 to 5.3.3

- A Firm's Code of Conduct or equivalent document should apply to all persons in the Firm.
- Firms should consider adopting a sign-off process in which each person in the Firm declares that they have received and read documents such as Codes of Conduct, HR Manuals or job descriptions.
- In relation to the segregation of duties, Firms should be aware that there may be additional risks arising from seemingly minor decisions in regard to the segregation of duties.
- Documents setting out roles and responsibilities should be written in concise, plain, and easy to understand language.

#### Risk Management – GEN Rules 5.3.4 to 5.3.6

- A Firm's risk management systems and controls should be reviewed regularly to ensure that the systems and controls are operating as effectively as possible in practice.
- Firms should ensure that their documented risk management systems and controls accord with the way that the systems and controls operate in practice.
- Firms should review their risk management practices on a continuous cycle so that they can modify their systems and controls to meet the changing risks to which the Firm is exposed.
- Firms should consider having a risk management tool, such as a Risk Matrix or Risk Register, to enable them to manage risks in a formal way.
- Firms should have a regular, periodic process in place for their Governing Bodies to review the Firm's risks, and the risk management systems and controls. A report on, and discussion of, risks and risk management is a standing agenda item of the meetings of the Governing Bodies of many of the Firms reviewed.

#### Compliance – GEN Rules 5.3.7 to 5.3.12

- The Compliance function should receive, and be seen to receive, the full support of the Governing Body and senior management.
- The Compliance function should report regularly to the Governing Body and senior management on compliance issues.
- Where appropriate, a Firm should consider providing resources to support an outsourced Compliance Officer.

#### Internal Audit – GEN Rules 5.3.13 to 5.3.15

- The DFSA administered Rules require that Firms have an internal audit function. Therefore Firms should either establish and maintain such a function, or request a waiver of the requirement from the DFSA.
- There should be regular reviews by the internal audit function. The frequency of reviews will be determined by the Firm based on the nature, scale and complexity of its business.
- The findings of the internal audit function should be reported to the Governing Body or a relevant committee.

#### Business Plan and Strategy – GEN Rules 5.3.16

- Regular reviews of the business plan and strategy should be conducted by both senior management and the Governing Body.
- The business plan and strategy should be a living document which can easily be changed or adapted to suit circumstances.

Management Information – GEN Rules 5.3.17

- The discipline of preparing agendas and packs for meetings is recommended for all Firms, as this ensures that all members of the Governing Body/committee possess the same information.
- The amount and quality of the information provided to the Governing Body is something which each Firm's Governing Body and committees must consider and determine for themselves, and regularly review at meetings.
- Packs should be distributed in good time so that they can be read and digested by the members of the Governing Body/committee.

Staff and Agents – GEN Rules 5.3.18 and 5.3.19

- A system of having employees annually declare conflicts of interest, and compliance with regulations and policies and procedures, is a good discipline for Firms as it forces Employees to turn their minds to these issues at least once a year.

Outsourcing – GEN Rules 5.3.21 and 5.3.22

- Firms should ensure that outsourced service providers are adequately supervised, and that regular reviews are conducted of the performance of outsourced service providers.

Records – GEN Rules 5.3.24 to 5.3.27

- Firms can provide more practical guidance as to the requirements in their record-keeping policies, such as when a record of a communication must be kept.

**5. Report on Corporate Governance in the DIFC**

The DFSA will publish a report on the overall findings of the Questionnaire and Review in Q1 of 2014.

The DFSA would like to express its gratitude again to all Firms who participated in the Questionnaire and the Review. The published findings will assist the DFSA to fulfill its regulatory mandate, and Firms to better understand and comply with the obligations that apply to them.

Yours sincerely,



**Bryan Stirewalt**  
Managing Director  
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## APPENDIX 1

### 1. The Objectives of the Review

The objectives of the Review were to assess the corporate governance frameworks of DFSA Authorised Firms to:

- Determine if they are adequate and functional having regard to the nature, scale and complexity of the business and its structure;
- Determine if they are known and understood by the Firms' Authorised Individuals and relevant staff;
- Identify any deficiencies or gaps in the corporate governance regimes of Authorised Firms;
- Make recommendations to enhance the adequacy and effectiveness of corporate governance regimes of Authorised Firms;
- Identify the remuneration practices deployed by the Authorised Firms;
- Assess the remuneration structures and strategies within Authorised Firms,
- Determine how the remuneration and incentive practices in the DIFC affect fair dealings with customers; and,
- Test the level of compliance with the relevant requirements set out in the GEN module of the DFSA rulebook.

### 2. Scope

The Review focused on the following requirements in Chapter 5 of GEN:

- Corporate Governance – GEN Rule 5.3.30;
- Allocation of significant responsibilities – GEN Rule 5.2;
- Systems and controls – GEN Rule 5.3.1;
- Organisation – GEN Rule 5.3.2 to 5.3.3;
- Risk management – GEN Rules 5.3.4 to 5.3.6;
- Compliance – GEN Rules 5.3.7 to 5.3.12;
- Internal audit – GEN Rules 5.3.13 to 5.3.15;
- Business plan and strategy – GEN Rule 5.3.16;
- Management information – GEN Rule 5.3.17;
- Staff and agents – GEN Rules 5.3.18 to 5.3.19;
- Outsourcing – GEN Rules 5.3.21 to 5.3.22; and
- Records – GEN Rule 5.3.24 to 5.3.27.

### 3. The Questionnaire

On 18 February 2013, the DFSA:

- Sent out the Questionnaire to all Authorised Firms in the DIFC; and

- Confirmed that a sample of Authorised Firms would be chosen to participate in onsite firm visits for the Review.

Completion of the Questionnaire was not mandatory. However, the DFSA received responses to the Questionnaire from 221 Authorised Firms, which represents a participation rate of 81%.

After reviewing the data, the DFSA selected a sample of Authorised Firms to participate in the firm visits.

#### **4. Methodology**

The methodology adopted by the DFSA to assess the Firms selected for firm visits was as follows:

- Prior to the onsite visit, the DFSA requested each Firm to produce its documented corporate governance processes and procedures, and systems and controls. The DFSA conducted a comprehensive review of these documents prior to attending the onsite visits; and
- At the onsite visit, the DFSA interviewed selected members of each Firm's Governing Body, senior management and staff. The purpose of the interviews was for the DFSA to assess:
  - How each Firm's governance framework operates in practice; and
  - How well each Firm's directors, senior management and staff understand the governance framework.

#### **5. The Stages of the Review**

The Review was carried out in 2 stages:

- The first stage focused on the objectives referred to in paragraph 1 that relate to remuneration. The findings of this stage of the Review are set out in a document published by the DFSA titled "DFSA's Remuneration Thematic Review – Key Findings 2013", which is available on the DFSA's website; and
- The second stage focused on the other objectives referred to in paragraph 1 which do not deal specifically with remuneration. The findings of this stage of the Review are set out in this letter.

#### **6. The Second Stage of the Review**

The details of the Firms selected to participate in the second stage of the Review are:

- 8 Firms were companies;
- 4 Firms were branches; and
- Firms were chosen from each of the DFSA's 4 Prudential categories, and to represent a range of Financial Services provided.

The Firms co-operated fully with the DFSA, and the DFSA would like to thank all Firms for their participation, and for the spirit in which they participated.