

The enhanced PIB module of the DFSA Rulebook

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But then, that was before 9 December, 2012 when the new PIB module of DFSA set the DIFC financial services world alight.

Whilst the changes are not surprising, they are significant and are likely to have a significant impact on firms who now find themselves in category 3A because one of the financial services for which they are licensed is “dealing in investments as agent”. It now becomes more important than ever to look at the scope of these activities and for a firm to ask itself whether it really is dealing in investments as agent. Category 3A covers Dealing in Investments as Principal (only as Matched Principal) and Dealing as Agent. Category 3B covers Providing Custody (for a Fund) and acting as Trustee for a Fund. Category 3C covers Managing a Collective Investment Fund, Managing Assets, Providing Trust Services as a trustee of an express trust, managing a Profit Sharing Investment Account and providing Custody (other than for a Fund).

The fact of the matter is that firms which are in category 3A have much higher capital requirements to firms which are in category 3B or 3C.

In this article we will look at the scope of the financial service of “Dealing in Investments as Agent”. The reason for this is that there seems to be a widely held belief that where, for example, a fund manager places an order with a broker for and on behalf of a number of funds, this falls into the financial service of “Dealing in Investments as Agent”. In our view this activity more closely fits with the financial service of “Arranging Deals in Investments” than Dealing in Investments as Agent”. This is a potentially significant difference because it means that firms which are currently in category 3A could be in category 3B, 3C or 4 where the capital requirements are easier to meet.

Rule 2.8.1 in GEN defines “Dealing in Investments as Agent” as “buying, selling, subscribing for or underwriting any investment as agent”. The important point to note here is that the definition talks about the actual act of buying, selling subscribing or underwriting rather than arranging for someone else to buy, sell, subscribe or underwrite. The exemption set out in rule 2.8.3 clarifies the scope of the definition by providing that a “Person does not Deal in Investments as Agent if that Person is merely receiving and transmitting a Client order in respect of an Investment.”

On a pure technical analysis of the scope of Rule 2.8.3, it could be argued that an Authorized Firm which has entered into an investment management agreement with a client which gives the firm discretion as to when and what to trade will never be receiving and transmitting a client order. Whilst this maybe accurate, this does not mean that because the activity of the firm does not neatly fit within the exception set out in Rule 2.8.3, the activity must of necessity therefore fall within Rule 2.8.1. In our view, Rule 2.9.1 is a much closer fit to the process of a firm placing an order with a broker pursuant to an investment management agreement. Rule 2.9.1(1) covers the financial service of “Arranging Credit or Deals in Investments” and provides that it means “making an arrangement with a view to another Person, whether as Principal or Agent, buying, selling subscribing for or underwriting an Investment.” It should be noted that there is no reference in this section to the transmission of an order, so Authorized Firms which are

operating pursuant to an investment management agreement which gives discretion as to what and when to trade are not excluded from this section.

While there is no change in the Base Capital Requirements for firms in 3A, 3B or 3C, the Risk Capital Requirements (RCR) will apply to 3A firms, but will not apply to firms in category 3B or 3C. Under the changes, the RCR is set at 10% of the Risk Weighted Assets (RWA) and then scaled up by 125%. In addition, category 3A firms are now subject to a Capital Conservation Buffer which has been set at 25% of the Risk Capital Requirement. In all, category 3A firms (and category 1,2 and 5 firms) will have an overall capital requirement of 12.5%. Category 3B, 3C and 4 firms will not be subject to these requirements but instead, will be subject to an obligation to take out Professional Indemnity Insurance which needs to be consistent with the risk profile and type of business carried out by the firm. A copy of the PII cover will need to be lodged with DFSA annually.

If you are a category 3A firm, under these new arrangements you may need to raise additional capital, alternatively, you may decide to consider whether the firm is or will ever be dealing in investments as Agent. If a firm is currently authorized to deal in investments as agent, but has not, and will not be dealing as agent, then an application to vary the current licence will need to be made to DFSA. The quarterly returns to be lodged by Authorized Firms are due at the end of April, so it is too late to get the benefit of a change in licence for the previous quarter, however, this should not discourage firms from lodging an application prior to the end of the next quarter.