DIFC Regulatory Updates

by Margaret Elder - m.elder@tamimi.com - Dubai International Financial Centre

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This article is a summary of some key regulatory developments that have been implemented in the Dubai International Financial Centre (“DIFC”) in recent months.

There have been several amendments to the DIFC Laws and the Dubai Financial Services Authority (“**DFSA**”) Rules. This article considers some recent changes that should be of interest to clients who are either already present in the DIFC or who are looking to establish a presence in the DIFC.

Retail foreign exchange transactions

In March 2014 the DFSA issued a letter to DIFC Senior Executive Officers advising that the DFSA is now allowing DFSA Authorised Firms and applicants to offer foreign exchange trading to retail customers in or from the DIFC subject to certain legal limitations, systems and control requirements. One key limitation is contained in one of the UAE Federal Laws prohibiting banking activity from being undertaken in the UAE Dirham in the DIFC.

Firms applying to undertake retail foreign exchange must obtain a retail client endorsement and also a waiver from the restriction under the DFSA Rules of carrying out the Financial Service of Providing Money Services in or form the DIFC. Once they are operating, retail foreign exchange firms will also be subject to additional DFSA compliance and control requirements.

Compliance with the United States Foreign Account Tax Compliance Act

On 1 May 2014 the DFSA issued a letter to DIFC Senior Executive Officers which announced that the UAE Government, spearheaded by the UAE Central Bank and the UAE Ministry of Finance, initiated a program to collaborate with the United States on Foreign Account Tax Compliance Act (“**FATCA**”) compliance. The DFSA is participating in this unified effort. An Inter-Governmental Agreement (“**IGA**”) was announced as agreed in principle in May between the UAE Ministry of Finance and the US Treasury with the final agreement to be settled before the end of the year. The DFSA’s expectation was clear that the compliance onus will remain with financial institutions caught by FATCA. All DFSA regulated entities should have assessed their obligations under FATCA regulations and commenced making the steps they deem necessary to ensure compliance in light of the IGA.

A new type of DIFC fund – Qualified Investor Exempt Funds

With effect from 21 August 2014 the DFSA has introduced a new category of fund that can be incorporated in the DIFC called a Qualified Investor Exempt Fund (“**QIF**”). This means there are now three categories of funds that can be established in the DIFC, namely Public Funds, Exempt Funds and QIFs.

In summary, Public Funds are subject to the most detailed regulation as they cater to the retail investor and some or all of its units can be offered by way of public offer. Exempt Funds have less stringent regulation than Public Funds, however units in an Exempt Fund can only be made available to 100 persons at a minimum subscription amount of USD50,000. Also units of an Exempt Fund can only be offered by way of private placement to persons who meet the criteria of a

Professional Client as defined in the DFSA's Conduct of Business Module Rulebook. This is the same for QIFs, except QIFs can only be made available to 50 investors with a minimum subscription amount of USD500,000. Also QIFs are subject to less regulation than Exempt Funds.

Unlike Public Funds and Exempt Funds, QIFs are not subject to many of the compliance requirements under the DFSA Rules due to the perceived lower risk of these types of funds because of the higher minimum subscription amount and sophistication of the investors. Compared to Public and Exempt Funds, QIFs have been given more flexibility in the use of a custodian, have no mandatory content requirements for their constitution, have less DFSA reporting obligations and have shorter notification and incorporation time frames.

The DFSA has looked at the fund regimes in place in other jurisdictions, to see where the DFSA funds regime sits in comparison to those jurisdictions and with the introduction of the QIF the DFSA is providing more options for applicants looking to establish a fund in the centre. This new category of fund is suitable where a low number of sophisticated investors who are willing to invest large amounts are targeted. We also note that existing Exempt Funds which now fall into the definition of a QIF can apply to the DFSA for a change of status.

Proposed changes to the DFSA Professional Client regime

On 15 September 2014 the DFSA released consultation paper 97 regarding changes to the DFSA's client classification regime. Several key changes are proposed which includes enhancements to the existing 'Professional Client' category. It is also proposed to allow DFSA Authorised Firms the flexibility to rely on client classification undertaken by their group subject to certain requirements and Client Agreements entered into by a member of its group in certain circumstances.

One of the key proposed changes is to split the category of Professional Client into three sub-categories. The three sub-categories proposed are briefly summarized as follows:

1. "Deemed" Professional Clients:

Deemed Professional Clients will include the current list of clients contained in the DFSA's Rulebook Conduct of Business Module Rule 2.3.2(2) and will be expanded to include Large Undertakings and the holder of a license under the DIFC's Single Family Offices Regulations.

Firms will have the option to classify deemed Professional Clients as Market Counterparties if they have complied with the required notice procedures. It is proposed that firms will no longer have to undertake an assessment on the net assets of a deemed Professional Client. Additionally deemed Professional Clients will no longer have the option to opt-in as a Retail Client under the DFSA Rules.

1. "Service-based" Professional Clients:

It is proposed that a firm will not have to undertake a detailed assessment on the client's net assets and expertise where certain types of Financial Services are provided to that client. The service-based Professional Client category will be limited to where the firm is providing credit to a client for a business purpose or is providing advising and arranging services to a client for corporate structuring and financing purposes. However the service-based Professional Client category will not be available to clients who are individuals.

1. "Assessed" Professional Clients:

Assessed Professional Clients are essentially the existing Professional Client category where clients are granted the status of Professional Client after meeting the net asset, knowledge and experience test. However it is proposed to increase the net asset threshold from USD500,000 to

USD1,000,000. Another proposed change is to introduce the assessment of individuals on a look-through basis allowing the professional status of one client to be attributed to another person in particular circumstances.

This consultation paper was open for public comment until 15 . After the DFSA has considered any comments received they shall then proceed to make the relevant changes to the DFSA’s Rulebooks. It is anticipated that the changes will expand the circumstances where Authorised Firms do not have to undertake detailed client classification and provide more flexibility for client on-boarding arrangements where the Authorised Firm is a part of a group.