DFSA’s Decision on MAS Clearsight: A Review

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One of the important things about DFSA disciplinary decisions is that they provide an insight into the DFSA’s view of how particular rules work and what they mean.

They are therefore important in assisting firms to review their internal policies and procedures from the DFSA’s point of view.

The purpose of this article is to take a look at the MAS Clearsight (MASC) Decision Notice and the important points which arise out of that decision. It is important to note that whilst DFSA Decision Notices provide guidance on DFSA’s view of certain regulations, more often than not it is an uncontested view. That is, most disciplinary matters are settlements between the Authorised Firm and the DFSA, and accordingly the decision does not reflect a robust questioning of DFSA’s position on particular rules.

The reason that this Decision Notice is worth reviewing is that the DFSA came to the view that:

- The investments which MASC was offering to investors amounted to a foreign fund under the Collective Investment Law 2010; and
- MASC was Advising and Arranging in relation to these Investments and accordingly was required to treat the Investors as clients and “on-board” them in accordance with the Conduct of Business module of DFSA.

DFSA came to this view, even though MASC was of the view that:

- It was not marketing a foreign fund; and
- The investors were investors, and not clients of MASC.

It will be important for firms to consider these findings particularly where they are providing services akin to a placement agent and finding investors for and on behalf of an issuer.

A Foreign Fund

In its response to the DFSA, MASC argued that the investment opportunity which it was providing to investors did not meet the requirements to be classified as a foreign fund. In its argument for why the investment opportunity should not be considered as a foreign fund MASC argued that amongst other things, it was not registered in a foreign jurisdiction as a fund; it did not have an investment manager, and there was no private placement memorandum.

The DFSA was of the view that the arrangement was a “foreign fund” under Article 11(1) of the Collective Investment Law. In coming to this view, the DFSA appears to have emphasised certain parts of the definition of ‘‘Collective Investment Fund’’ set out in the Collective Investment Law and in particular:

- Article 11(1) (a) which provides that the purpose or effect of the arrangements is to enable persons who participate in the arrangements to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits;
- The arrangements are such that persons who participate do not have day to day control over the

management of the property (Article 11(1) (b)); and
- The arrangements have either or both of the following characteristics: contributions of the investors are pooled, and/or the property is managed as a whole by or on behalf of the Fund Manager (Article 11(1)(c)).

Notwithstanding that MASC had not intended to create a fund, the DFSA found as a matter of fact that sufficient of the matters set out above existed for it to conclude that the arrangements constituted a Foreign Fund. In particular the words “purpose or effect” would allow the DFSA to conclude that an arrangement is a fund, whatever the intention of the parties to the arrangements. As result of the DFSA’s finding, certain other requirements followed, which had not been fulfilled by MASC.

The important part of the reasoning of the DFSA which is relevant to Authorised Firms, is that the DFSA looks at the structure and the purpose behind the arrangement (“purpose or effect”) when forming a view about whether the arrangement constitutes a fund (foreign or domestic). It will not be sufficient for an Authorised Firm to make the statement that the arrangement is not a fund, as this will not prevent DFSA from looking at the true structure ofthe arrangement and on that basis, forming a view about whether the arrangement constitutes a fund.

Investors v Clients

When looking at the reasoning of DFSA on this point it is important to look at the scope of the mandates which MASC signed up with the issuer. The scope of the mandates included identifying, short listing, introducing or referring investors” and:

- Conducting closing discussions and negotiations with investors and finalising the term sheet;
- Negotiating the best suitable terms on behalf of the issuer and the investors;
- Remaining the contact point between the issuer and the investors;
- Assisting the issuer in discussions and negotiations with investors;
- Assisting the issuer in closing discussions and finalising the term sheets with investors.

In its findings, the DFSA concluded that the investors should have been treated as clients of MASC because of the nature of the activities which MASC provided to investors. In this regard the DFSA concluded that the relevant conduct of MASC which resulted in investors being treated as clients, included:

- Making statements to investors to influence them to make investments in the books;
- Facilitating investments in the books by, amongst other things, providing term sheets to investors, obtaining signatures of investors, sending the signed terms sheets to the issuer and overseeing the payment of the funds into the SPV accounts.

Additionally, the term sheets provided by MASC included a statement that MASC was advising on the investment opportunity.

The above being the case, the DFSA concluded that the investors needed to be treated by MASC as clients and therefore the subject of the relevant provisions in COB (the Conduct of Business module).

It is clear that the scope of providing services according to a mandate entered into with an issuer, and the extent that providing additional services to an investor results in an investor becoming a client and therefore the subject of the provisions in COB, is going to be problematic for many Authorised Firms which provide these kind of services.

Authorised Firms which routinely act for issuers will now need to consider how they can manage the risk that somewhere in the continuum of providing services to the issuer, they unwittingly stray

into a relationship with an investor which results in the investor becoming a client, with all of the additional obligations which an Authorised Firm owes to a client.