

Retail Endorsement at the DIFC

Stuart Walker, Partner, Afridi & Angell, Dubai, United Arab Emirates
email: swalker@afриди-angell.com

Intro: Since the establishment of the Dubai International Financial Centre (DIFC) in late 2004, banks and other financial-service providers established or registered within the DIFC have been restricted to operating only in the wholesale market. From July 1, 2008 it has, however, been possible to provide financial services to retail customers in or from the DIFC.

Initially, the DIFC was described as a wholesale financial-services environment. Authorised firms were prohibited from dealing with retail customers. These were defined (broadly) as natural persons who had less than US\$ one million in liquid assets, and who were not knowledgeable in financial markets.

There are now two types of Client, namely Retail and Professional. Retail Clients are all clients that have not been properly classified as Professional Clients.

One reason for the change was that the original Dubai Financial Services Authority (DFSA) regime was already at or close to the strength of those in retail markets elsewhere. Authorised firms in the DIFC therefore bore many of the costs of retail-strength regulation, without the ability to address the full range of potential customers.

The growing maturity of the DIFC, as well as increased convergence across markets, prompted the DFSA to conduct a review and consultation process of, amongst other things, the retail restriction. The consultation process has resulted in significant amendments to the DFSA Rulebook. The amended rules came into effect on July 1, 2008.

Much of the business done in the DIFC is in areas which, in Europe, are covered by the Markets in Financial Instruments Directive (MiFID). The DFSA appears to have examined its own regime in the light of MiFID, with the aim of making it easier for firms who are subject to MiFID to enter the DIFC without major changes to their compliance regimes. The DFSA also appears to have looked at other European legislation, such as the Insurance Mediation Directive (IMD).

The DFSA has now brought its conduct of business regime closer to the MiFID regime: where a firm meets the requirements of MiFID, it should be able to carry its compliance arrangements into the DIFC with relatively few changes.

The key changes include:

Conduct of Business

- Client classification into Retail and Professional Clients.
- Enhanced list of entities that may be treated as Market Counterparties. (Market Counterparties are a subset of Professional Clients.)

- Enhanced suitability and Client Agreement provisions when dealing with Retail Clients.
- Marketing material directed at Retail Clients needs to reflect a fair and balanced view when presenting future forecasts or representations based on past performance.
- Enhanced training and competency requirements for firms' staff.
- Firms to have complaints-handling procedures for Retail Clients, including timeframes and manner of redress.
- Conduct of business requirements for insurance more closely aligned with those for other financial services.

Collective Investments

- Public Funds are open to all Clients, whilst Private Funds are available only to Professional Clients.
- Public Funds may now use fund administrators in Zone I or Recognised Jurisdictions, subject to due diligence requirements.
- Private Funds may use fund administrators in any jurisdiction.
- Revised requirements for outsourcing and delegation agreements, including removing the requirement for DFSA approval.
- Base capital requirement for fund custodians reduced from US\$10 million to US\$4 million.
- New regime for Supplementary Prospectuses encompasses replacement Prospectuses and 12 month-end dates for Prospectuses (where Units still on offer).
- Prohibition on single property funds removed and replaced with a disclosure regime.
- Shari'a Board conflicts prohibition replaced a disclosure regime.
- Marketing of Foreign Funds broadly aligned with new Domestic Funds regime.

Retail Endorsement

In order to deal with Retail Clients, firms must obtain a Retail Endorsement on their license. Both new applicant firms as well as existing firms can apply for the endorsement. There is no application fee.

In order to obtain a Retail Endorsement, a firm needs to:

- have adequate internal complaints-handling procedures;
- provide enhanced disclosure in all new marketing material; and
- have adequate systems, controls and procedures to be able to provide financial services to Retail Clients.

Transitional arrangements

There is a transitional relief available for firms who currently hold a license to operate in the DIFC. The objective of these arrangements is to ensure firms can continue to conduct their existing business with minimum disruption. It is important to note that there is little or no change for firms who do not wish to deal with Retail Clients.

In short, there is no Client classification required for existing Clients, as long as the firm continues to provide to such Clients the same services as before. No notice or consent is required for existing Marketing Counterparties to continue to be treated as such. No new Client Agreement is required for dealing with existing Clients. Firms can continue to distribute existing marketing material and Prospectuses for six months after implementation (ie. until 2009), mostly in the same manner as before.