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Retail therapy in the Dubai International Financial Centre

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Since the establishment of the Dubai International Financial Centre (DIFC) in late 2004, banks and other financial services 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. The purpose of this article is to (i) provide background information on the historic wholesale restrictions and (ii) provide information on the recent changes to the Dubai Financial Services Authority (DFSA) Rulebook.

The United Arab Emirates (UAE) is a federation of seven emirates (Abu Dhabi, Dubai, Sharjah, Ajman, Umm Al Quwain, Fujairah and Ras Al Khaimah). Each emirate has substantial autonomy. Various forms of economic activity are regulated at the federal level, the local emirate level, or both. Regulation of the banking sector has long been the preserve of the UAE Central Bank, a federal institution headquartered in the Emirate of Abu Dhabi. The basis for the UAE Central Bank's authority is Federal Law 10 of 1980 (the 'Banking Law'). Together with the various resolutions and circulars issued by the UAE Central Bank, the Banking Law provides the framework for the provision and regulation of banking services in the UAE outside of the DIFC. The creation of the DIFC (as a jurisdiction within a jurisdiction) required an amendment to the Constitution of the UAE, the passing of two federal laws and then the passing of two Dubai laws.

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 those natural persons who had less than US\$1m in liquid assets, and who were not knowledgeable in financial markets. Various reasons were given for the retail client restrictions. One possible reason was that the retail restriction was a protectionist measure designed to ensure that incoming financial institutions did not compete with local banks already established in the UAE. Another possible explanation was that the restriction allowed the DIFC to commence operations without having to put in place extensive consumer protection legislation. This also reflected the practice of many advanced jurisdictions in applying a lighter regulatory regime to transactions with wealthier or more sophisticated customers. By restricting the types of customers with

whom Authorised Firms could deal, the DFSA was able to adopt a lighter regime overall. This was appropriate to a regulator which was still building its capability. That stage is now substantially past, as recognised in the recent evaluations by the International Monetary Fund (IMF) and World Bank, published on the IMF's website.

The original DFSA regime was already at or close to the strength of those in retail markets elsewhere, partly reflecting the fact that products created in the DIFC may be sold to customers in other markets. 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 started with the release of Consultation Paper 52 (CP52) early in December 2007 and encompassed two further Consultation Papers (CP53 and CP54). The consultation process has resulted in significant amendments to the DFSA Rulebook. The amended rules came into effect on July 1, 2008.

One major international development of recent years has been the adoption in Europe of the Markets in Financial Instruments Directive (MiFID). Much of the business done in the DIFC is in areas which, in Europe, are covered by 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.

CATEGORIES OF CLIENTS IN THE DIFC

There are now two types of client, namely retail and professional. Retail clients are all clients that have not been classified as professional clients.

For a firm to deal with retail clients, it needs to apply for a Retail Endorsement on its License.

PROFESSIONAL CLIENTS

A professional client is a person who:

- either
 - has net assets (direct or indirect) of at least US\$500,000; or
 - is, or has been in the previous two years, employed by the firm, or employed by another Authorised Firm in a professional capacity; and
- has sufficient experience and understanding of relevant financial markets, products or transactions and any associated risks; and
- has not elected to be treated as a retail client.

Depending on the circumstances, a client may at times be treated as professional whilst at other times as retail. A firm also has the option to deal only with professional clients, but must then verify that any new client meets the criterion. Some types of client may be assumed to possess the necessary experience and understanding without conducting any analysis. Examples would be governments or other Authorised Firms.

A personal investment vehicle may be classified as a professional client if it is established to manage the investment portfolio of an

existing professional client. In this case, there is no need to meet the Professional Client net asset test.


MARKET COUNTERPARTIES

Market Counterparties are a sub-set of professional clients, who do not have to be given all the protections that would otherwise be required. Some Market Counterparties have to give their express consent for such treatment. Others have simply to be notified by the firm, with a right to object if they wish.

RETAIL CLIENTS

Only firms who have obtained a Retail Endorsement on their License can deal with retail clients. Retail clients are any clients that deal with an Authorised Firm or Authorised Market Institution, that are not classified as professional clients. When applying for an endorsement to its License, a firm needs to show that it can offer additional protections, especially in the area of internal complaints handling and dispute resolution systems.

It is important to note the following restrictions in terms



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