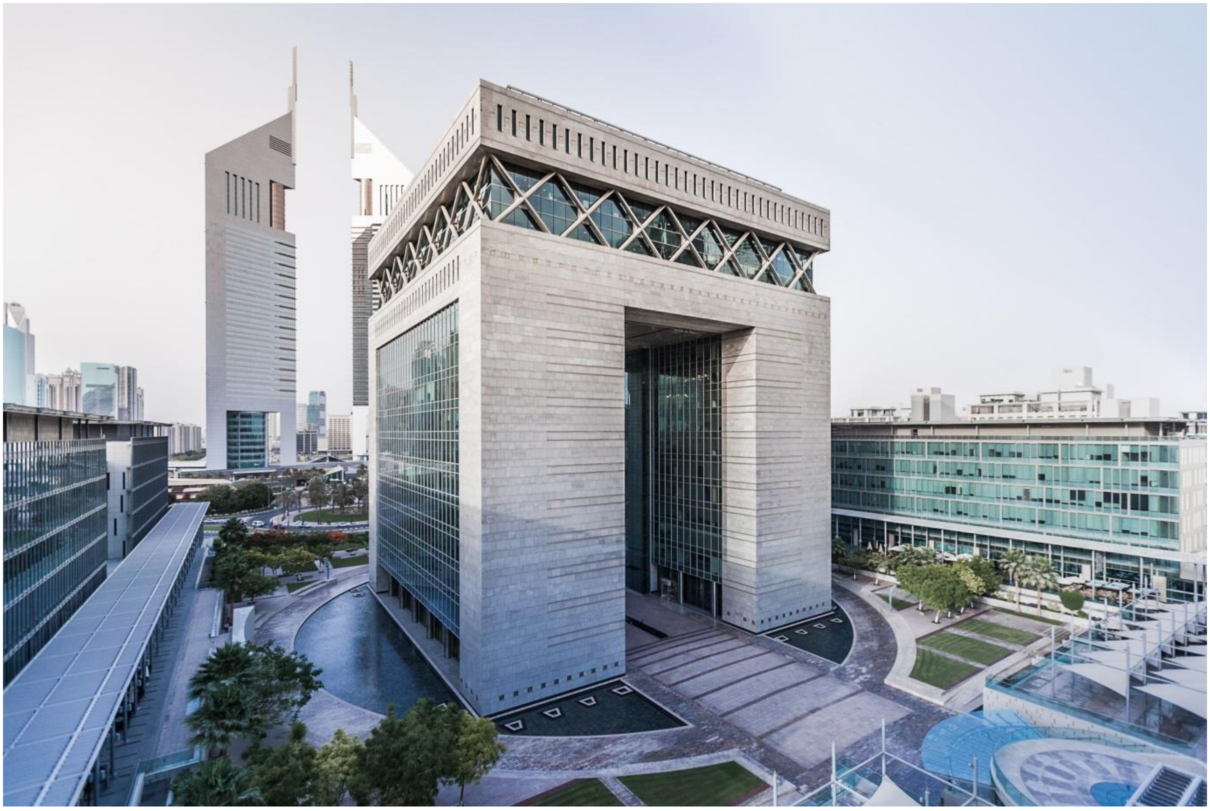
# FEEDBACK STATEMENT ON CP161 ENHANCING PROPORTIONALITY IN PRUDENTIAL REGULATION



**21 May 2025**

## I BACKGROUND

1. On 8 October 2024, the DFSA published Consultation Paper No. 161 on Enhancing Proportionality in Prudential Regulation ("CP161"). The consultation closed on 10 January 2025, drawing valuable comments from the industry. We thank those who contributed to the public consultation.

2. On 30 April 2025, the DFSA's Board considered the consultation responses and approved the making of rule changes in this area (as set out in revised AUD, COB, FER, GLO and PIB modules of the DFSA Rulebook).[1]

3. The revised rules are published on the DFSA's website on the same day as this Feedback Statement and will come into force on 1 July 2025, with certain rules coming into force after a transitional period on 1 July 2026.

4. In this Feedback Statement we explain how we took into account comments received from the public in shaping our final policy. We hope this paper will provide more clarity and understanding of our policy, as well as provide more transparency into the DFSA's policy-making process.

## II PUBLIC COMMENTS

### Removal of the Expenditure Based Capital Minimum

5. Commentators welcomed our proposal to remove the Expenditure Based Capital Minimum ("EBCM") for Authorised Firms ("AFs") that do not hold Client Assets or Insurance Monies, and are not safekeeping Fund Property on behalf of Unitholders.[2] This would include AFs who are only controlling but not holding Client Assets or Insurance Monies, and therefore will no longer be subject to the EBCM requirement from 1 July 2025.

6. Two respondents saw value in maintaining a blanket requirement around the wider application of the EBCM to all AFs in prudential category 3. As the purpose behind the EBCM is to ensure a certain level of capital is available to support the wind-down of the AF, any going-concern risks of the AF will be covered by the new Activity Based Capital Requirement ("ABCR"). Therefore, our initial proposals in this regard remain as consulted.

7. Some respondents pointed to certain differences in our application of the EBCM and the associated liquidity requirement, when compared to the Investment Firms Directive and Regulation ("IFD/IFR") in the EU.[3] The DFSA has not undertaken to transpose the IFD/IFR in its entirety but rather make alignments with, where appropriate, and adjustments to suit, the regulatory and risk profile of AFs operating in the DIFC.

### Liquid assets equal to or greater than the Base Capital Requirement

8. One commentator sought further clarification around our proposal that AFs in prudential category 3 continue to hold liquid assets even when not being subject

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1 Please, find the notice of amendments to AUD, COB, FER, GLO and PIB modules of DFSA Rulebook here, as applicable from 1 July 2025 and 1 July 2026.
2 See the amendments in Rule 3.7.1 in the PIB module here, as applicable from 1 July 2025.
3 EU Regulation 2019/2033 (here) and Directive 2019/2034 (here).

to the EBCM.[4] This proposal was in line with the existing regime for the majority of AFs in prudential category 4, who are currently required to hold liquid assets in an amount that is equal to or greater than their Base Capital Requirement ("BCR").

9. The liquidity requirement above is linked to and supports the basic authorisation requirement for AFs to have sufficient capital over and above their BCR, in the form of high-quality Common Equity Tier 1 Capital. The combination of these liquidity and capital requirements ensure that AFs are of sufficient financial standing when operating in the DIFC, equipped with loss-absorbing capital to support unexpected expenses and incidents.

### Extending the eligibility criteria for liquid assets

10. One of our proposals in CP161 around liquidity was to provide added flexibility on the types of assets that can be used to meet the liquidity requirement. We proposed to permit high-quality government bonds to be counted up to two-thirds of the liquidity requirement, provided such bonds are denominated in USD or AED.

11. Several commentators asked us to expand the scope of currencies in which eligible assets can be denominated. We listened to the feedback and have added GBP and EUR to the list of eligible currencies in our final rules (in addition to USD and AED denominated bonds).[5] We understand that AFs may benefit from added flexibility in this area as they operate in the DIFC, an international financial centre where cross-border business is often done in multiple currencies.

12. Two commentators suggested that certain types of exchange-traded funds and securitisations become eligible for the liquidity requirement. However, we have not adjusted our rules to permit these instruments as liquid assets as they display liquidity and market risk profile that is outside of our risk appetite in this regard.

### Activity based capital requirement

13. Commentators were content with our proposals to introduce the ABCR. However, some respondents sought clarification on the scope of application of the ABCR. Below is the exhaustive list of AFs in prudential category 3, for whom the ABCR will apply when they carry on one or more of the following Financial Services:[6]

    a) Dealing in Investments as Agent;

    b) Managing Assets;

    c) Managing a Restricted Profit Sharing Investment Account;

    d) Managing a Collective Investment Fund (except where the only Financial Service carried on is Managing a Venture Capital Fund);

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4 See the amendments in Rule 3.5.3(1)(b) in the PIB module here, as applicable from 1 July 2025.
5 See the amendments in Rule 3.5.3(2)(g) in the PIB module here, as applicable from 1 July 2025.
6 See the amendments in Section 3.8C of the PIB Module here, as applicable from 1 July 2026.

e) Providing Custody;

f) Providing Trust Services;

g) Acting as the Trustee of a Fund; and

h) Operating an Alternative Trading System.

14. Some respondents asked situational questions about how K-AUM (assets under management) and K-COH (client orders handled) elements of the ABCR would apply to their specific business lines and products. With regard to specific issues, AFs should reach out to their supervisory contacts during the transitional period to seek further clarifications on the application of K-AUM and K-COH to their situational case. The transitional period extends until 1 July 2026.

15. One commentator suggested that we introduce the K-DTF (daily trading flow) factor forming part of the EU's IFD/IFR regime. However, we note that K-DTF is applicable to proprietary trading AFs who are outside the scope of CP161. Therefore, we have not made any changes to our initial proposals around K-factors forming part of the ABCR.

### Overall capital requirement

16. One commentator sought confirmation as to what the overall capital requirement would be for an AF in prudential category 3 that were in scope of CP161. We confirm that the overall capital requirement is the highest of the BCR, EBCM (if applicable), and ABCR (if applicable).[7] AFs in category 3 whose prudential regime has not changed as a result CP161 will continue operating under their existing regime as usual.

17. Another respondent sought clarification as to what the BCR would be for an AF that carries on more than one Financial Service within the same prudential category. We have clarified our rules to confirm that the overall BCR is the figure associated with Financial Services on the licence of the AF that has the highest BCR allocated to it.[8]

### Dealing in Investments as Matched Principal

18. Several commentators sought further clarification on our proposal to move AFs that are Dealing in Investments as Matched Principal from prudential category 3A to category 2. They queried the rationale for re-categorisation and asked about the scope of prudential requirements that would continue to apply to these AFs after being moved into category 2.

19. The change of the prudential category for these AFs is technical in nature. The intention is to provide a clear delineation between the prudential regime applicable to AFs in categories 3 and 4, and those in categories 1, 2 (including AFs that are Dealing in Investments as Matched Principal) and 5, which are subject to the "Basel regime".

[7] See the amendments in Rule 3.5.2(c) of the PIB Module here, as applicable from 1 July 2026.
[8] See the amendments in Rule 3.6.2 of the PIB module here, as applicable from 1 July 2025.

20. After moving to prudential category 2, AFs that are Dealing in Investments as Matched Principal will continue to comply with their risk-based capital requirements (the “Basel regime”), their BCR and EBCM, with no changes to the way they have been calculating these requirements to date. To that end, we have made some changes to the rules to ensure that certain prudential requirements that apply to AFs in prudential category 2 do not apply to AFs that are Dealing in Investments as Matched Principal, such as in relation to the capital conservation buffer, leverage ratio or interest rate risk, interest rate risk in the banking book.

21. The DFSA has reviewed the proportionality in its prudential regulation framework for AFs in category 4 (CP145 in 2022) and for those in category 3 (CP161 in 2024). In the near future, the DFSA is planning to perform a similar review of its prudential regime applicable to AFs in category 2, including those that are Providing Credit and Dealing in Investments as Principal (including, as Matched Principal). In the meantime, AFs in category 2 should continue complying with their on-going requirements in due manner as usual, before the DFSA has consulted on and made any rules changes applicable to AFs in category 2.

### Imposing individual capital and liquidity requirements

22. In CP161, the DFSA proposed to remove its requirements related to the Internal Risk Assessment Processes (“IRAP”) and Internal Capital Adequacy Assessment Process (“ICAAP”) for AFs in prudential category 3, similar to our earlier proposals in CP145 and subsequent rulemaking, where IRAP/ICAAP requirements were removed for AFs in category 4.[9]

23. The removal of the IRAP/ICAAP requirements for AFs in category 3 and 4 does not mean that these AFs may not be subject to an individual capital or liquidity requirement imposed by the DFSA, where necessary. The DFSA maintains its statutory powers to assess the prudential risk associated with individual AFs in any prudential category with a view to imposing additional prudential requirements, where necessary. In CP161, we proposed to introduce guidance to emphasise the fact, and remind our AFs in category 3 and 4, of the DFSA’s statutory powers in this area.[10] In line with the DFSA’s supervisory approach, any considerations for imposing additional capital or liquidity requirements will follow a discussion with the AF in question.

24. Commentators asked for further clarification around the hypothetical scenarios in which the DFSA would impose additional prudential requirements, including on what the expected range of such requirements would be, and whether specific risks, such as fraud risk, sanctions risk and others, may be the drivers for the additional requirements. Given the heterogenous population of AFs in category 3 and 4, and the individual nature of risks arising from various business models, the DFSA cannot provide further guidance around the expected size of any additional prudential requirement.

### Professional indemnity insurance

[9] See the amendments in Guidance to Sections A10.1 and A10.2 in the PIB module here, as applicable from 1 July 2025.

[10] See the amendments in Guidance to Rule 3.5.3 of the PIB module here, as applicable from 1 July 2025.

25. Several respondents commented on our proposal to remove the mandatory Professional Indemnity Insurance ("PII") cover for those AFs that will be subject to the ABCR. Two respondents argued that the PII should remain a blanket requirement for all AFs, while others supported our proposals to apply the PII on a subset of AFs only. On balance, we think our policy proposals are justified and in line with international best practice, where PII is typically mandatory for insurance intermediaries/managers and financial advisers/arrangers (the PII remains in place for these AFs in our jurisdiction).[11]

26. In CP161, we had proposed that PII must provide continuous cover in respect of claims arising from work carried out from the date the AF become subject to the requirement to have a PII cover. One commentator queried the importance of the period of PII cover and how easy it would be to source such a policy from the market. Reflecting on the feedback received, we agree that it would not be proportionate to require AFs to have such an extensive cover period. Consequently, we have reconsidered our initial proposals in this area and will require a shorter PII cover period of four years.[12]

### Transitional period and next steps

27. In CP161, the DFSA proposed a transitional period until January 2026. Several commentators called for a longer period to phase-in new requirements (e.g. the ABCR), while asking for those amendments that lead to more risk-sensitive and proportionate outcomes for the AFs to apply without a transitional period.

28. Based on this feedback, we have split the implementation into two stages. AFs will be able to immediately benefit from those changes that are aimed at alleviating undue regulatory burden and can be implemented by AFs, from 1 July 2025. On the other hand, for those changes that impose new requirements, such as in relation to PII or the ABCR, we believe there is merit in extending the transition period until 1 July 2026.

29. During the period between 1 July 2025 and 1 July 2026, certain AFs may observe a temporary decrease in their overall capital requirement, mainly due to the reduction or removal of the EBCM and the delayed introduction of the ABCR. Where that happens, we expect that AFs will understand the temporary nature of this effect and maintain sufficient resources to meet their overall capital requirement when approaching the implementation date on 1 July 2026.

30. The DFSA will be publishing the necessary templates and instructions to report the ABCR to the DFSA via the Electronic Prudential Reporting System ("EPRS"). The DFSA will publish a notice on its website on the publication of the new EPRS templates and instructions, and will engage with the impacted AFs to ensure awareness before these returns become mandatory for Q3 2026 submission.

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[11] See the amendments in Rules 6.1.1(c), 6.12.1 and Guidance to APP6 of PIB module here, as applicable from 1 July 2026.

[12] See the amendments in Rule 6.12.2 of the PIB module here, as applicable from 1 July 2026.