CONSULTATION PAPER NO. 160

UPDATES TO THE CLIENT ASSETS REGIME

6 August 2024

PREFACE

Why are we issuing this Consultation Paper?

1. The DFSA's Client Assets regime applies to Authorised Firms: (i) that hold or control Client Assets[1]; or (ii) that are authorised to provide the Financial Service of Providing Custody[2].

2. Following the review of the existing provisions of the Client Assets regime against our supervisory experience and rules applicable in comparable jurisdictions, we propose to amend, clarify and add a number of aspects to the regime. The proposals in this paper are intended to provide more clarity on what the DFSA requires from: (i) Authorised Firms that fall within the scope of the Client Assets regime; and (ii) Registered Auditors that prepare Client Asset Auditor's Reports.

Who should read this Consultation Paper?

3. The proposals in this Consultation Paper should be of interest to:

   a) Authorised Firms that have or wish to apply for the endorsement to hold or control Client Assets;

   b) Authorised Firms that carry on or are proposing to carry on the Financial Service of Providing Custody in or from the DIFC;

   c) Professional advisors to Authorised Firms that fall within the scope of the Client Assets regime; and

   d) Registered Auditors.

Terminology

4. In this Consultation Paper, defined terms have the initial letter of a word, or of each word in a phrase, capitalised and are defined in the Glossary Module (GLO). Unless the context otherwise requires, where the initial letter is not capitalised, the expression has its natural meaning.

What are the next steps?

5. Please provide your comments by accessing this link by **20 October 2024**. You will need to identify yourself and the organisation you represent (if applicable) when providing your comments. We may publish, including on our website, any comments you provide, unless you expressly request otherwise at the time of making comments.

6. Following public consultation, we will consider the comments received and proceed to make the relevant changes to the COB, AUD, MKT, CIR, GLO and GEN modules of the DFSA's Rulebook. We will issue a notice on our website

[1] Authorised Firms that hold or control Client Assets are required to obtain an endorsement. See GEN Rule 2.2.10A.
[2] GEN Section 2.13.

when the amended Rulebooks are published.

Structure of this Consultation Paper

7. This Consultation Paper is structured as follows:

   a) Background information
   b) Section 1 – Controlling Client Assets
   c) Section 2 – Investment management of Funds
   d) Section 3 – Client Asset Crisis Preparedness Pack
   e) Section 4 – Client Asset Auditor's Report
   f) Section 5 – Third Party Agent suitability assessments
   g) Section 6 – Third Party Agent written acknowledgment concerning Client Money
   h) Section 7 – Disclosure
   i) Section 8 – Reconciliation
   j) Section 9 – Client reporting
   k) Section 10 – Client Account naming
   l) Section 11 – Arranging Custody
   m) Annex 1 – Questions in this Consultation Paper
   n) Appendix 1 – Draft amendments to the General (GEN) module
   o) Appendix 2 – Draft amendments to the Conduct of Business (COB) module
   p) Appendix 3 – Draft Amendments to the Collective Investment Rules (CIR) module
   q) Appendix 4 – Draft Amendments to the Glossary (GLO) module
   r) Appendix 5 – Draft amendments to the Auditor (AUD) module
   s) Appendix 6 – Draft amendments to the Markets Rules (MKT) module

Background information: DFSA Client Assets Regime

8. The Client Assets regime advances the DFSA's statutory objective set out in Article 8(3)(e) of the Regulatory Law[3], which provides that the DFSA should "*protect direct and indirect users and prospective users of the financial services industry in the DIFC*". Additionally, Principle 9[4] of the *Principles for Authorised Firms* provides that "*where an Authorised Firm has control of or is otherwise responsible for assets or money belonging to a customer which it is required to safeguard, it must arrange proper protection for them in accordance with the responsibility it has accepted*". In line with this, the protection of Client Money and Client Investments has been a core aspect of our Rules since 2004, with

[3] Regulatory Law DIFC Law No.1 of 2004.
[4] GEN 4.2.9.

Client Crypto Tokens added in 2022.

9. During our supervisory process, we have observed that there are some aspects of the Client Assets regime that are not well understood by Authorised Firms, and some aspects are poorly complied with. To improve overall comprehension and compliance with the Client Assets Rules, we have reviewed the regime to assess and identify areas where we can provide more clarity and emphasis. It is worth noting that this Consultation Paper builds on previous updates that were made to the Client Assets regime following Consultation Papers 61[5], 104[6], 106[7] and 117[8].

10. The review of the regime did not include the Rules on Collateral[9] and related provisions[10]. A separate policy project will aim to analyse the implications for the DFSA Rules of the latest DIFC framework changes such as the enactment of the DIFC Law of Security in March 2024. We also intend to cover provisions which adequately reflect the different types of collateral arrangements and clarify the implication of the right of re-use of collateral. If any amendments are necessary, we will publish a consultation paper on the proposed changes in due course.

11. Overall, the proposals in this Consultation Paper are designed to take into account the principle of proportionality, and are aimed at:

    a) providing greater clarity on the Client Assets regime for Authorised Firms that are Providing Custody or are holding or controlling Client Assets;

    b) enhancing specific areas where greater protection of Client Assets is desirable;

    c) introducing new requirements, where necessary, i.e. in relation to crisis preparedness; and

    d) providing a regulatory framework which is proportionate to the risks associated with their activities.

12. The key changes proposed include:

    a) broadening the circumstances in which an Authorised Firm will be controlling Client Assets under COB Rule 6.11.4(d);

    b) clarifying the requirements that apply to an Authorised Firm that only controls Client Assets under COB Rule 6.11.4(d);

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[5] https://dfsaen.thomsonreuters.com/sites/default/files/net_file_store/DFSA_CP61.pdf
[6] https://dfsaen.thomsonreuters.com/sites/default/files/net_file_store/CP104_Miscellaneous_Amendments.pdf
[7] https://dfsaen.thomsonreuters.com/rulebook/consultation-paper-no-106-regulation-arranging-representative-office-activities-and
[8] https://dfsaen.thomsonreuters.com/rulebook/consultation-paper-no117-miscellaneous-changes
[9] COB Rules 6.13.4 – 6.13.9.
[10] Such as COB Rules A6.4.4 - 6.4.5 on the right of re-use of Safe Custody assets.

c) clarifying that Investments and Crypto Tokens that are Fund Property are not Client Investments or Client Crypto Tokens, respectively and, as a result do not fall within the Client Assets regime, as is already the case for Money that is Fund Property;

d) introducing a requirement for Authorised Firms to compile and maintain a Client Asset crisis preparedness pack to facilitate Client Assets being promptly identified and returned to Clients in a crisis situation;

e) clarifying what Client Assets aspects the Registered Auditors should assess for the purpose of preparing Client Assets Auditor's Reports;

f) converting the Third Party Agent suitability assessment criteria from guidance to Rules and expanding some of the criteria;

g) changing the timing by which the written acknowledgment for Client Money accounts should be received from Third Party Agents;

h) improving Client Money disclosure Rules by: (i) requiring more detailed disclosures about the treatment of Client Money held with Third Party Agents; (ii) requiring Authorised Firms to make additional information available to Clients upon request about insolvency regime assessments in jurisdictions where Third Party Agents are located; and (iii) requiring disclosure to be made before the Client passes Money to the Authorised Firm;

i) amending the Rules to require more frequent reconciliations of Client Assets and clarifying that Client Assets should be recorded and reconciled on a settlement date basis;

j) clarifying the frequency of Client reporting and reflecting technological developments;

k) providing more flexibility around naming Client Accounts; and

l) clarifying the requirements that apply when an Authorised Firm is Arranging Custody.

13. Note there are other minor modifications and consequential amendments made in the accompanying draft rules.

Section 1: Controlling Client Assets

Activities that fall within the activity of controlling Client Assets

14. COB Rule 6.11.4 (a) to (d) and accompanying Guidance describe the ways in which Authorised Firms hold or control Client Assets. While COB Rule 6.11.4 (a) to (c) cover examples of holding (and by implication controlling) Client Assets, paragraph (d) addresses situations where Client Assets are held in the Client's own name and an Authorised Firm can exercise control over those assets under a mandate, to manage the assets on a discretionary basis.

15. Nonetheless, the COB Rule 6.11.4(d) wording "*managing assets on a*

discretionary basis" does not cover all the situations where an Authorised Firm would control Client Assets. There are situations where an Authorised Firm is holding a mandate, a power of attorney (PoA) or a similar authority from a Client, by virtue of which the Authorised Firm is controlling Client Assets, without the activity constituting "*managing assets on a discretionary basis*". For example, this would be the case if an Authorised Firm has the discretion - under a mandate, a PoA or similar authority - to bind a Client in respect of transactions involving Client Assets, without the need for further Client involvement or transaction confirmation.

16. To reflect this, we propose to amend the wording in COB Rule 6.11.4(d) to focus instead on the notion of 'control' stemming from a mandate or a similar authority granted by the client rather than on a specific activity such as *"managing assets on a discretionary basis"*. We also propose to update the accompanying Guidance to explain that it covers situations where the Authorised Firm exercises control over the Client Assets by having the authority to bind the Client by virtue of a mandate, PoA or a similar authority.

See draft COB Rule 6.11.4(d) and accompanying Guidance.

Requirements applicable to Authorised Firms that only control Client Assets

17. Under COB Rule 6.11.4(d) as the Client Assets are held in an account in the Client's own name, there are certain requirements which should not apply by virtue of the factual situation. This is acknowledged in Guidance point 4 to COB 6.11.4, where it says that "*In relation to assets referred to in Guidance item 3 that are held in the Client's name, only specific Rules in App 5 (Client Money Provisions) and App 6 (Safe Custody Provisions) are likely to be relevant, as the assets are already held in the Client's own name and the firm will control rather than hold the assets*." We propose to clarify further in the Guidance referred to above which requirements apply to Authorised Firms which only control Client Assets.

See draft Guidance to COB Rule 6.11.4.

Question 1:

Do you have any comments on the proposed clarifications regarding controlling Client Assets?

Section 2: Investment management of Funds

18. Under the DFSA framework, if an Authorised Firm is appointed by a Fund Manager, under a delegation, to act as an investment manager of a Fund, the Authorised Firm can do so if it holds a Licence to Manage Assets. In addition, carrying out the Financial Service of Managing Assets implies holding the Client Asset endorsement and compliance with the Client Assets Rules.

19. However, in this context a question arises as to whether Fund Property of a

Fund[11] should be subject to the Client Assets regime, given that – under the DFSA rules – it is already governed by a separate set of protections set out in the Collective Investment Law 2010 (CIL) and the Collective Investment Rules (CIR). In recognition of that principle, the current Client Asset Rules[12] explicitly state that Money that is Fund Property does not constitute Client Money.

20. In light of the fact that Fund Property already benefits from separate protection under the CIL and CIR, we are of the view that adequate protections already exist (e.g. through the requirements related to custody and segregation), and there is no need to duplicate such safeguards. Therefore, we propose to clarify that all categories of Client Assets (i.e. Money, Investments and Crypto Tokens) do not fall within the definition of Client Assets if they are Fund Property.

21. As a result of this amendment, Authorised Firms holding a Licence for Managing Assets and which are engaged exclusively in the activity of investment and portfolio management for a Fund, under a delegation from a Fund Manager, would not be subject to the Client Assets Rules and would not be required to hold the Client Asset endorsement.

22. However, if an Authorised Firm with authorisation to Manage Assets conducts dual activities such as: (i) investment management (delegated by the Fund Manager); and (ii) pure wealth/asset management, it should obtain the Client Asset endorsement for the second, non-Fund related, part of its business to which the Client Asset Rules will apply.

See draft COB Rules 6.13.1 and 6.13.1A.

Question 2:

Do you have any comments on the proposed clarifications regarding Fund Property?

Section 3: Client Asset crisis preparedness pack

23. The Regulatory Law sets out that one of the DFSA statutory objectives is to "*protect direct and indirect users and prospective users of the financial services industry in the DIFC*"[13]. Further to that, in 2022 the DFSA gained a specific resolution objective to "*protect client assets by providing prompt access to assets*".[14]

24. Therefore, the DFSA proposes to put in place Rules that would facilitate the identification, retrieval and, if necessary, prompt return of Client Assets to Clients in crisis situations, for example if the Authorised Firm is put into insolvency or is subject to resolution action.

25. Specifically, we propose that Authorised Firms should be required to compile and

[11] Defined in GLO as "The property held for or within a Fund".
[12] COB Rule 6.12.1(f).
[13] Article 8(3)(e) of the Regulatory Law DIFC Law No.1 of 2004.
[14] Article 8(3C)(b) of the Regulatory Law DIFC Law No.1 of 2004.

maintain a pack of documents, referred to as a Client Assets crisis preparedness pack (Pack), which should include vital existing information for the identification of Client Assets such as a master list of Client Accounts, details of Third Party Agents and copies of the most recent reconciliations.[15] The Pack is designed to assist the relevant parties involved in crisis situations (such as insolvency practitioners, accountants, lawyers and regulators) to easily identify, retrieve and, if needed, ensure the swift return of Client Assets.

26. In terms of scope, we recognise that where an Authorised Firm only controls Client Assets (see paragraph 12 above), the Client Assets are already held in the Client's own name and, hence, do not need to be returned. Therefore, we do not propose that the new requirement apply to such Authorised Firms.

27. Lastly, we acknowledge that Authorised Firms need time to compile their Client Asset Packs, therefore we propose a transition timeline of three months to comply with the new Rule.

See draft COB Rule 6.11.2(4) and draft COB section 6.14.

Question 3:

Do you have any comments on the content of the Client Asset crisis preparedness pack?

Question 4:

Do you consider that the proposed transition timeline is adequate?

Section 4 – Client Asset Auditor's Report

28. Authorised Firms that have the Client Asset endorsement or Provide Custody are required to submit an Auditor's Report to the DFSA on an annual basis.[16] The Auditor's Reports assess the Authorised Firm's compliance with the Client Assets regime.

29. The proposals set out in this section are designed to provide more clarity to Registered Auditors on the DFSA's expectations on the content of Client Asset Auditors' Reports. In addition, if the Auditor's Report findings point to material non-compliance with the DFSA's Client Asset Rules, the Authorised Firms would be required to contact the DFSA and explain how the breaches are remedied.

Clarifications on what the Auditor should assess

30. The Safe Custody Auditor's Report[17] requires the Auditor to state "*the extent to which the Authorised Firm was holding or controlling Client Investments or Providing Custody*". In this regard, we propose to clarify that Registered Auditors should report the aggregate value – and not on, as it is currently phrased, the

[15] This list is non-exhaustive.
[16] GEN Rule 8.6.1(c) and (e).
[17] AUD Rule A.4.1.1(a).

'extent' - of Safe Custody assets that were being held or controlled or for which the Authorised Firm was Providing Custody.

See draft AUD Rule A.4.1.1(a).

31. Registered Auditors are required to report any material discrepancies that have taken place in Client Asset reconciliations.[18] However, the Rules do not currently require the Auditor to report on whether the material discrepancies were rectified during the relevant period. Such information is vital to the DFSA to ensure ongoing compliance with the Client Asset Rules. Therefore, we propose to amend the relevant Rules accordingly.

See draft AUD Rules A2.1.1(b)(iii) and A4.1.1(b)(iii).

Safe Custody Crypto Token Auditor's Reports

32. Consultation Paper 153[19] proposed to extend the requirement to submit the Safe Custody Auditor's Report to Authorised Firms that hold or control Client Crypto Tokens or Provide Custody in relation to Client Crypto Tokens. The Rules on this took effect on 3 June 2024.

33. Nonetheless, if an Authorised Firm Provides Custody or holds or controls both Client Investments and Client Crypto Tokens, two distinct Safe Custody Auditor's Reports should be required reflecting the specificities of each respective type of Client Asset. In light of this, we propose to add a separate Appendix to the AUD Rulebook specifying the content of the Safe Custody Crypto Token Auditor's Reports.

See draft AUD App5.

Response to Auditor's findings

34. If findings of material non-compliance with the DFSA's Client Asset Rules are identified in Auditor's Reports, the DFSA expects to receive a formal reply from the Authorised Firm providing explanation in respect of the matters identified by the Registered Auditor. To this end, we propose to add a requirement that Authorised Firms report to the DFSA, within 30 days after the submission of the Auditor's Report, the steps being undertaken to remediate the Auditor Report's findings of material non-compliance.

See draft COB Rules A5.12.1 and A6.10.1.

Question 5:

Do you have any comments on any of the changes proposed to the Client Asset Auditor's Reports?

Question 6:

[18] AUD App Rule 2.1.1(b)(vii) and App Rule 4.1.1(b)(iii).
[19] https://dfsaen.thomsonreuters.com/sites/default/files/net_file_store/CP153_Updates_on_the_Regulation_of_Crypto_Tokens_1.pdf (launched on 4 January 2024).

Do you consider that the period of 30 days to report to the DFSA on the Registered Auditor's findings of material non-compliance is adequate?

Section 5 – Third Party Agent suitability assessments

35. Before a Third Party Agent is selected for the purpose of opening a Client Account and transferring Client Assets, Authorised Firms are required to perform an assessment to determine whether the Third Party Agent is suitable.[20] The requirements are currently contained in Rules and supplemented by Guidance. The Guidance lists the criteria that should be considered when assessing Third Party Agent suitability.

36. Our supervisory experience indicates that Authorised Firms tend not to consider all the criteria listed in the Guidance when carrying out the suitability assessments. As we consider that such assessments are a vital element of the Client Assets regime, fostering the choice of suitable and sound Third Party Agents, we propose to convert the assessment criteria from the current Guidance to Rules. By this, we intend to emphasise the importance of these assessments and that all the criteria should be considered by the Authorised Firms in the process.

See draft COB Rules A5.6.1(2) and A6.5.3.

Creditworthiness of Third Party Agents

37. We acknowledge that satisfying the criterion related to assessing the credit rating of the Third Party Agent may not deliver the desired outcome, given that a prospective Third Party Agent may not always have such a rating.

38. To reflect such situations, we propose to amend the wording of this criterion by referring to a wider concept of 'creditworthiness' of the Third Party Agent. This would require Authorised Firms to take a wider view of the credit profile of the prospective Third Party Agent. Such an approach is aligned with the departure from a mechanistic reliance on credit ratings alone, promoted by international standard setters such as International Organisation of Securities Commissions[21], the Basel Committee and the Financial Stability Board[22].

See draft COB Rules A5.6.1(2)(b) and A6.5.3(b).

Client Money placement diversification

39. When Client Money is placed with a Third Party Agent it is held as a deposit on the Third Party Agent's balance sheet. This means that if the Third Party Agent were to fail, the deposit would typically be treated as an unsecured liability and would be exposed to loss.

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[20] COB Rules A.5.6 and A6.5.1
[21] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD524.pdf
[22] https://www.fsb.org/wp-content/uploads/r_140512.pdf

40. Currently, unlike in other jurisdictions, the Rules do not require Authorised Firms to consider whether a concentration of Client Money placed with a single Third Party Agent is in the Client's best interest. In this regard, diversification can serve as a useful tool to limit concentration risk. In particular, Principle 3 of IOSCO's *Recommendations*[23] *Regarding the Protection of Client Assets* states that appropriate arrangements should be in place to safeguard Clients' rights related to Client Assets to minimise the risk of loss and misuse. The Principle 3 implementation notes provide that consideration should be given to "*the need for diversification and mitigation of risks, where appropriate, by placing Client Assets with more than one third party*".

41. In light of this, we propose to include an additional criterion that an Authorised Firm assessing the suitability of a Third Party Agent for holding Client Money needs to consider. The criterion consists of assessing whether diversification in respect of Client Money placements across several Third Party Agents is desirable.

42. We would expect that Authorised Firms consider this criterion along with all the other suitability assessment criteria. In this regard, an Authorised Firm should document (in their suitability assessment of the Third Party Agent) how it has had regard to all the suitability assessment criteria.

See draft COB Rule A5.6.1(2)(h) and accompanying Guidance.

Depositor protection in Third Party Agent's jurisdiction

43. Currently, our Rules require the Authorised Firm to consider as part of the suitability assessment the insolvency regime of the jurisdiction where the Third Party Agent is located.[24] In some jurisdictions, additional protections may exist, for example depositor preference or a deposit guarantee scheme, which could provide additional protection to Client Money held with a Third Party Agent in case of the Third Party Agent's failure. In light of this, we propose to expand the scope of the insolvency regime criterion to also encompass consideration of whether there is a deposit guarantee scheme or depositor preference scheme in place that would provide some form of protection to the Client Money in the event of the Third Party Agent's failure.

See draft COB Rule A5.6.1(2)(e).

Question 7:

Do you have any comments on the proposal to convert the suitability assessment criteria from Guidance to Rules?

Question 8:

Do you have any comments on amending the criterion to require an assessment of the creditworthiness of the Third Party Agent?

[23] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD436.pdf
[24] Guidance item (c) to COB Rule A5.6.2.

Question 9:

Do you have any comments on adding the requirement to consider diversification of Client Money placement as part of Third Party Agent suitability assessments?

Question 10:

Do you have any comments on the proposal to broaden the criterion related to the insolvency regime in the Third Party Agent's jurisdiction i.e. to include consideration of additional protections in respect of Client Money in the event of the Third Party Agent's failure?

Section 6 – Third Party Agent written acknowledgement concerning Client Money

44. When an Authorised Firm opens a Client Money account with a Third Party Agent, it is required to obtain a written acknowledgment from the Third Party Agent. The written acknowledgement is required to stipulate, in summary, that: (i) there is no right of set off on the Money passed to the Third Party Agent in respect of any sum owed to it by the Authorised Firm; and (ii) the title of the account sufficiently distinguishes the Client Money account from any account containing Money that belongs to the Authorised Firm.[25]

45. Currently, the DFSA Rules provide that the written acknowledgment is to be received by the Authorised Firm "*within a reasonable period*". By way of Guidance, the DFSA has considered a reasonable period to be twenty days. Nonetheless, given that the substance of the written acknowledgment is fundamental for the segregation of the Client Money, we propose to amend the rule and require that the written acknowledgment must be received before the Client Money is passed to the Third Party Agent. This approach is analogous to the requirements[26] applicable to Client Investments and Client Crypto Tokens.

See draft COB Rule A5.7.2.

Question 11:

Do you have any comments on the proposal to require that the written acknowledgment must be received before Client Money is a passed to the Third Party Agent?

Section 7 – Disclosure

Client Money disclosure on insolvency regime in Third Party Agent's jurisdiction

[25] COB Rule A5.7.2.
[26] COB Rule A6.6.1.

46. In line with the current disclosure requirements[27], if Client Money is held in a jurisdiction outside the DIFC, the Authorised Firm must disclose this fact to the Client and that the market practices and insolvency and legal regime applicable in that other jurisdiction may differ from the legal framework in the DIFC. However, this Rule does not specifically require the Authorised Firm to disclose the legal treatment that Money would be subject to in the event of the Third Party Agent's insolvency.

47. Incidentally, as part of the Third Party Agent suitability assessment[28], the Authorised Firm is required to have regard to the insolvency regime in the jurisdiction where the Third Party Agent is located. As the Authorised Firm has this information available, we propose that a statement be included as part of the Client disclosure that upon the Client's request the Authorised Firm will make further information concerning the assessment available to the Client. A consequential amendment is proposed in respect of Client Investments and Client Crypto Tokens.

See draft COB Rule A5.9.1(f).

Client Money disclosure on how Money is held by Third Party Agents

48. Under the current disclosure Rules, Authorised Firms are not required to disclose how Client Money is held with a Third Party Agent, i.e. that it is held as a deposit (on the Third Party Agent's balance sheet) and the legal implications of it in the event of the Third Party Agent's failure. The absence of this disclosure may lead to an incorrect understanding of the extent of the DFSA's Client Money protections by the Clients of Authorised Firms.

49. In light of this, we propose to add a disclosure requirement that focuses on the specific factual and legal situation. In particular, the disclosure should clearly state that when Client Money is passed to a Third Party Agent (in the DIFC or outside the DIFC), the Money is held on the Third Party Agent's balance sheet as a deposit. The disclosure should also clearly state that if the Third Party Agent fails, the Money is likely to be treated as an unsecured liability.

See draft COB Rule A5.9.1(d).

Timing of Client Money disclosures

50. Currently, the Authorised Firm must make Client Money disclosures to a Client "*before*" or "*as soon as reasonably practicable after the Authorised Firm receives the Client Money*"[29]. We are of the view that Clients should be aware of all of the particulars around how the Client Money will be held before they decide to give their Money to the Authorised Firm and propose to amend the Rule accordingly. This approach is consistent with the disclosure rules[30] for Client Investments and Client Crypto Tokens.

[27] COB Rule A.5.9.1(d).
[28] COB Rule A5.6.1.
[29] COB Rule A5.9.1.
[30] COB Rule A6.7.1.

See draft COB Rule A5.9.1.

Client Investments and Client Crypto Tokens disclosures

51. Authorised Firms that Provide Custody are required to comply with a list of disclosure obligations.[31] Nonetheless, currently the disclosure obligations do not explicitly apply to Authorised Firms that hold or control Client Investments or Client Crypto Tokens. It goes without saying that our regulatory intention has always been that the disclosure requirements apply to all the Authorised Firms that hold Client Investments and Client Crypto Tokens. These requirements would not apply to firms that are only controlling Client Assets. Therefore, we propose to clarify this in the Rules.

See draft COB Rule A6.7.1(2).

Question 12:

Do you have any comments on the proposal to add a disclosure statement that upon the Client's request the Authorised Firm will make further information available concerning the assessment of the insolvency regime in the jurisdiction where the Third Party Agent is located?

Question 13:

Do you have any comments on the proposal to require more prominent disclosures about the legal implications concerning Client Money when it is placed with a Third Party Agent?

Question 14:

Do you have any comments on the proposal to require Client Money disclosures to be made before the Authorised Firm receives Money from a Client?

Question 15:

Do you have any comments on the proposal to extend the disclosure requirements to Authorised Firms that hold Client Investments or Client Crypto Tokens?

Section 8 – Reconciliation

Client Asset recording and reconciliation

52. The trading of securities is not instantaneous and even if the transaction is settled on a 'delivery versus payment' basis, there is typically a gap of two to four days between the trade date and the settlement date. This can present some

[31] COB Rule A6.7.1(2).

challenges around the recording and reconciliation of Client Assets.

53. To date, we have not explicitly prescribed in our Rules the date Authorised Firms should use for recording and reconciling Client Assets positions. Therefore, we propose to clarify that Authorised Firms should record and reconcile Client Asset positions on a settlement date basis.

See draft COB Rules A5.11.1(3), A6.9.1(b) and accompanying Guidance and Guidance to COB Rules 6.12.5 and 6.13.10.

Frequency of Client Money reconciliations

54. Authorised Firms are required to have a system in place that can ensure that reconciliations of Client Accounts are carried out at least every 25 days.[32] In terms of benchmarking, it appears that - overall - this requirement is similar to what other regulators require, with some even moving towards more frequent reconciliations, depending on the frequency of transactions. Considering this, we propose to add guidance on factors that indicate that more frequent reconciliations should be performed, e.g. frequency, number and value of transactions as well as risks that the Client Money is exposed to.

See draft Guidance item 1 to COB Rule A5.11.1.

Frequency of Client Investments reconciliations

55. Authorised Firms are required to reconcile records of Client Accounts held with Third Party Agents against the monthly statements received from the Third-Party Agents at least every 25 business days.[33] To ensure a more accurate account of the Client Investments that the Authorised Firm holds, we propose that the reconciliation is performed within at least five business days of receipt of the statement from the Third Party Agent.

See draft COB Rule A6.9.1.

56. Authorised Firms are required to reconcile records of Client Account balances with individual client ledger balances every six months.[34] To ensure that more up-to-date balances are available, we propose that the reconciliation be performed at least monthly.

See draft COB Rule A6.9.1

Question 16:

Do you have any comments on the proposal to clarify that Client Asset positions should be recorded and reconciled on settlement date basis?

Question 17:

[32] COB Rule A5.11.1(1).
[33] COB Rule A6.9.1(a).
[34] COB Rule A6.9.1(e).

Do you have any comments on the proposal to amend the frequency of Client Asset reconciliations?

Section 9 – Client Reporting

Client Money reporting

57. Authorised Firms are required to provide Client Money reports to Retail Clients at least monthly and to Professional Clients at intervals agreed in writing.[35] With technological developments, there has been a shift to real time access through online platforms where Clients can access their accounts and portfolio information directly, and this practice seems to be increasingly replacing paper-based periodic statements.

58. Thus, in order to reflect the technological changes, we propose to clarify that, to satisfy the Client Assets Rules, the online approach should be combined with the sending of an electronic version of the statement in a durable form to the Client. Such an approach would ensure that if the online platform becomes unavailable, Clients would still be able to keep the record of their statements available in an independent and durable form.

See draft Guidance to COB Rule A5.10.1(1).

Client Investments reporting

59. Currently, Authorised Firms are required to provide Clients with reports on Client Investments, with Retail Clients receiving the reports at least every six months and Professional Clients - at intervals agreed in writing.[36]

60. However, we are of the view that clients should be informed more frequently about their Client Investments and twice a year appears to be too rare in today's day and age, especially when compared to other asset classes such as Client Crypto Tokens. Thus, we propose to require Client Investment reporting for both Retail and Professional Clients to be conducted monthly, and as proposed above for Client Money reporting, to satisfy the Rules, the online access can be combined with the sending of an electronic version of the statement in a durable form.

See draft COB Rule A6.8 and accompanying Guidance.

Question 18:

Do you have any comments on the proposals to update the Client reporting Rules?

Question 19:

[35] COB Rule A5.10.1(1).
[36] COB Rule A6.8.1.

Do you have any comments on the proposals to change the frequency of Client reporting on Client Investments?

Section 10 – Client Account naming

61. Currently, the Rules provide that a Client Account opened with a Third Party Agent must include the words 'Client Account' in its title.[37] In addition, the written acknowledgment in respect of Client Assets that the Third Party Agent must provide to the Authorised Firm needs to include the following wording: "*the title of the account sufficiently distinguishes that account from any account containing Money that belongs to the Authorised Firm and in the form requested by the Authorised Firm*".[38]

62. Based on our supervisory experience, we recognise that Authorised Firms can, at times, encounter difficulty in complying with this provision, as the Third Party Agents with which the account is held, may have internal naming conventions that do not permit the account title to include the wording 'Client Account'.

63. To help address these challenges, we propose to add some flexibility around the naming of the account to accommodate the use of other wording combinations (where it is not possible for Client Account to be used) - so long as the title sufficiently distinguishes that account from any account belonging to the Authorised Firm.

See draft COB Rules A5.4.1(d) and A6.4.2(d).

Question 20:

Do you have any comments on the proposal to permit more flexibility around the naming of Client Accounts?

Section 11 – Arranging Custody

64. In 2016, following the Consultation Paper 106[39], we removed the application of the majority of Safe Custody Provisions[40] for Authorised Firms that Arrange Custody, except for the provisions on recording keeping[41], disclosure[42] and the suitability assessment for non-DIFC custodians[43].

65. Despite this, some ambiguity remained around whether an Auditor's Report is

[37] COB Rules A5.4.1(d) and A6.4.2(d).
[38] COB Rules A5.7.2(b) and A6.6.1(a).
[39] https://dfsaen.thomsonreuters.com/sites/default/files/net_file_store/CP_106_-_Regulation_of_Arranging_Rep_Office_Activities_and_Financial_Promotions.pdf
[40] COB App 6.
[41] COB Rule 6.14.
[42] COB Rule A6.7.1(1)
[43] COB Rule A6.5.1A.

required. This was due to, primarily, conflicting references in the AUD module[44] and the GEN module[45]. We are of the view that the original intention stated in Consultation Paper 106 should prevail and that Authorised Firms that Arrange Custody should not be required to submit Auditor's Reports, given that they do not hold or control Client Assets. We propose to clarify this in guidance in the relevant Rules.

See draft Guidance to GEN Rule 2.14.3 and draft Guidance to AUD App4.

Question 21:

Do you have any comments on the proposal to clarify that an Auditor's Report is not required for Authorised Firms that Arrange Custody?

[44] AUD Rule A4.1.1 Guidance point 1.
[45] GEN Section 2.14 Guidance point 3.

Annex 1. Questions in this consultation paper

Question 1:

Do you have any comments on the proposed clarifications regarding controlling Client Assets?

Question 2:

Do you have any comments on the proposed clarifications regarding Fund Property?

Question 3:

Do you have any comments on the content of the Client Asset crisis preparedness pack?

Question 4:

Do you consider that the proposed transition timeline is adequate?

Question 5:

Do you have any comments on any of the changes proposed to the Client Asset Auditor's Reports?

Question 6:

Do you consider that the period of 30 days to report to the DFSA on the Registered Auditor's findings of material non-compliance is adequate?

Question 7:

Do you have any comments on the proposal to convert the suitability assessment criteria from Guidance to Rules?

Question 8:

Do you have any comments on amending the criterion to require an assessment of the creditworthiness of the Third Party Agent?

Question 9:

Do you have any comments on adding the requirement to consider diversification of Client Money placement as part of Third Party Agent suitability assessments?

Question 10:

Do you have any comments on the proposal to broaden the criterion related to the insolvency regime in the Third Party Agent's jurisdiction i.e. to include consideration of additional protections in respect of Client Money in the event of the Third Party Agent's failure?

Question 11:

Do you have any comments on the proposal to require that the written acknowledgment must be received before Client Money is a passed to the Third Party Agent?

Question 12:

Do you have any comments on the proposal to add a disclosure statement that upon the Client's request the Authorised Firm will make further information

available concerning the assessment of the insolvency regime in the jurisdiction where the Third Party Agent is located?

Question 13:

Do you have any comments on the proposal to require more prominent disclosures about the legal implications concerning Client Money when it is placed with a Third Party Agent?

Question 14:

Do you have any comments on the proposal to require Client Money disclosures to be made before the Authorised Firm receives Money from a Client?

Question 15:

Do you have any comments on the proposal to extend the disclosure requirements to Authorised Firms that hold Client Investments or Client Crypto Tokens?

Question 16:

Do you have any comments on the proposal to clarify that Client Asset positions should be recorded and reconciled on settlement date basis?

Question 17:

Do you have any comments on the proposal to amend the frequency of Client Asset reconciliations?

Question 18:

Do you have any comments on the proposals to update the Client reporting Rules?

Question 19:

Do you have any comments on the proposals to change the frequency of Client reporting on Client Investments?

Question 20:

Do you have any comments on the proposal to permit more flexibility around the naming of Client Accounts?

Question 21:

Do you have any comments on the proposal to clarify that an Auditor's Report is not required for Authorised Firms that Arrange Custody?