



CONSULTATION PAPER NO. 40

23 NOVEMBER 2006

**PROPOSAL TO REMOVE THE REQUIREMENT FOR A LICENSED
DIRECTOR/PARTNER AT THE HEAD OFFICE**

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Why are we issuing this paper?

1. This Consultation Paper sets out the DFSA's proposal to remove the current requirement for an Authorised Firm conducting Financial Services through a Branch in the DIFC to have a Licensed Director or Partner at its head office. Rule 10.3.4(b) of the Authorisation (AUT) Module of the DFSA Rulebook requires an Authorised Firm that is a Body Corporate with a head office located outside the DIFC to have at least one of its Directors, who is ultimately responsible for the Firm's Financial Services in the DIFC, registered with the DIFC as a Licensed Director. A similar requirement applies under AUT Rule 10.3.5(b) to an Authorised Firm which is a Partnership and has its head office located outside the DIFC.
2. We are proposing to remove the head office Licensed Director/Partner requirement because it does not provide any additional regulatory benefit in terms of the monitoring and accountability of the Governing Body and the senior management of an Authorised Firm for its Branch operations in the DIFC. This proposal is consistent with the DFSA's risk based approach to regulation.

Who should read this paper?

3. The proposal in this paper would be of primary interest to:
 - (a) an Authorised Firm that conduct Financial Services in or from the DIFC through a Branch located in the DIFC;
 - (b) Licensed Directors or Partners of Authorised Firms conducting Financial Services through a Branch in the DIFC; and
 - (c) prospective applicants for authorisation to conduct Financial Services from a Branch in the DIFC.

How is this paper structured?

4. In this paper we set out:
 - (a) Defined terms in paragraph 8;
 - (b) Background in paragraph 9; and
 - (c) Scope of and reasons for the proposal in paragraphs 10 - 17.

How to provide comments

5. All comments should be provided to the person specified below. You may, if relevant, identify the organisation you represent in providing your comments. The DFSA reserves the right to publish including on its website any comments you provide, unless you expressly request otherwise at the time of making comments.

What happens next?

6. The deadline for providing comments on this proposal is **16 January 2007**. Once we receive your comments, we will consider if any further refinements are required to this proposal. We will then proceed to enact the changes to the DFSA's Rulebook. You should not act on this proposal until the relevant changes to the DFSA Rulebook are made. We will issue a notice on our website telling you when this happens.
7. Pending the finalisation of this proposal, the DFSA will continue to consider on a case by case basis any applications from firms that wish to conduct Financial Services from a Branch in the DIFC for waivers of the current requirement in AUT Rule 10.3.4(b) or 10.3.5(b), as is applicable to the firm.

Comments to be addressed to:

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or e-mailed to: damukotuwa@dfsa.ae

Defined Terms

8. The terms used in this paper have the same meaning as in the Rulebook Glossary, unless otherwise stated. For convenience of reference, in this Paper:
- (a) “a Licensed Director” is an individual who is a Director of an Authorised Firm which is a Body Corporate or an unincorporated association and carries out the Licensed Function described in AUT 10.2.2(b);
 - (b) “a Licensed Partner” is an individual who is a Partner of an Authorised Firm which is either a Partnership or a Limited Liability Partnership and carries out the Licensed Partner function described in AUT 10.2.2(c);
 - (c) “Branch” means a place of business within the DIFC:
 - i. which has no legal personality;
 - ii. forms a legally dependent part of an Authorised Firm whose principal place of business and head office is in a jurisdiction other than the DIFC; and
 - iii. through which the Authorised Firm carries on Financial Services in or from the DIFC;
 - (d) “Firm” means an Authorised Firm;
 - (e) “Governing Body” includes the board of directors, partners, committees of management or other governing body of an Undertaking;
 - (f) “head office” is a principal place of business or registered office of an Authorised Firm that conducts Financial Services from a Branch located in the DIFC;
 - (g) “SEO” means a Senior Executive Officer; and
 - (h) “senior management” includes the Governing Body.

Background

9. The DFSA has received a number of applications for waivers of the current requirement to have a Licensed Director or Partner at the head office of an Authorised Firm conducting Financial Services through a Branch in the DIFC. A key argument for such waivers is that it is difficult and impractical for large international organisations with complex and extensive operations over many jurisdictions to identify a specific Director or Partner (or a number of them) as the individuals having ultimate responsibility for a Branch operation. This is said to be the case because:
- (a) Directors or Partners at the head office are not sufficiently close to the business operations of a Branch located in a different jurisdiction; and

- (b) of the reluctance on the part of such Directors or Partners to assume individual accountability, when in fact all Directors or Partners of the Firm are legally accountable for the overall management and operations of the Firm including that of its Branches.

Reasons for and scope of the proposal

- 10. Generally, the requirement for an Authorised Firm that conducts Financial Services from a Branch located in the DIFC to have a Licensed Director/Partner at its head office is intended to serve two purposes, i.e. such a Director or Partner is expected to:
 - (a) act as a conduit for passing critical information relating to the Branch operations of the Firm to its Board and senior management; and
 - (b) provide the DFSA with a key contact at the Board or senior management level of the Firm at its head office by being an individual registered with the DFSA.
 - 11. However, we are of the view that the requirement for a Licensed Director or Partner at the head office does not provide a meaningful regulatory benefit for the reasons that are set out below.
 - 12. First, a Firm which conducts Financial Services from a Branch in the DIFC must, like any other Authorised Firm, have an Authorised Individual who is registered with the DFSA as its Senior Executive Officer (SEO) (see AUT Rule 10.3.1(a)). The person who must be so registered with the DFSA as the SEO is an individual who, either alone or jointly with other Authorised Individuals, must bear the ultimate responsibility for the day-to-day management, supervision and control of all or any parts of the Firm's Financial Services carried on in or from the DIFC (see AUT Rule 10.2.2(a)(i)). Therefore, by requiring a Firm to have at its head office a Licensed Director or Partner who bears ultimate responsibility for the Financial Services conducted from its Branch has the potential to conflict with the mandatory SEO's role. This is because the SEO role clearly envisages that the SEO having the ultimate responsibility for the day-to-day management, supervision and control of the activities of that part of the Firm's business for which it is accountable.
 - 13. Secondly, the requirement that only specific Directors or Partners of a Firm be designated as the individuals assuming ultimate accountability for the operations of a Branch of the Firm derogates from the overall accountability of the entire senior management of the Firm for the Firm's operations. This is because such a requirement may be perceived by the other members of the Board or senior management of a Firm as reducing their individual responsibility towards Branch operations for which they have no designated accountability. Additionally, subjecting only some Directors or Partners of a Firm to the DFSA's licensing process, which encompasses applying the 'fitness and propriety' test to only those Directors or Partners with designated accountability for the Branch operations, does not promote a consistent approach to regulation.
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14. Thirdly, as is evidenced by the waiver applications already received by the DFSA, large Firms with international operations would have practical difficulties in finding individuals located at their head office to act as Licensed Director or Partner. This is because such individuals may not only lack the necessary skills, knowledge and expertise relating to a Branch operation located elsewhere, but may also be reluctant to assume such accountability for a Branch operation due to actual or perceived reduction in accountability of the other members of the Board or senior management for the branch operations.
 15. Finally and most importantly, our regulatory regime already provides adequate mechanisms for ensuring effective monitoring of a Firm's operations by its senior management. Where a Firm conducts Financial Services through a Branch located in the DIFC, we are of the view that these general requirements are sufficiently broad and flexible to deal with risks associated with such operations. The key aspects of those general obligations include requiring a Firm to:
 - (a) establish and maintain systems and controls to ensure its affairs are managed effectively and responsibly by its senior management. It must also undertake regular review of those systems and controls to ensure their continued effectiveness. The adequacy of the systems and controls will depend on factors such as the size, nature and complexity of the business of the Firm (see GEN Rule 5.3.1 and guidance);
 - (b) implement clear reporting lines that take into account the nature, scale and complexity of its business (see GEN Rule 5.3.2);
 - (c) establish and maintain risk management systems and controls to identify, assess, mitigate, control and monitor its risks (see GEN Rule 5.3.4);
 - (d) develop, implement and maintain policies and procedures to manage the risks to which the Firm and its customers are exposed and, appoint an individual to advise its Governing Body and senior management of such risks (see GEN rule 5.3.5 and 5.3.6(1)); and
 - (e) establish and maintain arrangements to provide its Governing Body and senior management with the information necessary to organise and control its activities, to comply with legislation applicable in the DIFC and to manage risks. The information must be relevant, accurate, comprehensive, timely and reliable (see GEN Rule 5.3.17).
 16. When authorising a Firm, the DFSA takes into account whether an applicant meets the relevant requirements including the systems and controls referred to above. Clearly, the systems and controls requirements must necessarily deal with specific risks arising from conducting Financial Services through a Branch in the DIFC (see AUT App 1.1). Similarly, the DFSA's supervision of Firms can rely on these specific obligations to ensure that a Firm which operates through a Branch meets the relevant requirements on an on-going basis. Where necessary, the DFSA has the ability to deal with the Governing Body and senior management of an Authorised Firm, regardless of where they are located, as they are accountable for having in place adequate mechanisms to monitor and control the business and affairs of the Authorised Firm (see GEN Rule 5.2.1(c)).
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17. In view of the above considerations, we are of the view that the current requirement in AUT Rules 10.3.4(b) and 10.3.5(b) (as is applicable depending on whether the Firm is structured as a Body Corporate or Partnership) is not necessary to ensure proper monitoring and accountability of the senior management of a Firm for its Branch operations. This is because the other existing regulatory requirements referred to above already provide adequate mechanisms for effective monitoring of, and accountability at the senior management level of the Firm for its Branch operations. Therefore, we propose to remove the current requirement in AUT Rules 10.3.4(b) and 10.3.5(b) (see Annex A for the proposed Rule amendments).