EFFECTA'S ESSENTIAL INSIGHTS: A REGULATORY UPDATE

UAE, October 2022

Welcome to EFFECTA's Essential Insights, a quarterly newsletter aimed at providing its readers with succinct overviews of some of the key regulatory issues currently faced by firms.

Historically, in the knowledge of it being holiday season, the summer has been a quieter period for regulators in the UK and UAE in terms of issuing final rules or consultation papers. It is safe to say 2022 has not followed this trend and there has been a wave of new papers, final rules and consultations from the FCA. Similarly, a wave of consultation papers, thematic review reports and Dear SEO Letters have also been published by regulators in the UAE.

For this reason, it has been incredibly difficult to pick which topics to include in this Q3 Newsletter. Whilst we hope this newsletter gives its readers the nuts and bolts of many of the regulatory matters currently being reviewed, it is by no means exhaustive. Therefore, should you have a question on any matter even if it is not contained within this Newsletter, please do reach out. Our consultants are diverse in background and knowledge base, each one holding their own area of expertise, so whatever your question, we will have someone who will be able to help.

More information about our individual consultants can be found on our website, but if you would like to discuss any of the topics covered in this newsletter and what implications they may have to your business, please do reach out to us on info@effectacompliance.com.

To review Effecta UK's Newsletter, please click here.

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In this newsletter Effecta Middle East ("Effecta ME") will cover the following topics:

1. Dubai's Virtual Assets Regulatory Authority ("VARA")

In August 2022, the UAE announced that the first independent regulator for virtual assets, VARA, released regulatory guidelines for marketing. VARA provides a framework for Virtual Asset Service Providers ("VASPs").

Does your firm intend to conduct any form of virtual asset business? If so, are you aware of the regulatory developments occurring in this asset space?

2. Dubai Financial Services Authority ("DFSA") – Cyber Security Thematic Review Report

The DFSA Cyber Thematic Review Report highlights key findings from the review launched in January 2022. The aim of the review was to determine:

- whether progress had been made on the areas requiring improvement, as highlighted in the Cyber Thematic Review Report 2020;
- the development of firms' cybersecurity frameworks; and
- the level of implementation of the DFSA Cyber Risk Management Guidelines within firms.

Is your firm's Cyber Security framework adequate to ensure compliance with DFSA's expectations?

3. Abu Dhabi Global Market ("ADGM") Financial Services Regulatory Authority ("FSRA") Capital Market Framework Enhancements

The FSRA announced enhancements to their capital markets framework. Enhancements included the introduction of rules relating to spot commodities, virtual assets, securities, benchmarks, derivatives, and environmental instruments.

The ADGM is the first financial centre in the MENA region to implement a regulatory framework for environmental instruments and spot commodity activities.

Are your firms' policies and procedures consistent with the new rules and do they reflect their practical implications?

4. Financial Services Regulatory Authority ("FSRA") Consultation Paper on OTC leveraged products

The FSRA issued Consultation Paper No.5 of 2022 - proposed amendments to rulebooks for Authorised Persons offering over-the-counter ("OTC") leveraged products to retail clients.

The proposed changes are intended to provide protection for retail clients when dealing with high-risk products.

Has your firm reviewed the possible impact and the practical implications of the proposed regulation?

5. Enforcement Actions – Common Reporting Standard ("CRS") Regulations

Five financial institutions were fined by the FSRA for breaching CRS Regulations. The financial institutions have been ordered to pay penalties and administrative fees ranging from AED 30,000 to AED 119,000 for contraventions of the CRS Regulations.

Is your firm compliant with the CRS Regulations and do your policies and procedures outline your reporting obligations?

6. DFSA – Consultation Paper No. 144 – Miscellaneous Changes

The DFSA issued Consultation Paper ("CP") no. 144 'Miscellaneous Changes' in which it proposed to update a number of DFSA rulebooks.

Has your firm reviewed the CP and assessed its impact and the practical implications of the proposed rule changes?

7. DFSA – Regulation of Crypto Tokens

The DFSA issued a Feedback Statement to explain the conclusions they reached following their CP that was published in March 2022 (CP No. 143 - Regulation of Crypto Tokens). The Feedback Statement provides the DFSA's rationale behind the rules that will be implemented on 1 November 2022 for entities seeking to provide financial services related to crypto tokens.

Has your firm reviewed the CP No. 143 and the recent Feedback Statement to assess the impact and the practical implications of the new regulatory regime?

1. Dubai Virtual Assets Regulatory Authority

Background

In August 2022, the UAE announced the first independent regulator for virtual assets, the VARA, released Administrative Order 1/2022 outlining new marketing regulations.

What do the guidelines address?

The VARA marketing regulations set out the framework for marketing, advertising or promotion of virtual assets in the UAE.

The regulations are wide-reaching and apply to any entity marketing virtual assets and contain a non-exhaustive list of actions that include all forms of communications available for marketing, advertising and promotion to UAE residents. It is to be noted that even the use of social media, endorsements, billboards or plain advertising across any platform are covered under the definition of marketing.

The wide scope of reach means that even an entity not licensed by VARA can be subject to the enforceable restrictions and must apply to VARA for authorisation or present a valid a permit from a competent authority outside the UAE.

In summary, all marketing and promotional material related to virtual assets should:

- avoid being misleading;
- include prominent disclaimers; and
- not induce sales by implication nor advise the use of credit to purchase virtual assets.

Are there penalties for non-compliance?

If entities are found to be in breach of the marketing restrictions, VARA is able to issue censures, cease and desist orders or, in serious cases, may even issue fines ranging from AED 50,000 to AED 500,000.

If you require advice on the marketing regulations and how they may impact your business, please contact us at info@effectacompliance.com.

2. DFSA – Cyber Thematic Review Report

Scope of DFSA Cyber Thematic Review – January 2022

The aim of the DFSA Thematic Review was to determine:

- whether progress had been made on the areas requiring improvement, as highlighted in the DFSA Cyber Thematic Review Report 2020;
- the current maturity of firms' cybersecurity frameworks; and
- the degree of implementation of the DFSA Cyber Risk Management Guidelines within firms.

What were the overall results of the Thematic Review?

Improvements in the maturity of cybersecurity frameworks were observed by the DFSA and most firms had implemented the recommended governance and hygiene guidelines identified in the DFSA Cyber Risk Management Guidelines, although more improvements are required to implement resilience practices. The DFSA highlighted significant improvements in:

- user authentication controls;
- password security controls;
- multi-factor authentication; and
- third-party cyber risk management.

Although improvements were identified, the DFSA noted that all 14 key findings from the DFSA Cyber Thematic Review Report 2020 continue to require further improvement.

Many firms have adopted cybersecurity best practices over the last year, but firms still need to implement a strong cybersecurity framework.

What should firms be doing now?

Firms should review the DFSA Cyber Thematic Review Report 2022 and ensure that their cybersecurity frameworks include (as appropriate):

- encryption techniques;
- vulnerability assessments and penetration testing;
- continuous monitoring detection and response capabilities;
- third-party cyber risk management;
- cyber risk identification and assessment capabilities;
- IT asset identification and classification; and
- incident response testing programme.

The DFSA indicated their intentions to conduct cyber thematic reviews every two years.

If you would like Effecta to conduct a gap analysis review of your current cybersecurity framework against the DFSA Cyber Risk Management Guidelines, please contact us at info@effectacompliance.com.

3. FSRA – Capital Markets Framework Enhancements

What are the enhancements?

On the 27 September 2022, the FSRA made enhancements to their Capital Markets Framework to include the enhancements to rules relating to:

- spot commodities
- virtual assets
- securities
- benchmarks
- derivatives
- environmental instruments

The ADGM is the first international financial centre in the MENA region to implement a regulatory framework for environmental instruments and spot commodity activities.

Who will benefit from the enhancements?

Whilst conventional financial services activities will significantly benefit from the changes, custodians/MTFs operating within ADGM are now able to seek approval from the FSRA to engage in non-fungible token ("NFT") activities.

This follows on from the innovative establishment of the comprehensive regulatory framework for virtual asset activities, which was introduced in 2018 and continues to enhance the globally leading position of the ADGM.

Markets-related activities will be positively impacted and those affected may include:

- Reporting entities
- Recognised investment exchanges
- Listed entities
- Remote bodies
- Recognised clearing houses
- Market intermediaries
- Multilateral Trading Facilities ("MTFs")
- Organised trading facilities
- Remote members
- Issuers
- Sponsors

What should firms be doing now?

Firms should be reviewing the enhancements now to identify what opportunities there may be or if there are any additional resources, infrastructure or controls they need to implement to ensure they are compliant with the enhanced Capital Markets Framework.

Effecta has extensive experience in the design and ongoing monitoring of systems and controls relating to Capital Markets activity. If you would like to discuss the impact of these changes to your business, please contact us at info@effectacompliance.com.

4. FSRA Consultation Paper on OTC Leveraged Products

What is the scope of the Consultation Paper?

The FSRA has issued CP No. 5 of 2022 – 'Proposed amendments to rulebooks for Authorised Persons offering OTC leveraged products to retail clients'.

The FSRA seeks views on proposed amendments to the Conduct of Business Rules ("COBS"), the Prudential – Investment, Insurance Intermediation, and Banking Rules ("PRU") and those relating to Fees for Authorised Persons.

The amendments to the COBS, PRU and FEES Rulebooks proposed within the CP include a formalisation, through Rulebook provisions, of existing conditions placed on the licenses of Authorised Persons offering OTC Leveraged Products to Retail Clients.

In addition, the FSRA is proposing further regulatory enhancements that have been benchmarked against standards established by peer regulators and international standard-setting bodies.

What are the key changes proposed in Consultation Paper No. 5 of 2022?

The proposed changes are intended to provide protection for retail clients when dealing with high-risk products.

The paper proposes the following:

- definition of "OTC leveraged products";
- prohibition of offering binary options to retail clients ;
- margin close-out requirements for retail clients;
- 50% margin close-out requirements put in place to protect clients from losses resulting from adverse market movements relating to the class of underlying assets;
- prohibition on making or accepting referrals by unregulated persons or third parties;
- prohibition on trading account funding through credit cards or a third-party credit facility; and
- Financial appropriateness assessment required for all clients offering OTC leveraged products to retail clients is appropriate given their financial situation and in the light of the high level of losses suffered by the target market.

Other proposed changes include:

- granting a six-month transition period in relation to the meeting of the proposed introduction of margin close-out requirements, the prohibitions on referrals by unregulated third parties, and the use of credit cards and/or credit facilities; and
- amendments to FEES to reflect that Authorised Persons wishing to offer those products, the application fee and annual supervision fee for these firms are each set at US$40,000 to reflect this and these fees are reflected in the existing Financial Service Permissions.

What are firms required to do?

Authorised Persons providing OTC leveraged products to retail clients should be reviewing the proposed rules to identify whether additional resources, infrastructure or controls may be required to ensure compliance with the proposed rules.

If you require advice on the proposed rules and how they may impact your business, please contact us at info@effectacompliance.com.

5. FSRA Enforcement Actions – Common Reporting Standard Regulations

What are the CRS requirements?

The UAE introduced the CRS Regulations in 2017 and began the reporting of information for tax purposes, pursuant to the Organisation for Economic Co-operation and Development ("OECD") CRS, in 2018. This followed the UAE Cabinet's decision for the Ministry of Finance ("MoF") to co-ordinate with various government authorities and financial services regulators (including the ADGM Registration Authority, the FSRA, the DIFC and the DFSA) for financial institutions to collect information when implementing the UAE CRS Regulations.

The MoF requires relevant government authorities to issue regulations for financial institutions for the collection and reporting of this information.

Under the CRS, the UAE has opted for the widest approach. Reporting financial institutions are required to perform due diligence procedures and report information on all accounts held by an account holder who is resident for tax purposes in a jurisdiction other than the USA or the UAE jurisdiction. The USA is excluded because jurisdictions will be reporting to the USA under FATCA.

What enforcement action was taken?

Five financial institutions were fined by the FSRA for breaching CRS Regulations.

The reporting financial institutions have been ordered to pay penalties and administrative fees ranging from AED 30,000 to AED 119,000 for contraventions of the CRS Regulations.

The failures identified by the FSRA include:

- Failure to apply adequate due diligence procedures;
- Failure to keep records of the performance of due diligence;
- Failure to report required information in a complete and accurate manner; and
- Failure to obtain valid self-certification of tax information from clients.

What are firms required to do?

Firms should be reviewing their reporting obligations, ensuring they are collecting the correct information for reporting purposes and documenting their internal procedures for doing so. Firms who do not have any reporting obligations should also maintain adequate procedures to demonstrate that they have assessed the requirements and determined their applicability.

6. DFSA – Consultation Paper No. 144 – Miscellaneous Changes

What are the proposed changes to the rules?

The DFSA CP No. 144 proposes to update a number of rule changes as summarised below:

- reporting deadline updated for the delivery of audited financial statements by branches;
- enhancements to reporting obligations in relation to market abuse;
- an expansion of the Eligible Custodian definition;
- additional reporting obligations for Category 3C firms in respect of capital requirements;
- a new reporting form for Money Service Providers; and
- changes to the fee for an endorsement to operate a Fund Platform.

What are firms required to do?

Firms should review the proposed rule changes to identify whether additional resources, infrastructure or controls may be required to ensure compliance with the proposed new rules once implemented.

If you require advice on the proposed rules and how they may impact your business, or if you require assistance with your compliance documentation, please contact us at info@effectacompliance.com.

7. DFSA – Regulation of Crypto Tokens

What are the proposed changes to the Rules?

The DFSA issued a Feedback Statement explaining the rationale behind the new rules for the crypto tokens regulatory regime, which are intended to be implemented on 1 November 2022 for entities wishing to provide financial services in connection with crypto tokens.

In the Feedback Statement, the DFSA stated that they had received a wide range of feedback from stakeholders in response to CP No. 143 which allowed them to include the opinions of firms in the DIFC, crypto businesses and law firms. Following this response, which largely supported the proposals as they were originally presented, the DFSA have made some changes to the proposed rules, to address potential ambiguities.

The DFSA report in their Feedback Statement that no major amendments are to be made that would materially change their proposed regime for regulating crypto tokens, except as highlighted in Part 1, Section 2: Recognition of Crypto Tokens. Within this section, the DFSA have agreed to create an initial list of 'Recognised Crypto Tokens' that will not require a separate recognition via the formal DFSA application process.

The DFSA reiterated that it is their wish for firms providing services in crypto tokens to be incorporated in the DIFC, so they may provide adequate oversight of those entities and ensure their management and operational staff are situated in the DIFC. This also helps to establish clarity about which legal entity is providing the relevant service to clients, who is liable for that service, and which regulatory protections apply to the clients.

What are firms required to do?

As the new crypto tokens regulatory regime rules will be implemented on 1 November 2022, firms should be reviewing the proposed rules now to identify whether additional resources, infrastructure or controls may be required to ensure compliance with the proposed new rules once implemented.

Those firms applying to the DFSA to become authorised to provide crypto token-related products and services are expected to display a readiness in terms of human capital, and resources to prepare for the new regulatory regime.

If you require advice on the proposed rules and how they may impact your business, or if you require assistance with your compliance documentation, please contact us at info@effectacompliance.com.