

# EFFECTA'S ESSENTIAL INSIGHTS: A REGULATORY UPDATE

## UAE, February 2023

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.

2022 was a busy year for UAE regulators with an increase in enforcement action, introduction of corporate tax legislation and continued supervisory oversight through thematic reviews. As the new year unfolds, changes to new and existing regulatory regimes have been announced in relation to investment funds, while anti-money laundering and targeted financial sanctions awareness remains a key priority.

Our clients from all areas of financial services are having to grapple with understanding and implementing new rules, many of which become effective in 2023. Whilst we hope this newsletter gives our 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](mailto:info@effectacompliance.com).

To review Effecta UK's Newsletter, [please click here](#).

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

### **1. The Financial Services Regulatory Authority ("FSRA") of Abu Dhabi Global Market ("ADGM") Consultation Paper No. 8 of 2022 – Private Credit Funds**

The FSRA issued a Consultation Paper relating to private credit funds. The intention of issuing the paper was to determine the public views on the introduction of new private credit funds framework within the existing collective investment funds regime.

Is your Firm a start-up or an SME that intends to establish or manage a credit fund? If so, these proposed new rules may be applicable to you.

### **2. Dubai Financial Services Authority ("DFSA") – Thematic Review on Outsourcing and Third-Party Risk**

A thematic review on outsourcing and third-party risk was conducted to determine the exposure that authorised firms in the Dubai International Finance Centre ("DIFC") have to outsourcing and third-party risks. The review sought to capture:

- level or materiality, and
- the existence of a robust supporting control framework.

Does your firm rely on third parties to support your business operations or perhaps you outsource key functions to a Group entity? If so, does your Firm have appropriate outsourcing systems and controls in place?

### **3. DFSA Proposes to Lower Regulatory Requirements for Lower Risk Firms**

The DFSA issued a Consultation Paper on 7 November 2022, in which they proposed to reduce certain regulatory burdens concerning capital requirements for lower risk firms.

Will your firm be classified as a low-risk Firm under the revised DFSA classifications? If so, how will the proposed regulatory amendments affect your firm?

### **4. DFSA Enforcement Action – AML Deficiencies**

The DFSA has fined the DIFC Branch of the Bank of Singapore approximately \$1,100,000 for its failure to follow DFSA anti-money laundering rules and for operating outside the boundaries of its licence.

Has your firm recently reviewed your AML framework to make sure that the systems and controls implemented are robust and effective?

### **5. UAE Federal Corporate Tax Implementation**

The UAE issued a new Federal Decree – Law No. 47 of 2022 – which relates to the taxation of corporations and businesses. The law will be applicable to all Firms and is effective for all company financial years starting on or after 1 June 2023.

Is your firm prepared for the introduction of the new corporate tax law?

### **6. DFSA – Amendments to AML Rules and Guidance**

On 22 November 2022, updates to the Regulatory Law 2004 and the DFSA AML module were published. The DFSA issued a letter to MLROs as a reminder of these updates and to provide useful information to MLROs on relevant AML guidance.

Has your firm reviewed the recent amendments and assessed their possible impact and practical implications on your existing AML framework?

### **7. UAE Securities & Commodities Authority ("SCA") – Preparation for Issuance of a New System for Investment Funds**

In December 2022, the SCA held a media briefing in which they outlined their plans to achieve a 100% increase of the amount of money managed by local funds and introduce new types of investment funds under the regulation of Board Decision No. 01/RM of 2023 concerning the regulation of investment funds which replaced the Board of Directors' Decision No. 9/RM of 2016 Concerning the Regulations of Investment Funds.

Will the new fund regime affect how your firm conducts business under SCA?

## 1. The Financial Services Regulatory Authority ("FSRA") of Abu Dhabi Global Market ("ADGM") Consultation Paper No. 8 of 2022 – Private Credit Funds

### Why was the Consultation Paper issued?

On 12 December 2022, the FSRA issued Consultation Paper No. 8 of 2022 - Private Credit Funds. The intention of issuing the paper was to determine the public views on the introduction of new private credit funds regulation within the existing investment funds regime.

Any collective investment funds that originate loans to borrowers, buy existing loans from third-party lenders or invest in any combination of these may be determined to be 'private credit funds'.

### What did the Consultation Paper include?

The Consultation Paper proposals would increase the variety of funds available in the ADGM, and would be particularly attractive for start-up firms and also Small and Medium Enterprises ("SMEs").

It is proposed that the funds may only be offered to professional clients, as either Qualified Investor Funds ("QIF") or exempt funds as it is recognised that any new regulations must proportionately reflect the risks of private credit funds and the need to introduce appropriate regulatory controls.

The proposed credit fund framework would allow:

- private credit funds and their fund managers to arrange and originate loans where the manager of the fund holds the relevant financial services permission to manage a collective investment fund (Note: in this example the fund manager and the fund will not be engaging in providing credit or arranging credit); and
- mandate specific investment and operating requirements concerning concentration risk, conflicts of interest, gearing, stress testing, permitted and prohibited investments, reporting and disclosure.

### How will this impact Firms?

The proposed rules would provide existing fund managers with an avenue to invest in credit facilities through a proportionate, risk-appropriate regulatory framework that has necessary regulatory safeguards to ensure that such funds operate in a safe and sound manner.

**If you require advice on the regulatory regimes concerning investment funds and how they may benefit your business, please contact us at [info@effectacompliance.com](mailto:info@effectacompliance.com).**



## 2. Dubai Financial Services Authority ("DFSA") – Thematic Review on Outsourcing and Third-Party Risk

### Scope of DFSA Cyber Thematic Review – November 2022

In light of the publication issued by the Financial Stability Board in November 2020 titled 'Regulatory and Supervisory Issues Relating to Outsourcing and Third-Party Relationships', the DFSA issued a thematic review on the same topic. The aim of the DFSA thematic review is to determine the level and materiality of outsourcing and third-party arrangements at authorised firms and examine the supporting control frameworks.

### How is the Thematic Review being conducted?

The review will be conducted over two phases:

- The first phase required all DFSA authorised firms (excluding representative offices and credit rating agencies) to respond to a questionnaire in December 2022, providing an overview of their outsourcing and third-party arrangements and controls; and
- The second phase is expected to be launched in Q1 2023 engaging a subset of authorised firms to be selected from the outcome of the first phase. The second phase will involve a detailed review of the control framework, including policies and procedures, and an on-site assessment visit.

Following the review, the DFSA will be publicly sharing key findings and observed practices.

### What should firms be doing now?

Authorised firms should review their arrangements for outsourcing and third-party involvement in the provision of products and services by considering (as appropriate):

- Which areas of your business utilise or are party to outsourcing or third-party arrangements?;
- Are adequate policies and procedures in place to govern outsourcing or third-party arrangements?;
- Who is responsible for the oversight of any/all outsourcing or third-party arrangements?;

- What are the key factors considered when conducting due diligence on outsourcing or third-party arrangements?; and
- How often are outsourcing or third-party arrangements reviewed by the Firm?

If you require assistance to review your current systems and controls framework in relation to outsourcing and third-party risk, please contact us at [info@effectacompliance.com](mailto:info@effectacompliance.com).



### 3. DFSA Proposes to Lower Regulatory Requirements for Lower Risk Firms

#### What are the proposals?

On 7 November 2022, the DFSA issued Consultation Paper No. 145, in which they outlined proposals to reduce the capital requirement requirements for Firms that are deemed to pose a lower prudential risk.

#### What are the proposals?

The proposed amendments to the regulations include:

- New classification for activities posing a lower regulatory risk;
- Removing Expenditure Based Capital Requirements ("EBCR") for lower-risk firms, effective 1 Jan 2024;
- Relaxing liquidity requirements for lower-risk firms (i.e. with the removal of the Expenditure Base Capital Minimum ("EBCM") for lower-risk firms, they propose that the EBCM-driven liquidity rule also falls away);
- Raising the capital requirements for Alternative Trading System ("ATS") and crowdfunding platform operators;
- Raising the base capital requirements for some category 4 firms. (e.g. ATS operators and crowdfunding platforms are currently subject to a base capital of USD 10,000, which becomes USD 140,000 if the firm holds or controls client assets. The new proposal is that these firms are subject to a flat-rate USD 140,000 base capital requirement);
- Removing the obligation for categories 3B, 3C and 4 firms to report Internal Risk Assessment Process ("IRAP") to the DFSA.

#### How will the DFSA classify 'Low-Risk'?

The DFSA proposes of the following criteria shall be considered when identifying which firms may be classified as low-risk:

- a. Perceived risk arising from regulated activities; and
- b. Perceived risk arising from holding or controlling client assets and insurance monies.

With regards to (a), the DFSA believes that any firm that provides the financial service of advising, arranging, insurance intermediation,

and insurance management may, in general, represent lower risk.

With regards to (b), any Firm with an endorsement on their licence to hold or control client money will not be included in the low-risk category.

#### What should Firms be doing now?

Firms should review their current business activities to determine whether they qualify as a lower-risk firm in accordance with the DFSA's revised classifications. ATS and crowdfunding platforms should consider the potential impact of an increase in base capital requirements.

**If you would like to discuss the potential impact these changes may have on your business, please contact us at [info@effectacompliance.com](mailto:info@effectacompliance.com).**



## 4. DFSA Enforcement Action – AML Deficiencies

### Background

The DIFC branch of Bank of Singapore Limited has been fined around US\$1.1M by the DFSA for failing to adhere to DFSA legislation. The fine originally imposed was US\$2M, however, the bank offered the DFSA an enforceable undertaking to remediate deficiencies and agreed to settle the matter.

### What offences occurred?

It was found that the bank had acted outside the scope of its licence by conducting the financial service of arranging deals in investments in respect of products it was not authorised for..

Deficiencies were also identified in the bank's suitability and client classification processes in addition to its key AML systems and controls, including the:

- Assessment of risks posed by clients;
- Suspicious activity reporting process and follow-up action;
- Customer due diligence ("CDD") and enhanced CDD methods;
- AML business risk assessment; and
- Identification of source of wealth and source of funds.

### What lessons are to be learned?

All firms should ensure that their AML systems and controls enable them to comply with the DFSA's AML Module and applicable Federal AML Legislation. The effectiveness of those systems and controls should be reviewed regularly to ensure that weaknesses are identified and brought to senior management's attention. Further, appropriate and timely action should be taken where deficiencies are identified.

**If you require Effecta to conduct a full analysis review or health check of your existing AML systems and controls, please contact us at [info@effectacompliance.com](mailto:info@effectacompliance.com).**



## 5. UAE Federal Corporate Tax Law Implementation

### Background

On 9 December 2022, the UAE federal government issued the Federal Decree Law No. 47 of 2022 on Taxation of Corporations and Businesses (the "Law"). The Law is effective for financial years starting on or after 1 June 2023.

The new tax regime will levy a 9% fee for taxable profits exceeding AED375,000. However, in cases of profits lesser than (or equal to) this amount, a 0% tax rate will apply. The intention behind this approach is to provide an attractive environment to assist start-up companies and SMEs.

The UAE Ministry of Finance has stated that the new Law, whilst supporting the Organisation for Economic Co-Operation and Development ("OECD") inclusive framework, will help increase the UAE's global economic competitiveness, as well as providing the national economy with sufficient flexibility to deal with and support international financial systems.

### Will the corporate tax law apply to me?

The corporate tax law will apply to:

- UAE companies, or other applicable persons, that are incorporated or effectively managed and controlled in the UAE;
- Individuals who conduct a business in the UAE as specified in the upcoming cabinet decision;
- non-resident/foreign legal entities that have a permanent establishment in the UAE; and
- a UAE free zone entity may benefit from a 0% corporate tax rate on its qualifying income if the entity is considered as a qualifying free zone person.

The corporate tax law will not be applicable to the following categories of business:

- natural resource extraction activities (they remain subject to existing local emirate-level taxation);
- government entities;
- pension funds;
- investment funds;
- public benefit organisations;
- free trade zones (will benefit from the 0% corporate tax rate on qualifying income);

- personal income from employment from public or private sectors interests or personal income earned back from bank deposits; and
- real estate investments by individuals in a personal capacity.

### What should Firms do now?

All firms should determine to what extent the new Law will be applicable to their businesses. In the cases where the new Law will be applicable, Firms are reminded that the filing and payment of corporate tax must be made within nine months after the end of the relevant financial reporting year. Firms are encouraged to seek appropriate tax advice, where necessary.



## 6. DFSA – Amendments to AML Rules and Guidance

### What are the changes to the Regulatory Laws and DFSA Rules?

On 22 November 2022 updates to the Regulatory Law 2004 and the DFSA AML Module were implemented by the DFSA. On 6 December 2022, the DFSA issued a letter to Money Laundering Reporting Officers ("MLROs") as a reminder of these updates and to provide useful information to MLROs on relevant AML guidance.

The letter highlighted amendments following recent changes to federal AML legislation:

AML rule 3.1 – reference to proliferation financing added to the definition of "money laundering"

AML rule 3.2 – AML glossary now includes a definition of proliferation financing; and

AML 14.5:1 guidance – Firms are no longer required to submit a semi-annual report to the DFSA. Periodic reports should be made available at the DFSA's request.

MLROs are advised to review the guidance provided by relevant authorities, including:

- FATF guidance – including best practice and examples of proliferation financing;
- UAE guidance – the Executive Office for Control and Non-Proliferation ("EOCN") guidance on the proliferation of weapons of mass destruction; and
- UAE training and development – the EOCN has produced the Dedicated Online Financial Integrity Network ("DOLFIN") e-learning platform, with the aim to increase awareness and understanding of implementing targeted financial sanctions ("TFS").

### Action items for Firms

Firms should review their current AML documentation to ensure that all relevant policies and procedures are up-to-date and in compliance with the current AML rules and Federal AML Legislation, as applicable. Firms are also reminded to include relevant updates in AML training.

**If you require advice on the rule changes and how they may impact your business, or if you require assistance to review your firm's AML documentation (including training-related material), please contact us at [info@effectacompliance.com](mailto:info@effectacompliance.com).**



## 7. UAE Securities & Commodities Authority ("SCA") – Preparation for Issuance of a New System for Investment Funds

### What are the changes to the fund regulations?

In December 2022, the SCA held a media briefing in which they indicated positive intention to achieve a 100% increase in the amount of money managed by local funds and introduce new types of investment funds.

### What are the changes to the Fund Regulations?

The key changes brought in are:

New categories of fund structures have been introduced such as:

- Family funds – as local fund where the ownership of its units is restricted to one or more persons from one family; and
- Self-managed funds – where a local fund is established by two or more individuals or corporates.

There is also a reduction in capital requirements of fund management companies from AED 50 million to 1 million, and fund administration companies from AED 5 million to AED 1 million. The new fund regulations remove foreign ownership restrictions, allowing 100% foreign ownership of such companies.

Further provisions under the new regulations include:

- Certain investment funds may issue and offer sukuk and bonds to the general public;
- public real estate funds may be offered to the public through the book-building mechanism;
- permitting mergers and acquisitions of local investment funds;
- applying buyback rules for investment funds traded on the stock exchange;
- capital increases of investment funds may be increased in instalments and tranches;
- the promotion or distribution of foreign funds to retail investors is prohibited, with the only exception being that a promotion to a retail client can be made on the basis of a reverse solicitation from outside the UAE or from the UAE financial free zones (ADGM and DIFC); and

- non-UAE distributors of foreign funds may continue to promote foreign funds to professional investors and market counterparties on a reverse solicitation basis.

### How will this impact Firms?

Firms should consider which activities may be captured under the new fund regulation.

If you require advice on the proposed regulations and how they may impact your business, please contact us at [info@effectacompliance.com](mailto:info@effectacompliance.com).

