

To the Senior Executive Officers
of DFSA Authorised Firms

17 August 2010

**Subject: Outcome of Thematic Review
Client Assets and Insurance Monies**

Dear SEO

As discussed in the Dear SEO letter dated 31 March 2010, protection of Client Assets remains an important regulatory issue for the DFSA. During the second quarter of 2010, the DFSA conducted a thematic review in relation to an Authorised Firms' (Firms) compliance with the Client Money provisions, Safe Custody provisions and Insurance Monies provisions. These are found in the Conduct of Business (COB) Module of DFSA's Rulebook. A total of 16 Firms were selected for the thematic review.

The scope of the review was to assess the effectiveness and adequacy of systems and controls to safeguard Client Assets and Insurance Monies. While we did not find any instances where a Client had suffered losses as a result of custody arrangements, we did find certain areas where improvement was needed. This letter sets out three areas requiring improvement.

1. Appointment of Third Party Agents

The COB Rules stipulate that before a Firm pays Client Money to, holds Safe Custody Investments with, or Arranges Custody through a Third Party Agent, it must undertake assessment of the suitability of that agent (see COB Rules A5.6.1 and A6.5.1). Further, the Firm must be able to demonstrate the grounds for determining suitability.

The review found that a number of Firms were not able to satisfactorily demonstrate their prior assessment of Third Party Agents. Not only must a Firm undertake prior assessment of the Third Party Agent, but it must have systems and controls in place to ensure that the Third Party Agent continues



to remain suitable having regard to the guidance in Appendices 5 and 6 of the COB Module. This assessment must be documented.

2. Written Acknowledgement from Third Party Agents

When a Firm opens a Client Account with a Third Party Agent it must obtain a written acknowledgement from the Third Party Agent stating, among other things, that the Third Party Agent is not entitled to combine the account with any other account or to exercise any charge, mortgage, lien, right of set-off or counterclaim against Money in that account in respect of any sum owed to it on any other account of the Firm (see COB Rule A5.7.2). A similar requirement exists for Firms passing on Safe Custody Investments to a Third Party Agent (see COB Rule A6.6.1).

The review found that a number of Firms were not able to reproduce copies of the written acknowledgement. A small number of Firms indicated they had difficulties obtaining such written acknowledgement from certain banks. In respect of Client Money, Firms must obtain such written acknowledgement within a reasonable time period. COB Rule A5.7.3 provides that if such acknowledgement is not obtained within a reasonable period, then the Firm must refrain from making further deposits of Client Money with that Third Party Agent and withdraw any Client Money from that Client Account.

3. Auditor's Report

If a Firm controls or holds Client Money, it must require its auditor to produce a Client Money Auditor's Report (see GEN Rule 8.6.1(d)). Similarly, if a Firm controls or holds Insurance Money, an Insurance Monies Auditor's Report must be produced (see GEN Rule 8.6.1(e)). Also, if a Firm holds or controls Client Investments, Arranges Custody or Provides Custody in or from the DIFC, a Safe Custody Auditor's Report must be produced (see GEN Rule 8.6.1(f)).

Even though many Firms in the DIFC are licensed to Arrange Custody, the review found that many Firms had not required their Auditors to produce a Safe Custody Auditor's Report. Such report should include the Auditor's opinion on whether the Firm has, throughout the year, maintained systems and controls to enable it to comply with the Safe Custody Provisions in Appendix 6 of the COB Module. Given the varying levels of risk involved in different financial services, the requirements in the Safe Custody Provisions which apply to the firms licensed to Arrange Custody are less than those that apply to the Firms Providing Custody. They relate mainly to the systems and controls the Firm must have in place to ensure the Third Party Agent is suitable and remains suitable.

If a Firm is licensed to carry out the activity of Arranging Custody, but has not yet done so, an Auditor's Report is still required indicating no activity has taken place. If a Firm has not carried out this activity or no longer plans to do so, the Firm should review its business plan to assess whether it is worthwhile remaining licensed for this activity. If in doubt then the Firm should discuss this with its DFSA Relationship Manger.

Yours sincerely,



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Acting Managing Director, Supervision

cc. Compliance Officers of Authorised Firms