

By Email

18 October 2012

To the Senior Executive Officers of DFSA Authorised Firms

Dear SEO

OUTCOME OF THEMATIC REVIEW – CLIENT TAKE-ON PROCESSES AND SUITABILITY

As outlined in our letter dated 12 March 2012, the DFSA undertook a thematic review during the first half of 2012, focusing on the overall client take-on process. This included the aspects of client take-on relating to the type of client (retail, professional or market counterparty), the suitability of the client for specific products (as required by Conduct of Business Rules) and the customer due diligence process related to initial client take-on (as required by Anti-Money Laundering Rules). A total of 14 Firms were selected for the thematic review, representing nearly 5% of all Authorised Firms.

The overall findings of the review were positive; however, a number of issues were identified in relation to client agreements and proper evidence supporting suitability analysis. We have highlighted the major issues from the thematic review below.

Professional Client Definition

The Professional Client definition was tested extensively during the theme review visits. The majority of the Firms visited dealt with Professional Clients only. Most Firms rely on relationship managers / investment advisors to classify their clients, and most of the client files contained extensive narratives on clients' backgrounds. However, there was not always sufficient evidence on file to support the relationship manager's / investment advisor's narratives, in particular to justify the financial knowledge and experience requirement or self-certification by clients. At the very least, the DFSA expects to see more evidence on file to support the Professional Client designation and more comprehensive sampling from either compliance monitoring or from internal audit to test the designation thoroughly. We do not wish the painful lessons of the financial crisis, regarding suitability of products and services, to fade from memory as we move forward.

Suitability Limits and Waivers

Currently, the DFSA Conduct of Business (COB) Rules allow Firms to limit/waive suitability requirements, in certain circumstances, when making a recommendation. This is possible if the Firm has given a written warning to the Professional Client which clearly states either that the Firm will not consider suitability or will consider suitability only to the extent specified in the notice. Once the Professional Client has given his / her express written consent after a proper opportunity to consider the warning, then the Firm is able to limit/waive the suitability requirements.

The DFSA was pleased to see from the review that where clients had opted to limit/waive suitability there was no evidence of coercion or “leading the client”. In instances where the Firm limits/waives suitability, Firms are expected to ensure no advice is given and comprehensive sampling from either compliance monitoring or from internal audit is done on a periodical basis.

Client Agreements

Overall, the client agreements in place were of good quality. However, there were some cases where these agreements did not meet the COB requirements and other instances where agreements were not evident on local file. This, in part, reflects the international nature of finance and the use of booking centres elsewhere. However, where a financial service is carried out in or from the DIFC; the Firm is expected to have a client agreement in place locally. This agreement must be in line with the COB requirements. Firms where deficiencies were identified have been referred to the respective relationship managers to address this matter.

AML Issues

This review was not a comprehensive look at customer due diligence or know your customer principles, however, we did include certain aspects of our AML Rules in the client take-on process. The only problematic area noted in the limited scope of this review related to AML Rules is the client take-on process in an acquisition. The DFSA recognises the difficulty of bringing all existing clients in a merger or acquisition to a new standard, rapidly. Firms are reminded of the importance of ensuring that client's accepted in this manner or client's migrated from other offices of the Firm, must satisfy *all* current DFSA requirements. This should be a consideration in any merger or acquisition due diligence process, and certainly when a Firm is considering migration of clients from another office or jurisdiction.

Next Steps

The Supervision Division will hold an outreach session detailing the findings of the review on 23 October 2013. Conduct issues will continue to remain an important priority for the DFSA, both in terms of normal risk assessments and with thematic reviews.

Sincerely,



Bryan Stirewalt
Managing Director, Supervision