Questions and Answers – The Client Classification Regime

Status of this document

These questions and answers are designed to assist Authorised Firms ("Firms") to apply the client classification regime in chapter 2 of the Conduct of Business (COB) module of the DFSA Rulebook. They do not constitute legal advice and should not be acted upon as such. If there is any inconsistency between any statement in this document and the relevant Rules or associated Guidance, the Rules and Guidance prevail.

Firms should, where they consider necessary, obtain their own legal advice in relation to their specific situations.

This document does not cover each and every aspect of the Rules in COB chapter 2. It selectively addresses issues where we feel clarification may be helpful.

This document is a living document – as we become aware of new or changing issues, we will amend the document as appropriate.

Version 1.0 Published on 26 April 2015

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Guiding principles

A Firm should bear the following in mind when applying the client classification regime:

- the underlying purpose of the regime – which is to ensure that the Firm gives the right level of regulatory protection to a Client, taking into account the Client's resources, knowledge and experience; and
- the Principles for Authorised Firms (in section 4.2 of the General (GEN) module), for example 'Principle 1 – Integrity' which requires a Firm to observe high standards of integrity and fair dealing and 'Principle 6 – Information and interests', which provides that a Firm must pay due regard to the interests of its customers.

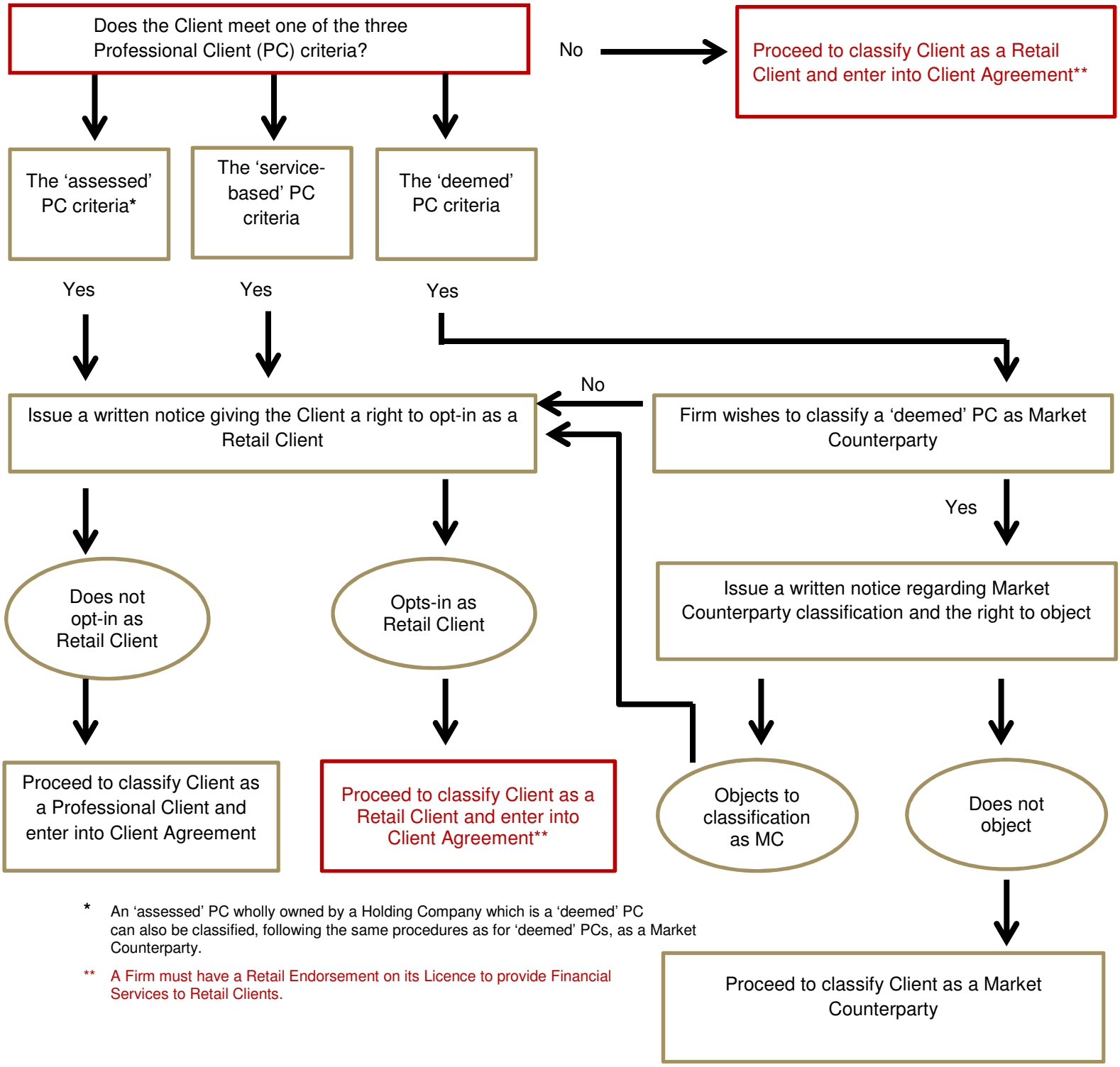
If a Firm faces a situation where it can adopt one of two approaches when providing a Financial Service, it is more appropriate for it to adopt the approach which is consistent with not only the letter of the Rules, but also the spirit of the Rules.

Terminology & Structure

Capitalised terms in this document are generally defined terms in the Glossary (GLO) Module of the DFSA Rulebook, unless otherwise indicated.

Illustration of a classification of a new Client

Decision Tree



* An 'assessed' PC wholly owned by a Holding Company which is a 'deemed' PC can also be classified, following the same procedures as for 'deemed' PCs, as a Market Counterparty.

** A Firm must have a Retail Endorsement on its Licence to provide Financial Services to Retail Clients.

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Questions and Answers

Application

Question 1: Must all Firms carry out a client classification?

Answer: All Firms must classify Persons (i.e. Clients) with or for whom they carry on Financial Services in accordance with chapter 2 of COB. There are three exceptions:

(a) Credit Rating Agencies – which do not have Clients for their services when they issue ratings;

(b) Representative Offices – which do not have Clients because they only carry out marketing and promotional activities; and

(c) Insurance Special Purpose Vehicles (ISPVs) – These are established by Insurers to provide their Financial Services and the Insurers, and not their ISPVs, have the client relationship with policyholders or insureds.

Identification of a Client

Question 2: Who is the Client when a Firm provides Financial Services to a trust?

Answer: The trustee is the Client, and not the beneficiaries. This is because:

(a) the trustee is legally responsible for managing the trust for the benefit of the beneficiaries;

(b) the trustee owes fiduciary duties to beneficiaries when managing the trust property; and

(c) the trustee obtains Financial Services from the Firm in its capacity as the manager of the trust.

COB Rule 2.3.7(2) contains one exception where a Firm may classify a trust (and not the trustee) as its Client. This is for a personal investment vehicle (which can be in the form of a company, trust or foundation), which is set up solely for the purpose of facilitating the management of an investment portfolio of an individual who meets the Professional Client criteria.

Question 3: Is a Fund Manager, pension fund operator or trustee required to classify the Unitholders, members or beneficiaries of their funds?

Answer: (a) In the case of a Collective Investment Fund – the Fund Manager must carry out the client classification relating to investors (including potential investors) in the Fund.

(b) In the case of a pension fund – the operator (fund manager) must carry out the client classification of investors (members, including potential members).

(c) In the case of a trust, the trustee is not required to carry out any client classification relating to the beneficiaries, unless it is a Collective Investment Fund under paragraph (a).

Question 4: Who is the Client when an agent obtains Financial Services for, or on behalf of, another person?

Answer: COB Rule 2.3.1(3) deals with this situation. There are two scenarios:

(a) If the Firm is aware that a Person ('agent') is obtaining Financial Services from the Firm for another person ('principal'), the Firm must treat the principal, and not the agent, as the Client of the Firm, except in the case described in (b).

(b) If the Firm (Firm 1) provides Financial Services to another 'regulated firm' (i.e. a Person who holds a Licence issued by the DFSA or by another Financial Services Regulator) and that other firm is obtaining Financial Services for or on behalf of its own clients, Firm 1 must treat the regulated firm, not the clients of the regulated firm, as its Client. This is because the clients of the other regulated firm are protected under the regulatory regimes applicable to that firm. See also Q5.

Question 5: Who is the Client when an insurer deals with an insurance broker?

Answer: An insurer 'Effecting a contract of insurance' or 'Carrying out a contract of insurance' with a policy holder may do so through an insurance broker acting for that policy holder. The Insurer must treat the broker as its Client (where the broker is a regulated firm – see Q4(b)). However, an insurer continues to have obligations to policy holders. The DFSA is of the view that an insurer may also treat the policy holder as its Client, in recognition of those obligations.

In the case of reinsurance, while a reinsurer must treat as its Client the insurance broker through whom a cedant acts, it may additionally treat the cedant as its Client.

Timing of classification

Question 6: When should a Firm undertake a classification of a potential client?

Answer: COB Rule 2.3.1 requires a Firm to classify a Person before providing a Financial Service to the Person, to ensure the Firm gives the Person the right level of regulatory protection.

A Firm must ensure that the client classification is carried out sufficiently in advance of providing to a Person a Financial Service. In doing so, the Firm should take into account the time needed to complete applicable formalities, such as giving a potential Professional Client a written notice relating to the right to opt-in as a Retail Client, entering into a Client Agreement and compliance with the prior written notification required before a Person can be classified as a Market Counterparty. Guidance notes 1 – 4 under COB Rule 2.3.1 also contain further clarification.

Question 7: Can a Firm rely on outdated information about a Client?

Answer: No. If there is a material period of time between a Firm making the classification and the actual provision of a Financial Service, the information the Firm used for the classification could be outdated. Accordingly, the Firm should verify the currency and accuracy of the information.

For example, if a Firm classified an Undertaking as a 'Large Undertaking' under COB Rule 2.3.4(2) based on the information in the most recent balance sheet at the time of the classification, but there is a more recent balance sheet when the Firm first provides a Financial Service, the Firm must obtain the more recent balance sheet to verify whether that Undertaking still meets the 'Large Undertaking' criteria.

Relevance of the type of product to client classification

Question 8: Is the type of financial product relevant to client classification?

Answer: Yes. Some financial products may be designed for Professional Clients only. If this is the case, a Firm can only provide such products to those who are Professional Clients. An example is a Unit in a Qualified Investor Fund or an Exempt Fund.

Question 9: When a Firm provides a Financial Service relating to different financial products, are they different Financial Services?

Answer: It depends on the nature of the financial product involved.

For example, if a Firm provides to a Client the Financial Service of 'dealing as agent' in relation to 'equity' products, it does not provide a different Financial Service if it also provides 'dealing' services relating to 'derivatives'. This is because the Financial Service of 'dealing as agent' covers dealing in 'Investments', which include both 'equities' and 'derivatives'.

In contrast, if a Firm advises a Client in relation to 'equities' and 'insurance contracts', it provides two different Financial Services, 'Advising on Investments' and 'Insurance Intermediation'.

Question 10: Must a Firm undertake separate classifications when different financial products are involved?

Answer: Although the Financial Service provided to a Client is the same, sometimes a Person who is classified as a Professional Client in respect of one type of a financial product (e.g. equity) may not have adequate knowledge and experience relating to a different type of financial product (e.g. derivatives). In this case, a Firm should not classify the Client as a Professional Client when advising and arranging relating to derivatives.

Types of Clients

Question 11: Can a Firm give different classifications to a single Client?

Answer: Yes. This would usually occur where the Firm offers different Financial Services to a single Client. Examples are as follows:

(a) A Firm offers the Financial Services of 'providing credit', 'advising on financial products or credit' and 'arranging credit or deals in Investments' to an Undertaking. If the Firm provides credit to the Undertaking for business purposes, it would be able to classify the Undertaking as a 'service-based' Professional Client under COB Rule 2.3.5. If the Firm also provides advising and arranging services to the Undertaking in respect of a credit hedging arrangement (which is a derivative), the Undertaking may not have sufficient knowledge and experience relating to such derivatives. In that case, the Firm must classify the Undertaking as a Retail Client for advising and arranging, and as a Professional Client for providing credit.

(b) The Client may wish to opt-in as a Retail Client in respect of some but not all Financial Services offered by the Firm.

(c) A 'deemed' Professional Client may agree to classification as a Market Counterparty for some, but not all, Financial Services. In this case, the Client would have Professional Client and Market Counterparty classifications for different Financial Services offered by the Firm.

Retail Clients

Question 12: In what circumstances can a Firm classify a Person as a Retail Client?

Answer: A Firm can classify a Person as a Retail Client under three scenarios:

(a) A Firm with a Retail Endorsement may elect to classify all its Clients as Retail Clients and so not need to undertake any due diligence relating to the wealth, knowledge and experience of those Clients.

(b) A Firm must classify a Person as a Retail Client if, after undertaking the necessary due diligence, the Firm finds that the Person does not meet the Professional Client criteria.

(c) A Firm must classify a Professional Client as a Retail Client when that Client exercises the right to opt-in as a Retail Client (see Q16).

Professional Clients – General

Question 13: Are there differences between the three different types of Professional Clients?

Answer: While 'deemed', 'service-based' and 'assessed' Professional Clients receive a similar level of regulatory protection, there are some differences:

(a) the criteria that a Firm must apply to classify a Person as a particular type of a Professional Client are different.

For example, to classify a Person as a 'deemed' Professional Client, that Person must be included in the list under COB Rule 2.3.4(1). The Firm must obtain some documentary evidence to establish that the Person belongs to one of the specified types of entities that are included in that list. In contrast, to classify a Person as an 'assessed' Professional Client, a Firm must undertake a detailed assessment against the asset test and the knowledge and experience test (see Q22).

(b) The consequence of being classified as a certain type of a Professional Client can also be different. For example, it is mainly 'deemed' Professional Clients who can be classified as Market Counterparties. (see Q26).

Question 14: Must a Firm provide on-going reminders to Professional Clients about their right to opt-in as a Retail Client?

Answer: No**.** There is no continuing obligation on the part of the Firm to remind a Professional Client of the right to opt-in on an ongoing basis.

Question 15: For how long can a Firm rely on an existing Professional Client classification?

Answer: A Firm can continue to rely on the existing classification until one of the following occurs:

(a) the Client tells the Firm that it wishes to opt-in as a Retail Client;

(b) the Firm becomes aware that the Client no longer fulfils the Professional Client criteria; or

(c) a new Financial Service substantially different to those previously provided to the Client is offered, and – upon re-classification (see Q18) - the Client is found not to meet the Professional Client criteria in respect of that service.

Question 16: What should a Firm do when a Professional Client exercises the right to opt-in as a Retail Client?

Answer: If a Professional Client requests to opt-in as a Retail Client, and the Firm has a Retail Endorsement, the Firm can continue to provide Financial Services to the Client, but as a Retail Client and not as a Professional Client.

If the Firm has no Retail Endorsement, it must promptly advise the Client that the Firm is unable to provide, in going forward, any Financial Services to the Client as a Retail Client. The Firm must also make all necessary arrangements to ensure that it no longer provides Financial Services to a Client once that Client has exercised the right to opt-in as retail, subject to one exception.

In some cases an existing Professional Client may ask to be re-classified as retail only for some, but not all, Financial Services provided by the Firm. The Firm may, in such a case, continue to provide the Financial Services other than those for which the Client has sought retail status. The DFSA expects Firms which do so to maintain clear records that the Client wished to continue as a Professional Client for those other Financial Services.

Financial Services and financial products that were previously provided are not affected by the exercise of the right to opt-in as retail.

Firms without a Retail Endorsement must not persuade their Clients not to exercise their right to opt-in as retail.

Question 17: Must a Firm monitor whether a Client continues to meet the Professional Client criteria?

Answer: There is no mandatory obligation for a Firm to monitor whether Professional Clients continue to meet the relevant criteria. However, if a Firm becomes aware that circumstances relating to a particular Professional Client have changed materially, the Firm cannot continue to provide Financial Services to that Client as though nothing has changed.

Sometimes a Firm may become aware of change of circumstances affecting a particular Client through the ordinary course of its dealings with that Client. For example, an Undertaking which is an 'assessed' Professional Client may no longer have the employee who held the requisite knowledge and experience. The Firm may become aware of this when a new employee starts making decisions relating to transactions for that Undertaking. Once the Firm becomes aware of such a change, the Firm should not continue to provide Financial Services to the Undertaking as a Professional Client unless the Undertaking is found, after an assessment, to have the relevant knowledge and experience among its employees.

Question 18: What should a Firm do when a new Financial Service is offered to an existing Professional Client?

Answer: When a Firm offers a new Financial Service to an existing Professional Client (other than a grandfathered client dealt with in Q[38]), there is no Rule which specifically requires a Firm to re-classify such a Client. If the new Financial Service is substantially similar to the Financial Services previously provided to the Client, the Firm can continue to use the same classification as before.

However, if the new Financial Service is substantially different to those previously offered (so that the Client's knowledge and experience appear not to extend to the new Financial Service), the Firm should re-classify the Client as appropriate. In doing so, the Firm can use the existing information relating to the Client, provided such information is accurate and not outdated.

'Deemed' Professional Clients

Question 19: What due diligence should a Firm undertake to classify a Person as a 'deemed' Professional Client?

Answer: To classify a Person as a 'deemed' Professional Client, a Firm does not have to undertake an assessment of a potential client's assets, knowledge and experience of that Person. The Firm should undertake some due diligence to ascertain that the Person falls within one of the specified categories listed under COB Rule 2.3.4(1). This may include:

(a) verifying that the Person has the relevant regulated status (e.g. that the Person holds a Licence issued by the DFSA or by a Financial Services Regulator outside the DIFC);

(b) obtaining copies of the most recent financial statements to establish:

- that the relevant criteria to be a Large Undertaking are met; or
- that the Person meets the criteria to be a trustee of a trust with at least assets of US$10 million;

(c) verifying information through publicly available sources – for example, by checking the website of the relevant exchange to ascertain whether an entity is a listed company on an exchange in an IOSCO jurisdiction; and

(d) where necessary, verifying any information directly with the Person.

'Service-based' Professional Clients

Question 20: What due diligence should a Firm undertake to classify a Person as a 'service-based' Professional Client?

Answer: A Firm does not have to assess a potential client's assets, knowledge and experience to classify that Person as a 'service-based' Professional Client. However, the Firm should undertake some due diligence to ascertain whether the parameters of the relevant 'service-based' Professional Client criteria are met, as noted below.

Business credit given to an Undertaking

Before classifying an Undertaking as a Professional Client under COB Rule 2.3.5, a Firm should:

(a) verify whether credit is for use in the business activities of the Undertaking (borrower itself), a related person of the borrower (such as a member of its Group or a natural person controller) or both the borrower and a related person; and

(b) establish that the borrower's relationship with the related person is one of the permissible categories (such as a Holding Company or a joint venture partner).

Corporate structuring and financing

Matters which a Firm should verify before classifying a potential client as a 'service-based' Professional Client under COB Rule 2.3.6 are those relating to the Financial Service itself and can be easily verified, such as whether the activity relates to a corporate restructure or refinancing.

In the case of the exclusion in COB Rule 2.3.6(2)(b), the DFSA is of the view that, generally, most advisory or arranging services provided to an individual are likely to be for the purposes of managing their private wealth. Such services would fall outside the scope of corporate structuring and financing activities. However, a natural person controller of a group of companies may undertake corporate structuring and financing activities for that group. As such, the individual would usually have significant assets under his control and relevant knowledge and experience. A Firm should generally have no difficulty in classifying such an individual as a Professional Client under the 'assessed' category.

'Assessed' Professional Clients

Question 21: In what circumstances can a Firm classify an individual as an 'assessed' Professional Client?

Answer: An individual can be classified as an 'assessed' Professional Client if the individual either:

(a) meets, in his own right, the two-pronged criteria based on net assets and knowledge and experience (see Q22)); or

(b) has a joint account with a family member who is both the primary account holder of the account and meets the two-pronged criteria referred to above. The individual must also confirm in writing that investment decisions relating to the joint account are generally made by that primary account holder with professional expertise.

To classify a joint account holder as an 'assessed' Professional Client in reliance on the primary account holder, the Firm must assess whether the primary account holder in fact meets the 'assessed' Professional Client criteria in his own right (in relation to both net assets and knowledge and experience). The Firm must also issue a written notice under COB Rule 2.4.1 to the primary account holder about the right to opt-in as a Retail Client. If the primary account holder exercises the right to opt-in as a Retail Client, the Firm can no longer classify either the primary account holder or the joint account holders as Professional Clients.

Question 22: What due diligence should a Firm undertake to classify an individual as an 'assessed' Professional Client?

Answer: A Firm must undertake a detailed assessment against the two-pronged test prescribed in the Rules – one relating to the net assets of the individual (unless he is an employee of the Firm) and the other relating to the relevant knowledge and experience of the individual.

To ascertain whether an individual meets the net asset test (i.e. US$500,000, which will increase to US$1 million on 1 April 2016), the DFSA expects Firms to obtain sufficient evidence, such as:

(a) copies of title documents;

(b) a recent certificate from a certified accountant, stating the net worth of the individual;

(c) recent bank statements; and

(d) the most recent tax returns lodged with a relevant government agency.

As the test is based on 'net' assets, any charges and mortgages held against relevant property (both real property and financial assets) must be discounted in the calculation. For more details see Guidance under COB Rules 2.3.7 and 2.4.2.

To ascertain whether an individual meets the test relating to knowledge and experience, the DFSA expects Firms to undertake a detailed assessment of the individual's knowledge and experience, particularly relating to the markets and products relevant to the type of Financial Services offered, and risks associated with such markets and financial products. For example, where a Firm proposes to offer advising and arranging services relating to investments in equity or bond markets in a particular jurisdiction, the Firm must assess the individual's level of knowledge and experience in investing in such markets to appreciate risks associated with such markets and investments.

The Firm must also retain evidence to demonstrate its compliance with the requirements. Such evidence may include records of previous transactions in relevant markets undertaken by the individual.

Question 23: Can a Firm rely on self-certifications made by an individual for classifying him as an 'assessed' Professional Client?

Answer: To classify an individual as an 'assessed' Professional Client, a Firm should not rely on self-certifications made by an individual about his net assets, or knowledge and experience. Instead, a Firm should, through objective and independent means, verify the information provided by the individual.

Question 24: In what circumstances can a Firm classify an Undertaking as an 'assessed' Professional Client?

Answer: A Firm can classify an Undertaking as an 'assessed' Professional Client if it:

(a) meets, in its own right, the two-pronged criteria based on asset and the knowledge and experience (see Q25); or

(b) has a 'look-through' entity which meets either the two-pronged criteria referred to above or the 'deemed' Professional Client criteria.

A look-through entity is a Holding Company, Subsidiary, controller or joint-venture partner of the Undertaking.

Where a Firm classifies an Undertaking in reliance on a look-through entity, the Firm must assess whether that entity meets the 'assessed' or 'deemed' Professional Client criteria as relevant (although that look-through entity is not itself the Firm's Client).

The DFSA expects a Firm to monitor whether the look-through entity continues to have the relevant relationship with the Undertaking. For this purpose, a Firm may make periodic inquiries of its Client (i.e. the Undertaking). It must retain records of the results of such inquiries to demonstrate its compliance with the relevant Rules.

Question 25: What due diligence should a Firm undertake to classify an Undertaking as an 'assessed' Professional Client?

Answer: A Firm needs to undertake a detailed assessment of the Undertaking's assets, knowledge and experience. While many aspects of the assessment for an Undertaking are substantially similar to that for an individual, there are some differences.

The asset threshold for an Undertaking is based on 'own funds' (i.e. cash and investments as shown in its most recent balance sheet) or 'called up capital' (i.e. amounts paid up on allotted shares). To ascertain whether an Undertaking meets the asset threshold, the DFSA expects Firms to obtain adequate evidence. Generally the most recent financial statements would suffice. Where such information is not available, a Firm could obtain a certificate issued by a certified accountant or the Undertaking's external auditor (if there is one) confirming the assets held by the Undertaking.

To ascertain whether an Undertaking meets the knowledge and experience criteria, the Firm must apply the relevant test to one or more individuals who make decisions relating to transactions on behalf of the Undertaking. For example, an Undertaking may have one individual making such decisions relating to equities, and another making decisions relating to derivative transactions. The Firm must assess whether the two individuals have requisite knowledge and experience relating to relevant markets and products.

Market Counterparties

Question 26: What due diligence should a Firm undertake to classify a Person as a Market Counterparty (MC)?

Answer: A Firm needs first to reasonably satisfy itself that the Person, or its Holding Company (which wholly owns it), falls within one of the specified categories under COB Rule 2.3.4(1). The Firm does not actually have to classify the Person as a 'deemed' Professional Client – instead the Firm need only obtain adequate evidence to ascertain that the Person or its Holding Company would fall within one of the relevant categories.

Once the Firm is reasonably satisfied, it must then give the Person a written notification:

(a) stating the Firm's intention to classify that Person as a MC; and

(b) stating the Person's right to object to MC classification within a specified period.

If the Person does not object within the specified period, the Firm can classify that Person as a MC.

The above notification can be given for any particular Financial Service or Transactions, or for all Financial Services and Transactions, to be provided to that Client. As there is no obligation to have a Client Agreement with MCs, Firms have greater flexibility to tailor their contracts with MCs. However, Firms must ensure that the contracts with MCs reflect the Financial Services and Transactions covered under the notification and the MC status.

Question 27: Do Firms have to give a Market Counterparty a right to opt-in as a Retail Client?

Answer: No. As noted in Q26, a Firm needs only reasonably satisfy itself that a Person meets the 'deemed' Professional Client criteria (and not actually classify the Person as such) before offering to carry on Financial Services with that Person as a Market Counterparty (MC). Therefore, the Firm does not have to give such a Person the right to opt-in as retail, which would be available to that Person if the Person were to be classified as a 'deemed' Professional Client. However, should a Person object to being classified as a MC, the Firm should consider whether to classify the Person as a 'deemed' Professional Client. If the Firm decides to do so, the Firm must, at the point of classification as a 'deemed' Professional Client, give to that Person written notice about the right to opt-in as retail (see Q15).

Client classifications made by related firms

Question 28: Is it mandatory for Firms (or Branches) within Groups to rely on client classifications made by Group members (or its head office)?

Answer: No. It is not mandatory for a Firm to rely on a client classification made by its Group members or, if it is a Branch, its head office or another branch ('related firms'). The Firm can always undertake its own classification.

The ability to rely on a client classification made by a related firm was introduced under COB Rule 2.4.4 to provide Firms greater flexibility. Where a Firm chooses to rely on such a classification, the Firm must comply fully with the requirements in COB Rule 2.4.4.

Question 29: What must a Firm do to rely on a client classification made by a related firm?

Answer: A Firm should first assess whether the regime under which the related firm classified the Client is substantially similar to the classification requirements under COB chapter 2. When doing so, the type of Financial Service or financial product the Firm proposes to offer to the Client, and the specific needs and the objectives of the particular Client, are factors to be considered.

For example, the UK/EU ('MiFID') regime requires an assessment of a Client's knowledge, experience and assets in a manner substantially similar to that required for 'assessed' Professional Clients under COB. Under that regime, a related firm may have classified an individual as an elective professional client for providing investment advice to that client. If the Firm proposes to provide advice relating to Investments to the same individual, the Firm may rely on the related firm's classification.

However, there are some differences between the MiFID regime and the COB regime – such as the difference between the MiFID asset threshold (a portfolio of financial instruments of at least EUR 500,000) and the COB asset threshold (at least $500,000,

and $1 million after 1 April 2016). While an individual who owns a portfolio of financial instruments of at least EUR 500,000 is likely to have other assets which would meet the asset threshold under COB, a Firm should consider the possibility that this may not be the case at the time it wishes to rely on the related firm's classification of the individual.

Another scenario is where an individual is classified by a related firm as an elective professional client under the MiFID regime, and the Firm wishes to provide to that individual the Financial Service of advising and arranging relating to credit or insurance. The client classification adopted by the related firm may not be appropriate because the MiFID regime does not cover credit and insurance, and the individual's knowledge and experience relating to credit or insurance may differ from the knowledge and experience in relation to investments.

Question 30: Is there a difference between outsourcing the client classification activity and relying on a classification of a related firm?

Answer: Yes.

A Firm outsources the client classification activity to a third party where the Firm contracts the third party to undertake the classification for and on behalf of the Firm. The third party is a service provider to the Firm. In contrast, where a Firm relies on a classification made by a related firm, the classification is undertaken by the related firm for its own purposes.

If a Firm outsources the client classification activity to a third party service provider, the Firm must comply with the requirements relating to outsourcing (see GEN chapter 5 and Appendix 1 of CIR). If a Firm relies on a client classification made by a related firm, the Firm must comply with the requirements in COB Rule 2.4.4. In both cases the Firm needs to ensure that the client classification it uses for a Client meets the relevant DFSA requirements.

Bundles of financial services

Question 31: Is it mandatory for a Firm within a Group to provide Financial Services as part of a 'bundle' of financial services provided by its Group members?

Answer: No, a Firm within a Group need not provide its Financial Services to a Client as part of a 'bundle' of financial services provided in conjunction with its Group members. The requirements relating to a 'bundle' of financial services were introduced to allow greater flexibility for Firms which are members of a Group. Such a Firm has two options:

(a) it can, as has always been the case, provide Financial Services to a Client on a stand-alone basis, even if its Financial Services may only form part of the services provided to the Client by it and its Group. In this case the Firm must adopt a client classification appropriate for the Financial Services it provides to the Client; or

(b) it can rely on COB Rule 2.4.5 in providing a 'bundle' of financial services in conjunction with its Group members.

Guidance notes 1 and 2 under COB Rule 2.4.5 indicate some types of arrangements which the DFSA considers to be a 'bundle' of financial services.

Question 32: What should a Firm consider before deciding to provide Financial Services as part of a 'bundle' of financial services?

Answer: A Firm should assess risks associated with providing a 'bundle' of financial services. Guidance note 4 under COB Rule 2.4.5 identifies some of the key risks.

For example, the Firm's Licence may only authorise it to provide the Financial Services of advising and arranging relating to Investments, while the bundle of financial services offered by other members of its Group may include insurance and credit facilities.

To mitigate the risk of contravening the Financial Services Prohibition under the Regulatory Law 2004, which prohibits the provision of Financial Services in or from the DIFC unless the Person holds a Licence authorising it to do so, the Firm should ensure that:

(a) those other services are not provided to the relevant Client in the DIFC; and

(b) the Client understands that such services are offered elsewhere by other members of its Group.

The Group members providing those other financial services should also ensure that they are properly authorised to provide the services in their relevant jurisdictions and those services are provided outside the DIFC.

Question 33: Can a Branch provide a bundle of financial services in conjunction with its head office or any other branch of the same legal entity?

Answer: Yes. Branches were not expressly referred to under COB Rule 2.4.5 because they have more flexibility to provide 'bundles' of financial services in conjunction with other parts of the same entity (e.g. the head office and other branches).

However, a Branch should also consider the risk of contravening the Financial Services Prohibition in the Regulatory Law 2004 if the bundle of financial services contains services which are not authorised under its Licence. A Branch could adopt similar risk mitigants to those noted in Q32.

Record Keeping

Question 34: What records must a Firm maintain to demonstrate its compliance with the client classification requirements?

Answer: A Firm must maintain adequate records to be able to demonstrate its compliance with the client classification requirements. While not exhaustive, generally these records include:

(a) evidence of information provided by a Client – such as any forms completed by the Client in response to inquiries made by the Firm;

(b) copies of any written notices from the Firm to a Client, evidence of their dispatch and any responses from the Client; and

(c) evidence provided by Clients as to their assets, knowledge and experience or their position or status.

Where a Firm relies on a classification made by a related firm (under COB Rule 2.4.4) or provides a bundle of financial services in conjunction with its Group members (under COB Rule 2.4.5), there are additional record-keeping requirements under COB Rule 2.5.3.

Question 35: What should a Firm do if records relating to client classification are not held by the Firm?

Answer: If a Firm relies on a client classification made by a related firm, or provides a bundle of financial services in conjunction with other members of its Group (or as discussed in Q33 for a Branch), the relevant classification records may not be held at or by the Firm. In this case, there is a risk that the Firm would not be able to meet its obligations relating to record-keeping under COB Rule 2.5.3(1).

A Firm must ensure that the DFSA has unrestricted access to records relating to Clients, including classification, even where the records are not maintained at or by the Firm. A Firm should not assume, without a proper risk assessment, that it can produce the records maintained by another party.

The DFSA expects Firms to undertake such an assessment of risks associated with accessibility of client records. To mitigate the risks, the Firm may, for example:

(a) obtain copies of relevant documents relating to classification of Clients maintained elsewhere;

(b) obtain written assurances from other parties that the Firm and the DFSA would be given unrestricted access to all the relevant documents for the Firm to be able to demonstrate its compliance with the Rules; and

(c) periodically test whether it could freely access records maintained elsewhere and take any remedial action as necessary.

If a Firm becomes aware of circumstances that would hinder its ability to access, or to provide the DFSA access to, records relating to classification of its Clients, the Firm must notify the DFSA immediately:

(a) of such circumstances; and

(b) what the Firm proposes to do in order to remedy the situation.

If the Firm cannot ensure unrestricted access to the records in relation to particular Clients, the Firm may need to undertake a fresh classification.

Transitional Rules (effect of the grandfathering provisions)

Question 36: Does the new regime introduced on 1 April 2015 require Firms to re-classify existing Clients?

Answer: No, except in the three events listed in Q38. This is because existing Clients and their existing classifications are grandfathered under COB Rules 2.6.1 and 2.6.2.

Question 37: Do Firms have to apply the US$1 million asset test to existing 'assessed' Professional Clients when the asset test changes on 1 April 2016?

Answer: No, as these Clients are grandfathered under COB Rule 2.6.3(2). The US$1 million asset test applies only to those Clients assessed on or after 1 April 2016.

Question 38: When does a Firm have to re-classify grandfathered Professional Clients?

Answer: A Firm must re-classify a 'grandfathered' Professional Client if one of the following three events occurs:

(a) the Client requests to opt-in as a Retail Client (see Q16);

(b) the Firm becomes aware that the Client no longer fulfils the relevant Professional Client criteria (see Q17); or

(c) a new Financial Service is offered to that Client after being grandfathered to the new regime.

Question 39: Do Firms have to enter into new Client Agreements with existing Clients when the new regime comes into force on 1 April 2015?

Answer: No. All existing Client Agreements are grandfathered under the new regime.

However, if a new Financial Service is to be provided to a grandfathered Professional Client, a Firm should consider whether a new Client Agreement (or an addendum to cover the new Financial Service) is required. This would generally be the case if the existing Client Agreement does not adequately cover the new Financial Service.

Question 40: What happens to waivers and modifications granted before 1 April 2015?

Answer: Most of the waivers/modifications in relation to client classification in force before 1 April 2015 are incorporated into the new regime. However, Firms that have any waivers and modifications from COB chapter 2 should assess whether there are any practical difficulties arising from any gap or discrepancy between the scope of the waivers and modifications under which they operate, and the new regime. If they become aware of such a gap or discrepancy, they should inform the DFSA immediately, so that we can consider what action is appropriate to address such a situation.