Dubai Financial
Services Authority

By Email

6 December 2012

To the Senior Executive Officers
Of DFSA Authorised Firms

Dear SEO

New and enhanced PIB module of DFSA Rulebook – roll-out and implementation

Over the past 18 months, the DFSA has been progressing successfully on an initiative to review and enhance the PIB module of the DFSA Rulebook, which prescribes the prudential rules for all Authorised Firms involved in banking and investment businesses. The new PIB module has been approved by the Board of the DFSA and will come into force on 9th December 2012.

The new PIB module incorporates requirements for advanced risk management standards consistent with international best practices and also includes provisions to implement the Basel III framework in a proportionate manner. The key features of the revisions to the PIB module achieved in this initiative include:

- enhanced quality and quantity of capital for Authorised Firms;
- introduction of capital and risk management requirements for operational risk;
- implementation of internal risk assessment and public disclosure requirements for Firms exposed to prudential risks;
- refinement in the prudential categories applicable to investment firms, to better align with the nature of risks posed;
- extending professional indemnity insurance requirement to a wider range of financial services activity; and
- focusing financial resource requirements for non-banking firms on availability of net liquid assets.

The purpose of this communication is to advise you about the critical changes to the prudential rules for different categories of Authorised Firms, the impact on compliance requirements and to describe the key elements of the DFSA's approach to implement the enhanced PIB module.

The coverage of enhanced PIB module

The new PIB module will continue to have the same scope, in that it will specify the rules regarding capital adequacy and risk management for Authorised Firms involved in banking and investment businesses, as in the past. Firms authorised to carry out contracts of insurance will not be covered by the new PIB module and their prudential rules will continue to be specified in the PIN module of the DFSA Rulebook.

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Structural changes to the PIB module

The most significant structural change to the PIB module involves a finer categorisation of Firms authorised to carry out different investment services, with the aim of facilitating application of relevant rules to address the divergent nature of risks to which they are exposed. Prudential category 3 as defined in the current PIB module has been split into three distinct categories, namely 3A, 3B and 3C. Authorised Firms currently falling under category 3 will be classified under one of these three categories, depending on the determinative financial services which they are licensed to perform. The following table indicates the classification of Authorised Firms based on the determinative financial services on their licence.

If your Firm has the following financial service on its licence, then it would be classified as -	**3A**	**3B**	**3C**
Dealing in Investments as Principal (only as a Matched Principal), Dealing in Investments as Agent	√		
Providing Custody for a Fund and, Acting as the Trustee of a Fund		√	
Managing Assets, Managing a Collective Investment Fund, Managing Restricted PSIAs, Providing Custody(other than for a fund) and Providing Trust Services as a trustee of an express trust			√

Consequently, Firms currently in prudential category 3 will face changes to their prudential requirements and the changes vary between the three new categories. Broadly, Firms in new category 3A will continue to be subject to risk-based capital requirements as in the current rules, while Firms in categories 3B and 3C will not be subject to risk capital requirements.

In addition, firms authorised to manage Restricted PSIAs will henceforth be classified as part of prudential category 3C. Firms authorised to manage Unrestricted PSIAs will continue to be classified either as Category 1 or Category 5 firm, depending on whether they are a Islamic Financial Institution or not. There are no changes to the prudential categories 1, 2, and 4. Therefore, if your Firm is currently in category 3, we suggest that you review Chapter 2 of the new PIB module to identify the prudential category to which your Firm will belong in the new regime and understand the changes involved. While dealing with individual chapters, we will endeavour to point out the relevant changes and their likely impact on different categories of Firms.

Changes for Firms in prudential category 3A

Firms licensed to carry out the financial services of Dealing in Investments as an Agent or Dealing in Investments as Principal (only as Matched Principal) will, henceforth, be classified under category 3A. Firms in this category will continue to face capital requirements as in the current rules but with the added elements of operational risk capital requirement and a capital conservation buffer. The higher level and quality of capital resources as applicable to Firms in higher categories will also be applicable to Firms in category 3A. The operational risk capital charge determination is detailed in Chapter 6 and the capital conservation buffer requirement, amounting to 25% of the Firm's risk capital requirement, is detailed in Section 3.9.

As highlighted earlier, these Firms will face the enhanced rules for determination of eligible capital resources detailed in Part 4 of Chapter 3. The Firms in this category will also be required to comply with the enhanced risk management requirements specified in each of the Chapters 4 to 6 dealing with credit, market and operational risks. Authorised Firms in category 3A will also be required to complete the Internal Capital Adequacy Assessment Process (ICAAP), which is described in Chapter 10 of the new module. The output of this ICAAP will be subject to a supervisory evaluation and could possibly lead to the imposition of individual capital requirement in the case of Firms exposed to additional risks.

Changes for Firms in prudential category 3B, 3C and 4

Authorised Firms classified under these categories will be subject to a capital adequacy framework which emphasises availability of liquid, net assets to meet their capital needs. The relevant rules along with the liquid assets eligible to meet these requirements are described in Section 3.5 of new PIB module. There are no changes to the base capital requirements and Expenditure Based Capital Minimum (EBCM) methodologies from the current module.

The most significant change will be removal of risk capital requirement as a component of the methodology for capital adequacy determination for Firms in categories 3B and 3C. This will also eliminate the need for such Firms to calculate and report their risk-weighted assets and risk capital charges as part of their prudential reporting. These Firms will not be subject to rules addressing credit, market and liquidity risks nor will they be subject to group risk provisions, except for sections 8.1 and 8.5.

Authorised Firms in categories 3B and 3C will be required to complete an Internal Risk Assessment Process (IRAP) and report the outcome to the DFSA. Details of these requirements are outlined in Chapter 10 of the new PIB module. These Firms will also be required to comply with rules specifying the systems and controls for managing operational risks as well as the rules mandating professional indemnity insurance cover for their financial service activities. These requirements are specified in Section 6.12 of the new module.

The DFSA is considering an outreach session to describe in detail the changes relevant to the Firms in categories 3A, 3B, 3C and 4. If you are interested in attending one of those sessions, please express your interest to your Relationship Manager at the DFSA.

Changes for Firms in prudential categories 1, 2, and 5

Authorised Firms in these categories will continue to face the same approach as in the current regime in respect of overall capital requirements. As outlined above, they will face higher level and higher quality of capital requirements along with capital requirements for operational risk exposures and a capital conservation buffer. Authorised Firms in these categories will be subject to internal capital adequacy assessment processes which form part of the Basel II framework for firms facing prudential risk exposures.

Regarding determination of capital requirements, these Firms will face rules implementing the standardised approach for credit risk forming part of the Basel II framework. There are no changes in rules in respect of market risk and liquidity risk, though we have provided additional guidance in respect of some market risk rules. The rules specifying the systems and controls requirements for all risks – credit, market, liquidity, operational and interest rate risk in banking book – have been introduced or enhanced. Given the extensive range of changes and the detailed nature of the new rules for Firms in these categories, the DFSA intends to host a workshop to describe the changes and discuss the issues involved in the roll-out of the new PIB module. If your Firm falls under one of these categories, please indicate your interest in participating in such a workshop by email to your Relationship Manager, by **Sunday, 23rd December 2012**.

Prudential Reporting

The new PIB module will come into force on 9 December 2012. However, the DFSA does not require an Authorised Firm to complete their quarterly prudential reporting under the new PIB rules until Q1 2013, the last reporting date for which is the 30th April 2013.

Waiver process for Firms operating as branches

For Authorised Firms operating as branches, a new rule has been introduced in order to remove the need to avail of a waiver from specific PIB rules. The aim is to streamline the processes involved and standardise the prudential framework for all branches. The new rule is set-out at PIB 1.1.2 and includes a useful table to clarify the rules that will apply to Authorised Firms permitted by the DFSA to operate as branches. Firms that are currently approved for a waiver will be subject to rule 1.1.2 and the historical waiver will no longer be required. We would advise all Authorised Firms to review the requirements and contact your Relationship Manager if you have any queries.

Further queries

We appreciate that there is a lot of information to cover and understand, following on from this comprehensive review of the PIB module. Please feel free to send any questions, in respect of the new PIB module, to Prasanna Seshachellam, Director, Supervision (Email: pseshachellam@dfsa.ae). We will respond to your questions at the earliest opportunity

Sincerely,

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