Dubai Financial Services Authority

CORPORATE GOVERNANCE THEMATIC REVIEW

of Authorised Firms in the Dubai International Financial Centre (DIFC)

Capitalised Terms are either defined in this paper or in the DFSA Rulebook.

Contents

Executive Summary

The Dubai Financial Services Authority (DFSA)[1] regulates the corporate governance obligations of Firms, which are Authorised[2] by the DFSA to provide Financial Services in the Dubai International Financial Centre (DIFC)[3] and Reporting Entities[4], whose securities are listed on NASDAQ Dubai.

In 2013, the DFSA carried out a thematic review (the Review) of the corporate governance arrangements of Firms. This report records the findings of the Review and the DFSA's general observations about the compliance by Firms with their corporate governance obligations at the time of the Review. The findings of the Review and the DFSA's general observations will be useful to Firms and the DFSA in assessing governance risks, and also in enhancing corporate governance standards in the DIFC. The findings are summarised below.

General Observations

- The DFSA generally found a good level of compliance by Firms with their statutory obligations, and that governance structures and arrangements generally reflected the nature, scale and complexity of businesses reviewed;
- However, the practices of many of the Firms reviewed fell short of their own stated policies. As business plans and strategies change so too will governance arrangements and responsibilities. Firms should seek to comply with their stated policies or amend them to reflect current practices; and
- A significant finding of the Review is the failure by Directors and their Governing Bodies[5] to enhance their education and development through ongoing training initiatives. This represents a significant risk to the effective governance of institutions. Governing Bodies need to recognise the need for the ongoing personal development of their Directors and implement strategies to achieve that goal.

1 - The DFSA is the integrated regulator of Financial Services and Designated Non-Financial Businesses or Professions in the DIFC.

2 - An Authorised Firm is defined in the Glossary Module of the DFSA Rulebook.

3 - The DIFC is a federal financial free zone situated in the Emirate of Dubai, United Arab Emirates (UAE). The DIFC was established pursuant to UAE Federal Law No. 8 of 2004, UAE Federal Decree No. 35 of 2004, and Dubai Law No. 9 of 2004. The DIFC occupies a physical territory of approximately 110 acres. It has its own legal system and courts distinct from those of the wider UAE, with jurisdiction over corporate, commercial, civil, employment, trusts and securities law matters.

4 - A Reporting Entity has the meaning given in Article 38 of the Markets law 2012.

5 - A Governing Body is defined in the Glossary Module of the DFSA Rulebook.

Governance

- The Governing Bodies of Firms were largely responsible for defining and setting the objectives of Firms and the strategies for achieving those objectives. However, some Governing Bodies did not set the strategic direction of the Firm. In smaller Firms, business plans and strategies were sometimes set by the Controller, Senior Executive Officer or another person;
- Firms generally had an adequate number and mix of individuals to execute their business plans. Firms also had senior management teams who understood and were responsible for the day-to-day management of the Firms' business and the execution of the Governing Bodies' objectives and strategies;
- Governance structures were generally appropriate to the nature, scale and complexity of the businesses reviewed. Body Corporates[6] (companies) were governed by a Governing Body, and Branches[7] of companies were governed by a management committee;
- Some Firms had not established the committees which were set out in their Corporate Governance Documents (CG Documents), making their actual governance structures inconsistent with their documented governance structures. In the absence of committee meetings there is a heightened risk that critical Firm functions, such as audit, risk management and compliance may not be adequately addressed by 'Governing Bodies';
- A significant proportion of committees, where they were established, did not minute their meetings nor did they have a charter or terms of reference; and
- Firms generally did not carry out structured, periodic reviews of their Governing Bodies and their committees, or their effectiveness.

Allocation of Significant Responsibilities

- All Firms inspected, and management teams interviewed, understood and complied with the requirement for senior management to be clearly responsible for the day-to-day management of their Firm's business in line with the Governing Body's objectives and strategies;
- There was adequate apportionment and recording of responsibilities between Governing Bodies and their senior management teams;
- A significant proportion of Firms had Controllers on their Governing Bodies, enhancing dominant person risk; and
- Governing Bodies were not sufficiently represented by independent members and, therefore, there is a risk that their objectivity may be compromised.

6 - A Body Corporate is defined in the Glossary Module of the DFSA Rulebook.
7 - A Branch is defined in the Glossary Module of the DFSA Rulebook.

Systems and Controls

- CG Documents describing corporate governance policies, processes, procedures, systems and controls were generally adequate but, in a number of Firms, actual practices did not match the guidelines specified in the CG Documents;
- A significant proportion of Firms did not have a formal process to periodically review their systems and controls at the level of the Governing Body;
- Some Firms did not comply with their own policy to conduct an annual review of their systems and controls; and
- Systems and controls established by a number of Firms remained untested, largely because of the nature and volume of business conducted by the Firm.

Organisation

- The roles and responsibilities of the executive and non-executive members of Firms were adequately documented and understood;
- Firms had clear reporting lines and accountabilities;
- Firms identified those staff who were providing Financial Services and provided adequate supervision; and
- Key duties were adequately segregated where possible.

Risk Management

- All Firms reported having adequate risk management structures in place;
- All Firms inspected had documented risk management systems and controls;
- Risk management practices did not always match policies;
- Most Firms reported using risk monitoring tools;
- A significant proportion of Firms did not carry out periodic risk reviews; and
- Most, but not all Firms, reported to the Governing Body on risk related issues.

Compliance

- All Firms reported having implemented adequate compliance monitoring policies, structures and processes;
- Most Firms implemented programmes to train staff on compliance issues;
- All Compliance Officers interviewed and tested on their Firm's compliance processes and procedures and compliance monitoring programmes, demonstrated a good understanding of their responsibilities;
- Outsourced Compliance Officers reported greater difficulties than in-house Compliance Officers in being fully informed of all of their respective Firms' compliance issues;
- No Firm had a formal documented policy for the escalation of concerns to the Firm's Governing Body or management committee; and
- Most, but not all, Firms maintained a breaches register and reported breaches to the DFSA.

Internal Audit

- A large proportion of Firms reported they had an internal audit function. However, some Firms reported that they did not have an internal audit function at all, despite this being a mandatory requirement, and did not disclose or discuss this issue with the DFSA;
- A large proportion of Firms had a charter or terms of reference specifying the role and responsibilities of the internal audit function;
- Firms reported that the internal audit function had unrestricted access to relevant records and to the Governing Body and senior management; and
- 50% of Firms outsourced the function.

Management Information

- Managing the quantity and quality of information presented to the Firms' Governing Bodies is a challenge, even for Firms with high quality corporate governance structures;
- The type, format, timeliness and quality of management information provided to Governing Bodies varied considerably between Firms;
- The primary focus of management information was on compliance and finance; and
- Some important areas of risk, such as conflicts of interest, related party transactions and systems and controls were omitted from many management reports.

Business Plans and Strategy

- Business plans and strategies were well established within Firms;
- A small but significant percentage of Firms indicated that persons, other than the Governing Body or senior management, approved the strategic direction of the Firm; and
- Business plans and strategies appeared to be reviewed on a periodic basis.

Staff and Agents

- Firms had adequate processes to ensure the suitability of anyone who acted for them;
- Generally, Firms had systems and controls to monitor their executive employees and to ensure they remain competent to carry out their functions; and
- Most Firms did not provide training to their Governing Bodies.

Outsourcing

- Firms' outsourcing policies were generally adequate and met expectations;
- Some outsourcing responsibilities were not clearly understood by all relevant staff; and
- Outsourced service providers were not always well supervised.

Records

- Record keeping practices were generally well documented;
- Firms were able to provide information and documents on request; and
- Records were maintained in English as expected.

About this Review

The Review comprised a questionnaire (the Questionnaire), desktop review of documented policies, procedures, systems and controls, on-site inspections of Firms and interviews with members of Firms' Governing Bodies, management teams and staff.

The Questionnaire

The Questionnaire was sent to all 301 Firms then Authorised in the DIFC. The DFSA received 262 responses, representing a participation rate of 87%, a statistically high response rate. However, not all responses received were complete and, following a data validation process, only 220 responses are considered for the purpose of this report.

Methodology for On-site Firm Visits

Following its analysis of the responses to the Questionnaire, the DFSA selected 11 Firms to participate in on-site Firm inspections. The DFSA requested the selected Firms to produce their documented corporate governance policies, processes, procedures, systems and controls which were reviewed prior to the on-site inspection.

At the on-site inspection, the DFSA interviewed selected members of the Firm's Governing Body, senior management and staff to assess how well the Firm's:

- governance framework operated in practice; and
- Directors[8], senior management and staff understood the governance framework.

Objectives

The objectives of the Review were to assess the corporate governance frameworks and practices[9] of Firms to:

- determine if they are adequate and functional having regard to the nature, scale and complexity of the business and its structure;
- determine if they are known and understood by the Firms' Authorised Individuals and relevant staff;
- identify any deficiencies or gaps in the corporate governance regimes of Firms;
- make recommendations to enhance the adequacy and effectiveness of corporate governance regimes of Firms; and
- test the level of compliance with the corporate governance requirements set out in the General Module of the DFSA Rulebook (General Module).

8 - Director is defined in the Glossary Module of the DFSA Rulebook.
9 - The corporate governance obligations for Authorised Firms are contained in Chapter 5 of the General Module.

The Legal Framework

The Companies Law[10] and the Companies Regulations guide the formation, registration and administration of companies in the DIFC.

The corporate governance obligations of Firms administered by the DFSA are located in Chapter 5 of the General Module.

Scope

This Review evaluated compliance by Firms with their legal obligations (hereinafter referred to as Expectations) under the following rules of the General Module.

TABLE 1

	Governance functions and themes	GEN Rule
1	Corporate governance	5.3.30
2	Allocation of significant responsibilities	5.2
3	Systems and controls	5.3.1
4	Organisation	5.3.2 to 5.3.3
5	Risk management	5.3.4 to 5.3.6
6	Compliance	5.3.7 to 5.3.12
7	Internal audit	5.3.13 to 5.3.15
8	Business and strategy	5.3.16
9	Management information	5.3.17
10	Staff and agents	5.3.18 to 5.3.19
11	Outsourcing	5.3.21 to 5.3.22
12	Records	5.3.24 to 5.3.27

Limitations of the Review

The Review did not assess Reporting Entities[11] or DIFC companies that do not carry on financial services activities in the DIFC. Furthermore, the sample size[12] of the on-site inspections was not sufficiently large enough to draw accurate conclusions as to the level of compliance across all Firms and therefore, should be viewed as indicative only. The corporate governance arrangements for staff and agents, outsourcing and records were not surveyed by the Questionnaire.

10 - DIFC Law No. 2 of 2009.

11 - The corporate governance obligations of Reporting Entities are contained in Chapter 3 of the DFSA Rulebook, Markets Rules.

12 - The DFSA only selected 11 Firms for on-site review as a larger sample was not within the resourcing capacity of the Review team.

Categories of Firms

The DFSA authorises Firms to carry out financial services activities in the DIFC under various categories of activities ranging from Representative Office (marketing) activities to deposit taking institutions (Category1)[13].

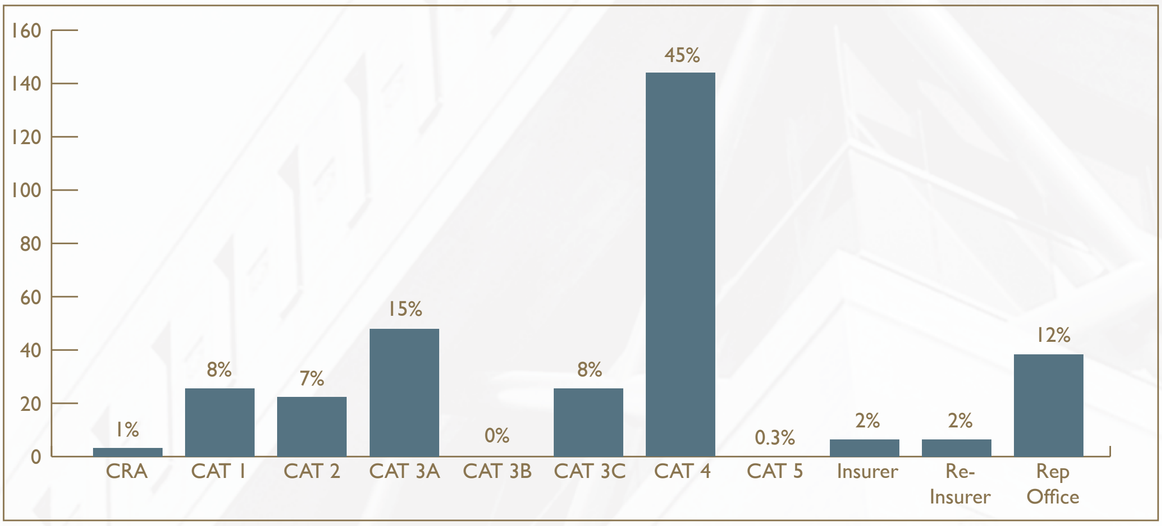

FIGURE 1: Percentage of Authorised Firms per category (as at 20.3.13)

Category 4 Firms represent the largest percentage of Firms in the DIFC and prospectively carry less risk because of the limited nature of their licensed functions. Firms are either companies registered in the DIFC or Branches of companies registered in other jurisdictions.

Of the 301 Firms Authorised as at 20 March 2013
61% are Bodies Corporate
45% are Category 4[14] Firms
39% are Branches

All categories of Firms, licensed as at the date of the review participated in the survey. 11 Firms representing Categories 1 to 5 were selected for the on-site inspection. Of those selected, eight were companies and three were Branches.

13 - Firm Categories and permissible functions are set out in Section 1.3 of the Prudential – Investment, Insurance, Intermediation and Banking Module of the DFSA Rulebook.

14 - Category 4 Firms are primarily licensed to advise on and arrange financial products and services.

Themes

The 12 themes reviewed are summarised in Table 1 on page 7, particularised in the General Module and described as *Expectations* in this paper. The following narrative addresses each of the 12 themes and sets out the findings of the Review and the DFSA's observations.

Theme 1 - Corporate Governance (GEN Rules 5.3.30)

Expectations

The DFSA expects Firms to have a Governing Body that:

- is clearly responsible for setting the objectives of the Firm and the strategies for achieving those objectives;
- comprises an adequate number and mix of individuals with the relevant knowledge, skills, expertise and time commitment; and
- has adequate powers and resources to discharge its duties and functions, including governance practices and procedures.

The DFSA expects the senior management of Firms to be clearly responsible for the day-to-day management of the Firm's business in line with the Governing Body's objectives and strategies.

Questionnaire Results

Firms said their Governing Bodies were made up of a mix of executive, non-executive and independent non-executive members. However, they also reported that there was a significant presence of Controllers[15] on Governing Bodies. The responses possibly reflect the high proportion, i.e. 45% of Category 4 Firms, that are predominately owner/operated businesses. Further responses indicated that a significant percentage of Controllers and Senior Executive Officers (SEO) also occupied the position of Chairman.

Constitution of Governing Body
82% of Firms said their Governing Bodies include executive members
67% of Firms said their Governing Bodies include non-executive members
35% of Firms said their Governing Bodies include Controllers
25% of Firms said their Governing Bodies include independent non-executive members
24% of Firms said their Governing Bodies have a Chairman who is also the SEO
20% of Firms said their Governing Bodies have a Chairman who is also a Controller

15 - Controller is defined in the Glossary Module of the DFSA Rulebook.

This information indicates an increased risk that dominant individuals could influence decision-making within Firms. Consequently Firms should consider strategies to balance this implication by appointing, where appropriate, a greater number of non-executive independent Directors to provide independent voices in strategic decision making.

However, on balance, the larger proportion of Firms, i.e. 64%, have appointed a Chairman who is neither a Controller nor the SEO thus enhancing the independence of the role.

The number of Governing Body meetings held annually by Firms varied considerably. However 52% of Firms said they held four or more meetings annually.

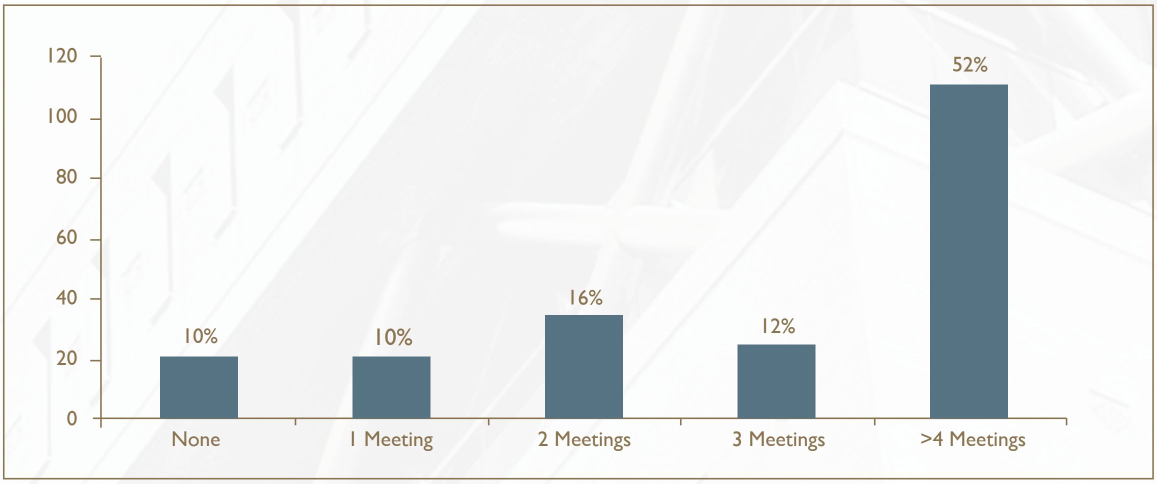

FIGURE 2: Number of Governing Body meetings held in 2012

A large percentage of Firms indicated they did not hold Governing Body committee meetings across a range of committee functions. For example, 92% of Firms did not hold a nominations committee meeting. The findings likely reflect the preponderance of Category 4 Firms in the sample, and the nature, size and complexity of the businesses of Firms surveyed. However, there is an underlying concern that critical Firm functions, such as audit, risk management and compliance may not be adequately addressed by the Governing Body in the absence of such committee meetings.

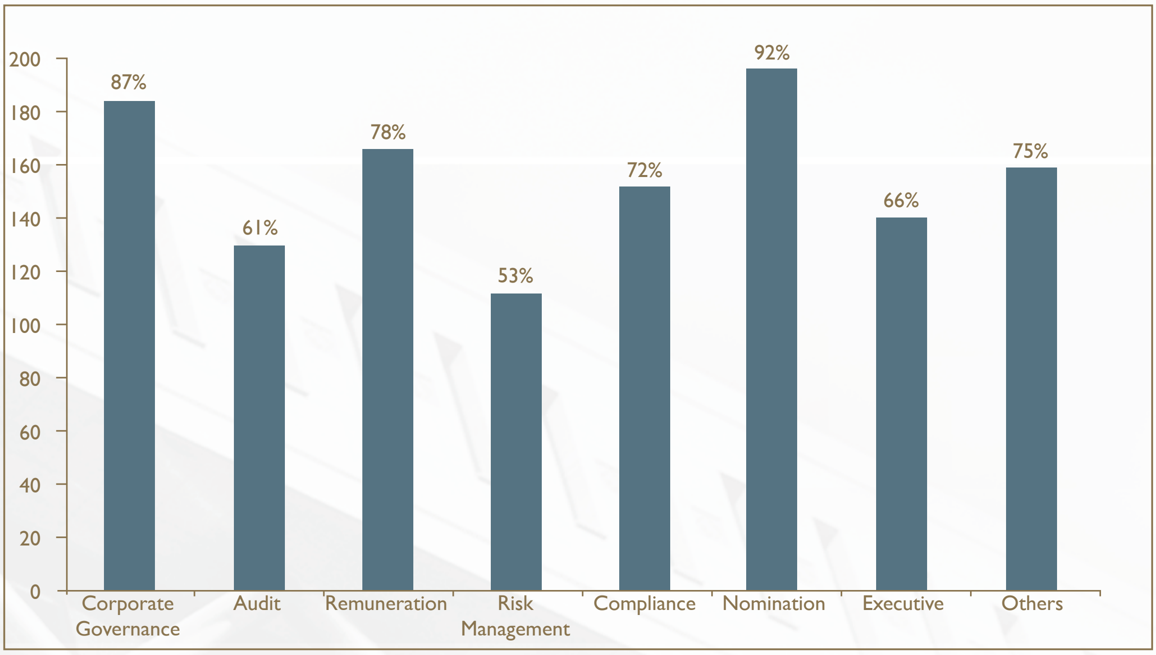

Figure 3: Type and percentage of Committee meetings not held

Committees	Charter or terms of reference	Meetings held	Minuted
Risk Management	95%	47%	93%
Audit	90%	39%	93%
Remuneration	86%	22%	88%
Compliance	83%	28%	89%
Executive	75%	34%	79%
Governance	68%	13%	87%
Nominations	62%	8%	78%
Other	87%	25%	88%

Good practice requires that Governing Bodies and their committees minute their meetings and operate under a charter or terms of reference that specifies their purpose, authority and duties. A large proportion of respondents indicated that committees of the Governing Body had not been established. However, in Firms where they were established, a small proportion of committees did not minute their meetings nor have a charter or terms of reference. It was reported that risk management and audit committees were more diligent in minuting meetings and having in place a charter or terms of reference. There is a strong expectation that all Governing Bodies and their committees will have a charter or terms of reference and that the committee meetings will be minuted.

Governing Bodies and their committees should carry out periodic reviews of their composition and effectiveness. 59% of Firms said they performed periodic reviews. Furthermore, only 47% of Firms said they reviewed the composition and effectiveness of the Governing Body's committees. A disproportionally large number of Firms are not carrying out these fundamental reviews. Periodic reviews of the Governing Body and its committees are essential to enhance the effectiveness of governance within Firms.

Firms should have written policies that prescribe their governance processes. Only 69% of Firms indicated that they had a corporate governance policy. A similarly large percentage of Firms, 67%, said they did not issue reports disclosing the extent to which the Firm complied with its corporate governance policies and procedures.

Interestingly, none of the 220 respondents indicated that their Governing Bodies have undertaken any corporate governance training, although the on-site testing identified one instance. This is a major concern for the development of good governance practices in the DIFC.

As expected, most Firms, i.e. 81%, said the strategic direction of the Firm was determined by the Governing Body. However, some Firms reported that other parties also determined the strategic direction of the Firm, as detailed below.

Strategic direction determined by:	
Governing Body	81%
Senior Executive Officer	54%
Senior Management Committee	15%
Committee of the Governing Body	8%
Finance Officer	7%
Chief Operations Officer	4%
Compliance Officer	2%
Risk Officer	1%
Other	25%

On-site observations of GEN Rules 5.3.30(1) and (2)

The DFSA's on-site review noted the following corporate governance structures:

For Companies and Branches
45% of Firms had in place a traditional structure of a Governing Body and committees. These were generally the larger Firms.
27% of Firms had a Governing Body and no committees. These were generally the smaller Firms with low business volumes.
The three Branches inspected adopted a structure whereby the Firm was managed by a Branch management committee, with the SEO as the final decision-maker for the Firm.

Companies
For the Firms without committees, their governance structures were not consistent with the structures specified in their CG Documents.

Some CG Documents contained imprecise information about the number of Directors appointed.

Other Governing Body arrangements failed to provide solutions to resolve a deadlock in Governing Body determinations.

Although CG Documents generally prescribed the number of Governing Body and committee meetings to be held each year, 18% of the sample did not comply with the stated intentions.

For the 45% of sampled Firms which did have committees, it was noted that the following committees were established to accommodate the business lines of the Firm.

Committees common to most Firms were:	
Risk Committee	51%
Audit Committee	39%
Executive Committee	34%
Compliance Committee	29%
Compensation/Remuneration Committee	23%
Corporate Governance Committee	11%
Nominations Committee	8%
Other	32%

Only 9% of Firms had a structure and formal process for reviewing the Governing Body and its effectiveness. No Firms had a structured and formal process for reviewing the committees and their effectiveness. Most Firms, however, stated that these reviews were carried out informally. For example, most of the Firms' Governing Bodies received regular reports from their committees and assessed the effectiveness of the committees by the quality of the reports.

Only one Firm reviewed provided evidence of corporate governance training for its Directors.

No Firms had a formal documented policy for the escalation of issues to the Firm's Governing Body. One Firm's failure to have escalation procedures caused it to breach, until remedied, a statutory requirement.

Branches

For Branches, the Governing Body and committees generally sat outside the Branch. However, the SEO assumed responsibility for the day-to-day oversight of the Firm.

Branches were generally managed by a Branch management committee that assisted SEOs to provide executive leadership and management to the Branch. Generally, these committees had terms of reference and their meetings were minuted.

SEOs generally sat on one or more regional/global committees for the group of companies as a whole.

On-site observations of GEN Rules 5.3.30(1) and (3)

All Firms inspected, and management teams interviewed, understood and complied with the requirement for senior management to be clearly responsible for the day-to-day management of their Firm's business in line with the Governing Body's objectives and strategies.

Case Study 1 – Corporate Governance structure
Two Firms had comprehensive and exemplary corporate governance structures. Both were part of a larger group of companies, though they were both subsidiaries and not Branches. One Firm had the following arrangements: • the Governing Body comprised of six people - two from its parent company, and four from the DIFC company (including the SEO and Finance Officer); • all Governing Body members received corporate governance training upon taking up their roles as Directors; • there were three local committees - an executive committee and two recently established operational committees. Committees dealing with audit, remuneration, finance and risk and compliance were at group level; • in 2013, the Governing Body conducted two reviews of its composition and effectiveness in discussions at Governing Body meetings. However, there was no formal procedure in place for conducting such a review; • no formal review of the committees was carried out. However, minutes of committee meetings were received by the Governing Body in their Board packs and the conduct of the committees reviewed through these minutes; • the Governing Body and its committees had either charters or terms of reference; and • there was no documented process in place for the escalation of issues to committees and Governing Body. However, the SEO and Compliance Officer were able to describe the process followed when such an issue arose.

Case Study 2 – Corporate Governance structure

One Firm had the following structure:

- the Governing Body was made up of five members - three executive and two independent non-executive members;
- the SEO was the Chairman of the Governing Body; and
- the SEO was also the Chairman of all of the Firm's committees, and had a veto power in respect of the decisions taken in those committees.

The DFSA found that this structure puts a lot of decision-making power in the hands of the SEO at committee level. At Governing Body level, this risk is mitigated by having an odd number of members so that majority decisions can be taken.

Recommendations

- Firms have the right and obligation to structure their corporate governance framework in a way which is appropriate to the nature, scale and complexity of their business. However, the CG Documents should match the Firm's practices. For a number of Firms reviewed, the framework in practice was not consistent with the CG Documents in regard to key issues. Firms should rectify this position.
- Firms should consider their structures and determine whether or not their structures put too much decision-making power in the hands of an individual or small collection of individuals.
- Governing Bodies and their committees should have a charter or terms or reference, and minutes of their meetings should be kept.
- A regular, formalised, periodic review of the Board and its committees and their effectiveness, should be conducted by the Governing Body. The regularity of the review will be a decision for the respective Firms.
- A formal and documented process for the escalation of issues to the Governing Body should be in place for each Firm.
- Regular and effective governance education and training is strongly recommended.

Theme 2 - Allocation of Significant Responsibilities (GEN Rule 5.2)

Expectations

The DFSA expects Authorised Persons[16] to:

- apportion significant responsibilities between the members of its Governing Body and its senior management. The apportionment of significant responsibilities must inter alia:
  - be appropriate to the nature, scale and complexity of the business;
  - be clear as to who is responsible; and
  - enable the business to be adequately monitored and controlled by the Governing Body and senior management;
- allocate to the SEO or the Governing Body, the functions of dealing with the apportionment of responsibilities, and overseeing the relevant systems and controls; and
- keep an up-to-date written record of the apportionment of responsibilities. The record must show that the members of the Governing Body and the senior management have accepted the apportionment of responsibilities.

Questionnaire Results

74% of respondents reported compliance with the DFSA expectations, yet on-site testing revealed a higher level of compliance.

On-site observations of GEN 5.2.1

As reported above, all Firms inspected, and management teams interviewed, understood and complied with the requirement for the Firms' senior management to be clearly responsible for the day-to-day management of the Firms' business in line with the Governing Body's objectives and strategies.

Most Firms had:

- organisational charts showing clear reporting lines;
- CG Documents setting out decision-making policies and guidelines, such as authority matrices and delegations;
- for companies, CG Documents setting out the roles and responsibilities of members of the Governing Body. These were in the form of Governing Body charters, though each Firm had a different name for the document, for example, statement of internal Governance or Corporate Governance manual. Other Firms documented the roles and responsibilities in their compliance and business plans;
- CG Documents setting out the roles and responsibilities of Governing Body committees, generally in the form of terms of reference; and
- CG Documents setting out the roles and responsibilities of members of senior management, generally in the form of job descriptions.

16 - An Authorised Person is defined, in the Glossary Module of the DFSA Rulebook, to be an Authorised Firm or an Authorised Market Institution.

Firm employees were able to accurately describe their decision-making processes and authority matrices as set out in the Firm's CG Documents.

On-site observations of GEN 5.2.2
For companies, the allocation of significant responsibilities was generally approved at the Governing Body level.

For Branches, the allocation of significant responsibilities was carried out by the SEO.

On-site observations of GEN 5.2.3
The records of most Firms generally bore the date of approval of the apportionment of responsibilities by the approving body (for example, the Governing Body). However, it was noted that 18% of Firms did not record the date of approval of the CG Documents.

Some Firms also adopted the practice of having members of senior management sign their position description, or a declaration that they will perform their duties as per the position description or other relevant CG Document. This was also a requirement for employees of the Firm.

Case Study – Documentation of the apportionment of responsibilities

One of the Firms documented its apportionment of responsibilities as follows:

- an overall high level document describing the Governing Body and its committees, its risk appetite and also the authority matrix;
- a Governing Body charter;
- charters for each for the five Governing Body committees;
- charters for each of the three senior management committees;
- a document setting out responsibilities of the key roles in the organisation; and
- an authority matrix, which set out in detail, decisions which may be required, who can initiate the process to make the decision, who should be consulted and at what level the decision should be made.

An example is a decision to change or modify the Firm's mission, vision, philosophy and guiding principles. Such a decision:

- should be initiated at SEO level;
- requires consultation with the Firm's executive committee and the majority shareholder; and
- needs to be made by the Governing Body.

The Chairman of the Governing Body and the SEO of the Firm were interviewed as to this aspect of the Firm's framework. Both demonstrated a good understanding of the framework, and in particular the authority matrix, by providing examples of decisions and the process by which they were made.

Recommendations

- Organisation charts should be up-to-date with clear reporting lines.
- Decision-making guidelines and/or authority matrices should be detailed. The DFSA recommends that such CG Documents should set out the decisions which may be required, who can initiate the process to make the decision, who should be consulted and at what level the decision should be made.
- The approval date of CG Documents should be clear, particularly in regard to charters or terms of reference.
- The body or the person approving the CG Document should also be clearly specified on the document.

Theme 3 - Systems and Controls (GEN Rule 5.3.1)

Expectations

The DFSA expects Authorised Persons to establish and maintain systems and controls, and policies that document their systems and controls, to ensure that a Firm's affairs are managed effectively and responsibly by its senior management, and to undertake regular reviews of its systems, controls and policies.

Questionnaire Results

Firms responded that they had in place a broad range of policies relevant to their operations. Policies relating to compliance, risk management, gifts and entertainment, conflicts of interest, codes of conduct (employees) and reporting breaches were more prevalent than other policies.

Existence of documented policies, procedures, codes or manuals	
Compliance	97%
Risk Management	92%
Gifts and Entertainment	91%
Conflicts of Interest	90%
Code of Conduct (Employees)	84%
Reporting Breaches	83%
Whistleblowing	74%
Ethics	71%
Remuneration	70%
Corporate Governance	69%
Fitness and Propriety (Employees)	69%
Share Dealing	69%
Outsourcing	66%
Recruitment (Employees)	61%
Code of Conduct (Directors)	58%
Fitness and Propriety (Directors)	49%
Related Party Transactions	49%
Recruitment (Directors)	34%
Succession Planning (Employees)	24%
Succession Planning (Directors)	18%
Other	43%

More than 90% of Firms said they reviewed their policies, procedures, codes or manuals and conducted the reviews annually or on a more frequent basis.

On-site observations of GEN 5.3.1

The on-site inspections observed that Firms had documented policies recording their systems and controls which, on paper, were appropriate and fit for purpose. However, it was observed that:

Documented systems and controls
36% of Firms did not have a formal process for periodically reviewing their systems and controls at the level of the Governing Body with several relying on ad hoc testing by the internal audit function (where it existed).
18% of Firms have not implemented and maintained their documented systems and controls, such as establishing an internal audit function.
18% of Firms acknowledged that many of their documented systems and controls had yet to be tested.
9% of Firms did not comply with their own policy to conduct an annual review of their systems and controls.

Case Study – Adequacy of systems and controls

One Firm acknowledged that, while its documented systems and controls appeared adequate on paper, they did not operate adequately in practice. For example:

- the Firm's income is dependent on the success of projects, so the Firm can anticipate that there will be delays in receiving income and also that there may be income which will never be received. The Firm, however, does not have in place an appropriate control to avoid breaching its prudential capital requirements;
- the Firm did not have basic Anti-Money Laundering (AML) controls in place such as a record of sign-off when taking on a client. It also did not have a process for checking a client against AML risk screening engines; and
- the Firm cited the low volume of its business and lack of profitability for the deficiencies.

Recommendations

- Firms should have systems and controls that align with the requirements of the business activity conducted. If a Firm's business model has changed or been modified due to economic or other circumstances, then the Firm's systems and controls, and its policies, should be modified accordingly.
- It is understandable that a Firm's business model may change to cope with harsh or changing economic conditions. However, Firms should consider whether the savings gained by the omission of a control is worth the risk to which the Firm may become exposed because of its omission.
- Firms should have a regular, periodic process in place for their Governing Bodies to review the Firm's policies and systems and controls, rather than carrying out ad hoc reviews.

Theme 4 - Organisation (GEN Rules 5.3.2 to 5.3.3)

Expectations

The DFSA expects Authorised Persons to:

- establish and maintain adequate measures to ensure that the roles and responsibilities of the:
  - Governing Body and its members;
  - senior management; and
  - Persons Undertaking Key Control Functions[17],

  are clearly defined and that there are clear reporting lines. The roles and responsibilities must also be documented and communicated to all relevant employees;
- ensure that any employee who provides Financial Services is clearly identified, together with his lines of accountability and supervision; and
- ensure that key duties and functions are segregated.

Questionnaire Results

There is some overlap in the results arising from the questions relating to the requirements set out in GEN Rules 5.2, 5.3.1 and 5.3.2. See the results for the 'allocation of significant responsibilities and systems and controls' referred to above.

On-site observations of GEN Rules 5.3.2 to 5.3.3

As stated earlier, all Firms had organisational charts, and documents setting out the roles and responsibilities of relevant persons and bodies. The following issues were observed:

- organisational charts were generally adequate and fit for purpose;
- the majority of Firms relied on the organisational chart to fulfil the requirements in both GEN Rules 5.3.2(1) and (2);
- 50% of Firms did not have a separate code of conduct. However, for these Firms, the Firms' expectations of its officers and employees were generally contained in other documents such as the compliance manual;
- one Firm, which did not have a code of conduct, has adopted the practice of requiring all employees to sign an annual declaration stating that they would adhere to the DFSA's Principles for Authorised Firms and Individuals, the Firm's policies and procedures and general ethical practices;
- one Firm implemented online training for its employees on its code of conduct, and required employees to complete online examinations on the code of conduct after completing the training and annually thereafter; and
- segregation of duties is more challenging in small organisations where individuals multi-task. In one Firm the Compliance Officer provided secretarial duties to the Firm's Governing Body, and its eight Governing Body and senior management committees.

17 - Persons Undertaking Key Control Functions is defined in the Glossary Module of the DFSA Rulebook.

This Governing Body decision was made to bring greater discipline to the minute-taking of committees, and the Governing Body envisaged that the Compliance Officer would also bring an independent mind to the matters discussed by these committees. However, this decision may also create a number of risks including:

- the time spent performing secretarial duties may compromise the time required for compliance duties; and
- the Compliance Officer may risk becoming too much a part of the business by participating in the Firm's business-oriented committees, thereby, compromising the ability of the Compliance Officer to bring an independent mind to any compliance issues.

Case Study – Structure of the Codes of Conduct

One Firm structured its documentation setting out the roles and responsibilities of the Firm's officers and employees as follows:
• an organisational chart;
• a high level document setting out the Firm's structure and the roles and responsibilities of all participants in that structure. The document provides details of the Firm's:
  ◦ Board of Directors;
  ◦ Management Committee;
  ◦ SEO/Licensed Director;
  ◦ Two executive Licensed Directors;
  ◦ One independent Licensed Director; and
  ◦ Compliance Officer or Money Laundering Reporting Officer.
• a comprehensive code of conduct manual which, inter alia, deals with:
  ◦ internal relationships;
  ◦ external relationships; and
  ◦ corporate integrity (ethical behaviour).
• the code of conduct applies to all Directors and employees of the Firm. Employees are required to sign a declaration stating that they have received a copy. The code of conduct also attaches the Firm's Human Resources (HR) manual and a number of the Firm's other policies (for example, policies in relation to confidentiality and conflicts of interest);
• a HR manual which refers to the code of conduct and provides details of the limits which apply for accepting gifts, hospitality etc; and
• comprehensive job descriptions for all roles, from the SEO to the cleaner. Job descriptions have to be signed by the relevant employee when he or she accepts the document.

Recommendations

- Codes of conduct or equivalent documents should apply to all employees regardless of position.
- Firms should educate staff about standards and obligations relating to conduct and ethics.
- Good practices would require all employees to acknowledge they have received, read and understood relevant CG Documents, including codes of conduct, HR manuals and job descriptions.
- Firms should be aware of, and have policies and practices to mitigate, the risks arising from the aggregation of duties.
- CG Documents setting out roles and responsibilities should be concise and written in plain, easy to understand language.

Theme 5 - Risk Management (GEN Rules 5.3.4 to 5.3.6)

Expectations

The DFSA expects Authorised Firms to:

- establish and maintain risk management systems and controls to enable them to identify, assess, mitigate, control and monitor their risks;
- develop, implement and maintain procedures to manage the risks to which they, and their customers, are exposed;
- appoint a risk adviser; and
- be aware of group wide risk policies and systems and controls where relevant.

Questionnaire Results

Identifying, recording and mitigating risk
96% of Firms said they have documented risk policies and procedures in place.
95% of Firms said they had identified and documented the risks to which they are exposed.
95% of Firms said the policies and procedures were accessible to all relevant staff.
88% of Firms said they maintain a risk register or matrix.
86% of Firms said they had appointed an individual to advise the Governing Body and senior management of the risks to the business.

Whilst there is a high level of compliance with this requirement, the DFSA expected 100% of Firms to respond positively due to the statutory obligation to do so.

80% of Firms stated that their Governing Body played a leading role in determining the Firm's risk appetite. Of these Firms, 34% said their Governing Bodies acted unilaterally. However, the results of the survey indicated that Governing Bodies largely acted in consultation with others. 53% of Firms said their risk appetite was determined by the Governing Body in consultation with one or more parties as illustrated in the table below.

Who is involved in setting the risk appetite of the Firm?	
Governing Body + Senior Management	30%
Governing Body + Risk Committee	21%
Governing Body + Risk Officer	16%
Governing Body + Risk Committee + Senior Management	12%
Governing Body + Shareholders	7%
Governing Body + Others	7%

The involvement of shareholders in setting the risk appetite of Firms is possibly a reflection of the large proportion of Category 4 Firms that are largely owner-operated businesses.

81% of Firms reported that they conducted a formal assessment of their risks within the last 12 months.

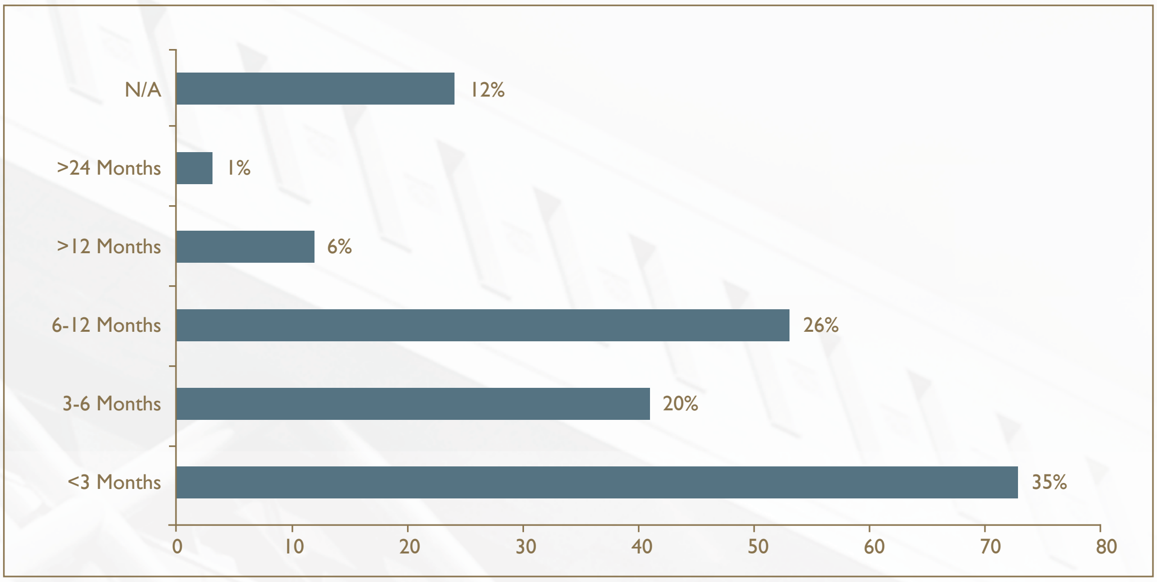

FIGURE 4: Last formal assessment of the Firm's risk

On-site observations of GEN Rule 5.3.4

All Firms inspected had documented risk management systems and controls that met the requirements of GEN Rule 5.3.4. Risk manuals inspected detailed the risk management framework, and the way risks were identified, assessed, mitigated, controlled and monitored. Most Firms included in their manuals:

- a statement setting out the Firm's risk appetite, although this varied from Firm to Firm;
- the categories of risks to which the Firm is exposed including market, credit, liquidity, operational, legal, reputational, business and information risks; and
- the roles of the Governing Body, relevant committees, senior management and the Risk Officer in the risk management process.

However, the following issues were observed:

- policies did not always match practices;
- some risks were not identified by Firms; and
- 27% of Firms inspected did not carry out periodic reviews, but instead conducted them on an ad hoc basis.

On-site observations of GEN Rule 5.3.5

Most Firms used monitoring tools such as a risk matrix or a risk register to manage the risks. The matrix or risk register generally set out the following:

- a description of the risk;
- the type of risk, for example, market, counter-party, reputational, etc;
- the risk rating. Firms used a variety of tools to rate the risk such as low, medium or high or a traffic light system of red, yellow and green;
- the status of the risk; and
- a description of the controls applied to the risk and their effectiveness.

Most Firms provided regular risk reports to the Governing Body (or to a committee of the Governing Body).

However:

- two Firms did not have a formal risk monitoring process in place, such as a risk matrix or risk register. These Firms managed risks by way of discussions between the Firms' officers at formal meetings (for example, management meetings) or at informal meetings. Admittedly, the volume of business conducted by these Firms was low, but the lack of a formal monitoring process means that there is the potential for key risks to be missed; and
- one Firm had a very simple risk matrix. However, as the Firm's major risk was the failure of clients to pay for its services, and the services provided by the Firm were largely transactional, the risk to the Firm was relatively low. Therefore, a simple risk matrix was fit for purpose for this particular Firm.

On-site observations of GEN Rule 5.3.6(1)

On-site inspections found that:

- one Firm's risk advisor was the SEO;
- four Firms' risk advisor was the Compliance Officer;
- five Firms had 'stand-alone' risk advisors (i.e. who did not perform another authorised function). Of these, two Firms had risk advisors domiciled in the UAE and three had risk advisors based elsewhere (for example, as part of the respective Firms' group structure); and
- one Firm had two risk officers – the Financial Officer, for financial risks, and the chief operating officer for operational risks.

On-site observations of GEN Rule 5.3.6(2)

Six Firms were part of a group and therefore:

- for the three Branches, the risk management systems and controls operated at group level; and
- for the three Firms which were companies and which were also part of a group, the Firm adopted the risk management systems and controls used by the group but made any necessary modifications to ensure compliance with the DFSA's requirements.

Case Study – Risk Management

One Firm identified its risks by carrying out a risk workshop facilitated by an external party. The workshop materials were produced by the Firm and are comprehensive (running to over 100 PowerPoint slides).

The Firm produced a risk matrix setting out its top five risks for each category. In the risk matrix, the following are specified for each risk:

- whether the risk is at Firm level, or at the business level of the Funds which the Firm manages;
- a description of the risk;
- the risk owner; and
- the assessment of the risk. The Firm uses a 'traffic-light' system to assess the risk as either red, yellow or green.

The Governing Body receives a risk report at each quarterly meeting. The Governing Body receives updates on the top five risks, and also all risks which are not rated green, whether they are in the top five or not. The minutes of the Governing Body meetings note that the risk reports are received and detail the discussions on the mitigation control of the risks and also any change in the risk ratings.

Recommendations

- A Firm's risk management systems and controls should be reviewed regularly to ensure that the systems and controls are operating as effectively as possible in practice.
- All Firms had adequate risk management systems and controls on paper, but the systems and controls in some Firms did not operate in accordance with the CG Documents in practice.
- Risks are not static, but change in response to changes in internal and external factors. Firms should review their risk management practices on a continuous cycle so that they may modify their systems and controls to meet the changing risks to which the Firm is exposed.
- For a number of Firms reviewed, the failure of their business model to gain traction meant that the volume of business carried out is not significant. Regular reviews of the risk management system and controls would enable these Firms to re-identify and assess their risks, and tailor their systems and controls, as appropriate, to manage and mitigate these risks. Should the Firm's risks change, for example, through an increase in the volume of business, then the Firm should commence the cycle of review again.
- Firms should have a risk management tool, such as a risk matrix or risk register, to enable them to manage risks in a formal way.
- Firms should have a regular, periodic process in place for their Governing Bodies to review the Firm's risks, and risk management systems and controls.

Theme 6 - Compliance (GEN Rules 5.3.7 to 5.3.12)

Expectations
The DFSA expects Authorised Firms to: • establish, maintain and document arrangements, including processes and procedures, to ensure that they comply with all legislation in the DIFC; • ensure that the Compliance Officer has sufficient resources, including staff, to perform his/her duties objectively and independently; • ensure that the Compliance Officer has unrestricted access to relevant records and the Governing Body and senior management; and • establish and maintain documented monitoring and reporting processes and procedures to ensure any compliance breaches are identified, reported and promptly acted on.

Questionnaire Results

Compliance framework
100% of Firms said there was a compliance monitoring programmes in place and records of compliance reviews are kept.
100% of Firms said the Firms' staff are trained on the Firm's and their own compliance obligations.
100% of Firms said the Firms maintain records of staff training events.
100% of Firms said the Firms have documents monitoring and reporting processes and procedures to ensure compliance breaches are identified, reported and promptly acted upon.
98% of Firms said the Compliance Officer provides written reports to the Governing Body.
98% of Firms said the Firms maintain a breaches register.
98% of Firms said they report breaches to the DFSA on a timely basis.

98% of Firms also said their Compliance Officers report frequently to their Governing Bodies and have the necessary access to the Governing Body, senior management and relevant records. The frequency of reporting is depicted in Figure 5 overleaf.

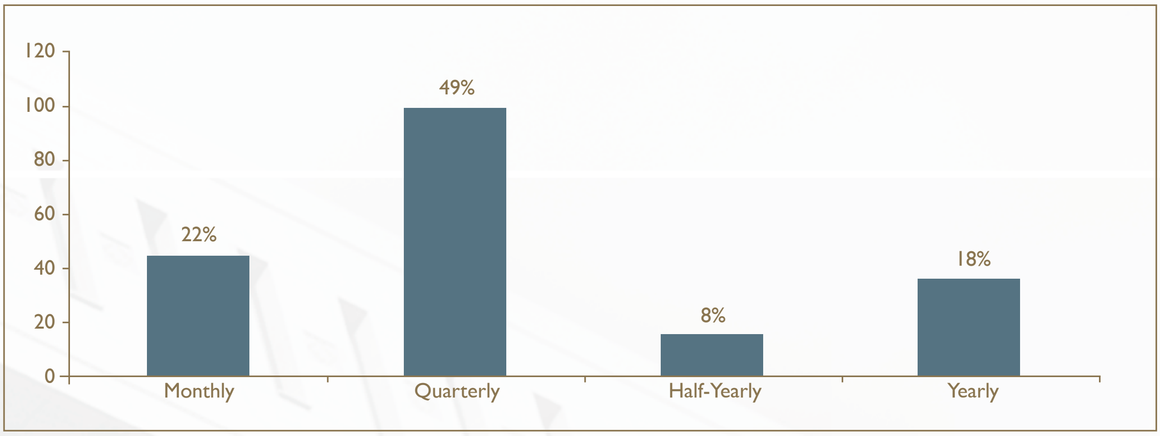

FIGURE 5: Frequency of compliance reports to Governing Body

On-site observations of GEN Rules 5.3.7 and 5.3.8

All Firms had compliance manuals setting out their respective compliance arrangements, including processes and procedures. Though some of the manuals were more clearly drafted than others, all were fit for purpose. The compliance manuals generally followed a similar structure and included:

- the regulatory framework of the DIFC;
- a summary of the DFSA laws and Rules applicable to the Firm, and particularly the DFSA Principles for Authorised Firms and Individuals;
- the duties of the Compliance Officer;
- the powers of the Compliance Officer;
- the Compliance Officer's reporting lines;
- training to be delivered by the Compliance Officer on the compliance function; and
- regular reporting on compliance issues to senior management and the Governing Body.

A number of compliance manuals contained the endorsement of the Governing Body, and also stated that the Governing Body was keen to foster a culture of compliance within the Firm.

All Compliance Officers were interviewed and tested on their Firm's compliance processes and procedures, and the compliance monitoring programme. All demonstrated a good understanding of their responsibilities. Outsourced Compliance Officers stated that they found it more difficult to be fully aware of all of the Firm's compliance issues, and to fulfil all of the duties and responsibilities expected of them.

On-site observations of GEN Rule 5.3.9

The following observations were made:

- two Firms had outsourced Compliance Officers;
- the remaining Firms had a single Compliance Officer performing the compliance function;
- all three Branches had in-house Compliance Officers;
- Firms that were part of a group also had access to a group compliance function; and
- the resources available to the compliance function of the Firms reviewed appeared adequate having regard to the nature, scale and complexity of their businesses and structure.

On-site observations of GEN Rule 5.3.10

When interviewed, all Compliance Officers stated that they had unrestricted access to:

- all relevant records; and
- the Governing Body and senior management as required.

It was difficult for the DFSA to test issues relating to access without an example of a live issue where the Compliance Officer had difficulty obtaining access to records or the Governing Body and senior management.

In one Firm, the Compliance Officer worked closely with three out of four members of the Governing Body who also respectively perform the roles of the SEO, Finance Officer and Licensed Director. The fourth Director of the Firm is an independent non-executive Director based overseas, who generally attends Governing Body meetings via electronic methods. The Firms' offices comprise a room in an open-plan setting, and, therefore, the Compliance Officer has unrestricted and immediate access to the majority of Governing Body members. This Compliance Officer was asked if he disagreed with the views of the three executive Directors on a compliance issue, whether he could elevate the issue to the independent Director and therefore, to the Governing Body. The Compliance Officer stated that he would feel comfortable doing so, but that an issue had never arisen which required such elevation.

On-site observations of GEN Rules 5.3.11 and 12

All Firms maintained a breaches register, and documented processes and procedures for monitoring and reporting breaches. These were assessed as fit for purpose.

Three Firms had implemented more comprehensive documented compliance monitoring and reporting programmes. These programmes monitored breaches of internal guidelines and policies and procedures, as well as laws or Rules.

Case Study – Monitoring
In one Firm, the documented compliance monitoring programme runs to some 55 pages of issues. Many of the issues are regulatory issues and are cross-referenced back to a DFSA law or Rule (for example, compliance with the Firm's permitted activities under its DFSA licence). Also monitored, are issues relating to compliance with the Firm's internal processes and procedures such as: • the Firm's restrictions on benefits and inducements; • corporate conflicts of interest; • personal conflicts of interest; • compliance with Shari'a obligations; and • corporate social responsibility (such as recycling of plastic bottles and double-sided printing).

Recommendations

- The compliance function should receive, and be seen to receive, the full support of the Governing Body and senior management.
- The compliance function should also report regularly to the Governing Body and senior management on compliance issues.
- Though this did not apply to any of the Firms reviewed, Firms may consider providing resources (even at a junior level) to support an outsourced Compliance Officer.
- Firms could consider, if appropriate, developing and implementing a more comprehensive compliance monitoring programme.

Theme 7 - Internal Audit (GEN Rules 5.3.13 to 5.3.15)

Expectations

The DFSA expects Authorised Firms to:

- establish and maintain an internal audit function for monitoring their systems and controls, and document their organisation and responsibilities; and
- ensure that the internal audit function has unrestricted access to relevant records and to the Governing Body and senior management.

Questionnaire Results

Internal audit function
91% of Firms said they have an internal audit function.
80% of Firms said they have in place a charter or terms of reference specifying the role and responsibilities of the internal audit function.
50% of Firms said they outsourced the internal audit function.

50% of Firms said the internal audit function was carried out by external service providers. The balance said the function was carried out by internal staff. Most Firms said the internal audit function audited their operations, financial, compliance, risk and governance functions. A lesser number of Firms, 58%, said the internal audit function audited their remuneration functions and a lesser number again, 22%, said the internal audit covered other functions.

Scope of internal audit included:	
Operations	92%
Compliance	90%
Risk	87%
Financial	87%
Governance	78%
Remuneration	58%
Other	22%

There were mixed responses as to the internal audit reporting and review arrangements. Whilst 50% of Firms said internal audit reported to the Governing Body and a similar proportion reported to the audit committee, a significant proportion of Firms, 23%, acknowledged other reporting arrangements. Furthermore, the scope of parties who reviewed the internal audit reports was larger than the reporting arrangements. For example, 29% of Firms said the internal audit function reported to the SEO but 77% of the Firms said their SEOs reviewed the internal audit reports.

The DFSA expects the internal audit function to report directly to the Governing Body or its audit committee, or for Branches, first to the management committee and then to the group audit committee or Governing Body.

	Who the internal audit function reports to	Who reviews the internal audit reports	Who reviews implementation of recommendations
Governing Body	50%	71%	59%
Audit Committee	49%	55%	48%
Senior Executive Officer	29%	77%	74%
Compliance Officer	13%	69%	63%
Finance Officer	12%	54%	43%
Chief Operations Officer	7%	29%	20%
Risk Committee	6%	29%	25%
Risk Officer	6%	38%	28%
Other	23%	25%	25%

The review of internal audit reports and implementation of recommendations was spread across a range of responsibilities. As would be expected, a broad range of functions reviewed the reports and the implementation of any recommendations with the Governing Bodies, SEOs and Compliance taking a lead role. It is unsurprising that risk committees, risk officers, Finance Officers and chief operating officers are also involved in such reviews. However, it is disappointing that the Governing Bodies and their committees do not feature more frequently in the review of internal audit reports and the implementation of recommendations. The DFSA expects a larger proportion of Authorised Individuals, Governing Bodies and their committees to review internal audit reports and the implementation of recommendations than is presently the case. Their failure to do so rates as a significant weakness of the internal audit function, which is a primary gatekeeper in the detection of risk and system and control failures.

On-site observations of GEN Rules 5.3.13 and 5.3.15

Despite being a specific requirement, two Firms did not have an internal audit function at the time of the visit. One Firm had only just put in place an internal audit function with an outsourced provider.

Of the remaining Firms:

- the internal audit function was performed at group level for six Firms; and
- the internal audit function was outsourced to external service providers for two Firms.

The internal audits conducted were generally of good quality. In one Firm, the findings of the internal audit led to a change in the Firm's conduct and practice of minuting the meetings of several of its committees. The internal audit report was discussed at the Board level and the decision to change the procedure was also taken at Board level, and recorded in the Board minutes.

There was evidence that internal audits were conducted on a regular basis. Two Firms conducted an internal audit review every year. Another two Firms conducted such a review every two years, but one Firm was considering making the review an annual event.

On-site observations of GEN Rule 5.3.14

For those Firms having an internal audit function, unrestricted access to records and to the Governing Body/appropriate committee were set out in the CG Documents. This was tested in interviews with the Firms' SEO and Compliance Officer, and by reviewing the internal audit reports for these Firms. No issues arose in relation to access being denied or obstructed. Generally most internal audit reports were discussed at the level of the Governing Body or a relevant committee.

Case Study – Failure to notify the DFSA
One Firm which did not have an internal audit function stated that the reason was that the small size and the low volume of business did not warrant an internal audit function. The Firm had advised the DFSA, at a risk assessment, that it had outsourced the internal audit function to an external service provider. However, the Governing Body subsequently took the decision not to proceed with the establishment of an internal audit function. The Firm did not inform the DFSA of this decision. As this is a clear breach of a DFSA administered Rule, the Firm should have discussed the decision with the DFSA.

Recommendations

- The DFSA administered Rules require that Firms have an internal audit function. Therefore, Firms should either establish and maintain such a function, or seek a waiver of the requirement from the DFSA.
- There should be regular reviews by the internal audit function. The frequency of reviews will be determined by the Firm based on the nature, scale and complexity of its business.
- The findings of the internal audit function should be reported to the Governing Body or a relevant committee.
- Governing Bodies or their relevant committees should review the implementation of audit recommendations.

Theme 8 - Management Information (GEN Rule 5.3.17)

Expectations

The DFSA expects Authorised Firms to establish and maintain arrangements to provide the Governing Body and senior management with relevant, accurate, comprehensive, timely and reliable information to:

- organise, monitor and control, its activities;
- comply with legislation in the DIFC; and
- manage risks.

Questionnaire Results

The information requirements of Governing Bodies will vary according to the nature, scale, structure and complexity of a Firm's business.

Firms reported that they provide a variety of reports, as indicated in Figure 6, to the Governing Body with the primary focus on compliance and finance. One would have also expected a greater level of reporting in respect of risks and systems and controls as they are fundamental to all Firms. Other areas of risk, such as related party transactions, conflicts of interest and breaches may be reported on an 'as required basis' but should be retained as a standing agenda item to avoid oversight.

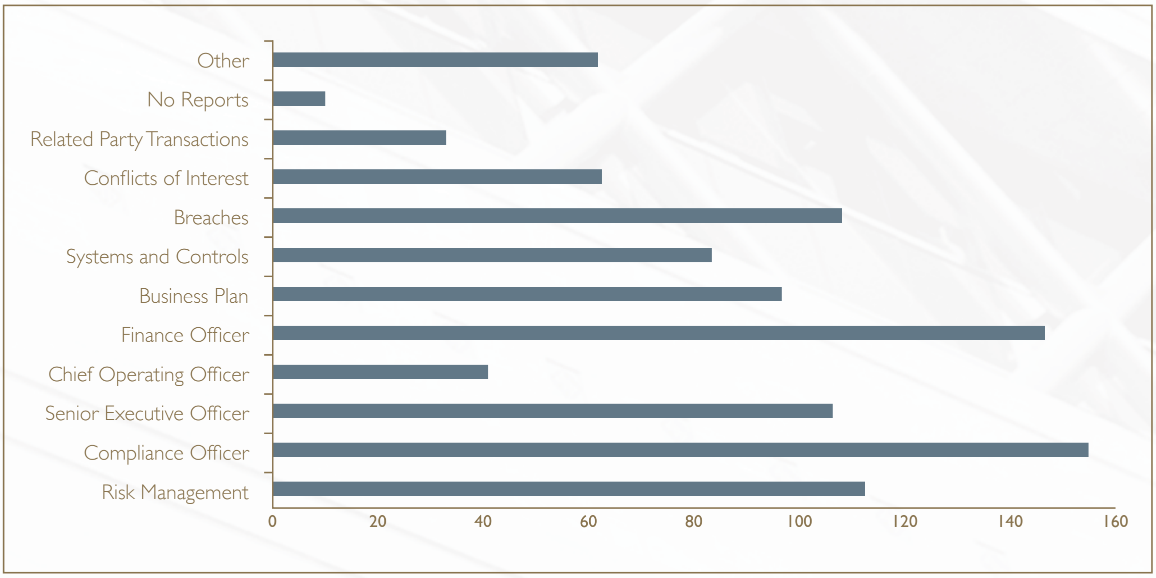

FIGURE 6: Type of reports provided by Firms to Governing Bodies

Management information
90% of Firms said an agenda is prepared and distributed prior to each Governing Body Meeting.
85% of Firms said management information packs are distributed prior to Governing Body meetings.
19% of Firms said non-executive members of the Governing Body do not have sufficient direct access to senior management.

On-site observations of GEN Rule 5.3.17
Companies
Seven Firms prepared agendas and Board packs for formal meetings of the Governing Body.

One Firm prepared an agenda for Governing Body meetings but not a pack. When asked to explain why no pack was prepared, the Firm stated that three of the Governing Body's members were executives of the Firm and had access to all documentation required for the meeting. However, documents for the meeting were sent to the independent non-executive Director.

Most Firms distributed Governing Body packs at least one week prior to the relevant meetings. However, there was often disagreement as to when the packs were distributed and received. In one Firm, the SEO stated that the packs were sent anywhere from two weeks to one week prior to the meeting. However, the Compliance Officer stated that the packs were sent two days prior to the meetings.

There was also disagreement as to whether packs contained too little or too much information. In one Firm, in which the corporate governance structures were exemplary, the Chairman of the Board stated that the packs contained too much information. However, the SEO stated that the Firm's Governing Body liked to get across the detail of the issues and demanded more, rather than less, information.

Most Firms adopted the practice of providing regular reports to the Governing Body. Generally the reports dealt with:

- business and strategy;
- finance;
- risk;
- Compliance; and
- audit.

Firms adopted different practices in terms of reporting. Some provided verbal reports only, whereas others provided written reports.

Firms were tested on their corporate governance structures by requesting the person interviewed (generally the SEO and/or a Director) to explain how an issue would be brought to the Governing Body's attention for a decision. In one Firm, the issue concerned a change in the Firm's business strategy from one business line to a completely different line as the Firm was not gaining any traction in the market in its preferred business line. The change was discussed at the Firm's executive committee, and then elevated to Governing Body level. The decision was made at Governing Body level, and the Firm then made the necessary changes to carry out the new strategy including appointing a new SEO with the appropriate skills, experiences and connections in regard to the new business line. Another strategy attempted was to enter into a partnership with another Firm outside the DIFC, but this did not eventuate. Progress against the new strategy was tracked by the executive committee and also the Governing Body.

Branches

For Branches, the Firm's SEO received reports through the Branch management committee. The reports required to be provided to the group varied from Branch to Branch. In one Firm, the SEO reported weekly in a telephone call to the group and provided more formal written reports on a quarterly and annual basis. In another Firm, the Firm reported to the group:

- daily on such matters as the Firm's exposures;
- weekly on trial balances and assets/liabilities;
- monthly on profit and loss, regulatory breaches and sanctions; and
- quarterly on budget, and changes in economic and regulatory conditions.

Case Study – Presentation of management information

The Governing Body

For one Firm, a typical agenda contained the following items:

- executive summary;
- update on action points from last board meeting;
- risk report;
- update on the Firm, its Funds and key initiatives;
- year to date financial performance;
- decisions required;
- external and internal audit reports; and
- compliance and regulatory update.

The Governing Body packs contained reports set out in PowerPoint slides for each of the reports mentioned above. The meetings of the Governing Body are well minuted, and allow the reader to track through an issue from when it was first raised to when it was resolved. Minutes of Governing Body meetings were signed-off as accurate by the Chairman and the company secretary.

Committees

The Firm adopted a similar approach to packs and minutes for the Governing Body's committees. For the Firm's audit committee, for example, the committee packs were not reviewed but the minutes for the meetings evidence that packs were distributed and also the agenda items for the meeting. Typical agenda items for the audit committee were:

- corporate structure;
- significant events (for the past year);
- audited financials;
- update on internal and external audit reports; and
- regulatory financial compliance.

The minutes contained summaries of the matters discussed and the resolutions adopted. The minutes were signed-off as accurate by the Chairman of the committee and the company secretary.

An interesting policy adopted by the Firm for its investment committees is that, for every investment proposal put forward to the committee, there will be a contrary view setting out the disadvantages of the new investment proposal. This is done so that the committee has the benefit of considering documents setting out both the advantages and disadvantages of the investment proposal. The policy received approval at Governing Body level, though the decision in regard to the investment proposal stays with the respective investment committee.

Recommendations

- The discipline of preparing agendas and packs for meetings is recommended for all Firms. Even though packs for the Governing Body/committee may amount to only a few pages for some Firms, the process of preparing the agenda and the packs means that all members of the Governing Body/committee are 'on the same page'.
- The correct amount of information to be provided to a Governing Body/committee in order for it to make good decisions is a matter for each Firm and its Governing Body to determine. Giving too much information, which cannot be read and understood in the time available, is as inappropriate as giving too little information.
- Packs should be distributed in a timely manner so that they can be read and digested by the members of the Governing Body/committee. Most Firms distributed packs at least one week ahead of meetings.

Theme 9 - Business Plan and Strategy (GEN Rule 5.3.16)

Expectations

The DFSA expects Authorised Firms to produce a business plan which:

- enables it to manage risks;
- takes into account current activities, and activities for the next 12 months; and
- is documented and updated.

Questionnaire Results

Business plans and strategy
99% of Firms said they have a current business plan.
96% of Firms said the Governing Body reviews the implementation and progress of the strategy against the plan.
92% of Firms said the Governing Body approves the business plan.

Surprisingly 9% of Firms indicated that persons, other than the Governing Body or senior management, approve the strategic direction of the Firm. This is a practice that should discontinue.

On-site observations of GEN Rule 5.3.16

Companies

All eight Firms had business plans which were approved by the Firm's Governing Body. The Firms also monitored progress against business plans at both:

- senior management level via the Firm's executive committee or equivalent. Generally such committees met every month or more frequently; and
- Governing Body level. Generally, Governing Bodies met every quarter in accordance with the documentation, though some Governing Bodies met less frequently.

Branches

All three Branches had business plans which were approved by the regional or global committee overseeing the Branch. Monitoring of progress against the business plan was undertaken by the Firms' respective Branch management committees, with reports then being presented generally by the SEO to the relevant regional/global committee.

The assessment of whether or not the approved business plans were appropriate for the particular Firm was not within the scope of the review carried out by the DFSA.

Case Study – Changing the business plan or strategy
An example of a Firm which changed its business plan and strategy has already been discussed on page 37. Another Firm faced a similar situation in that its proposed core business, which was developing niche Shari'a compliant products, also did not gain traction. The Firm, however, was able to conduct other activities which were also part of its plan and strategy, such as advisory services and proprietary trading, while waiting for the market to improve for its core business. Progress against the business plan was monitored by the SEO, who reported to the Governing Body on the matter.

Recommendations

- Regular reviews of the business plan and strategy should be conducted at the levels of both senior management and the Governing Body.
- The business plan and strategy should be a living document which can be changed or adapted to suit operational, financial or economic circumstances.

Theme 10 - Staff and Agents (GEN Rules 5.3.18 and 5.3.19)

Expectations

The DFSA expects an Authorised Firm to:

- maintain systems and controls to enable it to satisfy itself of the suitability of anyone who acts for it; and
- implement and maintain systems and controls to ensure, that employees are fit and proper, competent, capable of performing their functions and trained in DIFC legislation.

On-site observations of GEN Rules 5.3.18 and 5.3.19

All Firms had processes and procedures for screening employees to assess their fitness, propriety, and suitability for the role. Firms also generally carried out induction training, and particularly compliance and AML training, for new employees.

Firms adopted different processes and procedures for current employees. Some Firms required annual declarations from employees as to conflicts of interest, and compliance with regulations, policies and procedures. Other Firms created a continuing obligation on employees to remain fit and proper, avoid conflicts of interest and comply with policies and procedures, but without the need for employees to sign annual declarations.

Most Firms had in place annual mandatory compliance and AML training, in accordance with the requirement in AML Rule 12. Most Firms encouraged staff to attend training and develop skills, though this was generally on an ad hoc basis and left to individual staff to suggest.

Case Study – Training and development programme
One Firm sets out, in its employee handbook, a number of training courses for which staff will generally receive approval to undertake. The handbook sets out the costs which the Firm will reimburse, and leave given for study.

Recommendations

- Firms should embrace a practice whereby employees make annual declarations of conflicts of interest, and compliance with regulations, policies and procedures. This is a good discipline for Firms to adopt as it facilitates and enables employees to turn their attention to these issues at least annually.
- Firms should encourage employees to continue to develop their skills and abilities by way of training and development.

Theme 11 - Outsourcing (GEN Rules 5.3.21 and 5.3.22)

Expectations

The DFSA expects an Authorised Firm with a material outsourcing arrangement to:

- inform the DFSA of the arrangement;
- establish and maintain comprehensive outsourcing policies, contingency plans and risk management programmes;
- enter into a written contract with the provider, the terms of which must include access to information which the DFSA may require and an obligation to deal with the DFSA openly and co-operatively;
- ensure that the outsourcing arrangements do not reduce the Firm's ability to fulfil its obligations or hinder supervision of the Firm by the DFSA;
- remain responsible for compliance with legislation in the DIFC for any outsourced function; and
- undertake due diligence, and effectively supervise the outsourced service provider, and deal effectively with the provider's breach of any DIFC legislation.

On-site observations of GEN Rules 5.3.21 and 5.3.22

Companies

Two Firms did not have any outsourced functions.

The main functions outsourced by the other Firms were:

- Compliance;
- internal audit; and
- Shari'a Supervisory Board.

The Firms' outsourcing policies were generally adequate and complied with requirements. Most of these policies were contained in the Firms' compliance manual.

Interviews confirmed that due diligence is carried out on outsourced service providers and that the necessary contracts are in place. In one Firm, however, the Compliance Officer, when tested, was unaware as to whose responsibility it was to supervise the outsourced functions and also could not describe the process for supervising the outsourced functions.

Branches

All three Branches only outsourced computer and IT functions. However, a number of functions (for example, internal audit) were carried out at group level rather than at Branch level.

Case Study – Outsourcing practice
In one Firm, the internal audit function raised an issue as to the process for the appointment of the outsourced service providers. The Firm's investments are first considered by the Firm's investment committee. In order to properly consider the investment, the investment committee requires technical advice on the investment. The Firm uses outsourced service providers to provide this technical advice. The internal audit found that the Firm did not carry out appropriate due diligence on the technical advisors and recommended that the Firm: • develop a policy for the appointment of the technical advisors including the due diligence to be carried out on these advisors; and • develop a short-list of advisors, to be reviewed annually. This matter was raised with the Governing Body, and it approved the recommendation.

Recommendations

- The outsourcing policies of most Firms were adequate. However, Firms should ensure that the outsourced service providers are adequately supervised and their performance is regularly reviewed.

Theme 12 - Records (GEN Rules 5.3.24 to 5.3.27)

Expectations

The DFSA expects Authorised Firms to:

- make and retain records required by legislation in the DIFC;
- ensure the records are capable of reproduction on paper in three business days or less;
- make and retain records in the English language (with the exception of records to which Rule 5.3.26 relate); and
- have systems and controls to fulfil legal and regulatory obligations with respect to adequacy, access, retention and security of the records.

On-site observations of GEN Rules 5.3.24 to 5.3.27

The documented systems and controls of the Firms were adequate and complied with requirements.

In relation to the records requested of the Firms for the purposes of the Review, the Firms were generally able to comply with the time limits agreed with the DFSA.

One Firm conducted communications with a client in Arabic, but these communications were translated into English. In another Firm, some email communications were in German but the majority of the records were recorded in English.

Case Study – Records

One Firm's record-keeping procedures specified that:

- file notes had to be made of telephone conversations with external parties;
- all orders had to be documented, even if received verbally;
- records are kept for six years; and
- communications with clients are translated if in a different language to English.

The Firm also confirmed that it would take less than an hour to produce records on paper.

Recommendations

- The record-keeping policies of the Firms were generally adequate. However, Firms should provide more guidance as to record-keeping requirements in their record-keeping policies.

Conclusion

Governance is a shared responsibility and, therefore, Firms should ensure that good governance practices are understood and applied by all members of the Firm regardless of position. The DFSA has found that failure to comply with statutory obligations generally results from poor governance practices and a failure of Governing Bodies to exercise appropriate oversight of risk.

The findings of this Review demonstrate that governance is a continuum and that Firms need to evolve their governance policies, practices, strategies and structures in response to financial, economic and business fluctuations to better monitor, assess and mitigate risk.

The DFSA will continue to monitor governance practices on an ongoing basis but particularly those aspects of the Review where shortcomings were identified.

Tel: +971 4 362 1500
Fax: +971 4 362 0801
PO Box 75850
Level 13, The Gate, Dubai, UAE
Email: info@dfsa.ae
Website: www.dfsa.ae