



## **By Email**

7 April 2019

**To:** Senior Executive Officers (SEO) and Principal Representatives of DFSA Regulated Entities

**RE: 2019-2020: DFSA's Supervisory Priorities**

Dear SEO/Principal Representative,

Earlier this year, the DFSA issued its Business Plan for 2019/2020. This identified four strategic themes: Delivery; Sustainability; Engagement; and Innovation, which will drive our work over the course the next 2 years. In implementing these strategies, we continue to fine tune our risk-based approach to make appropriate use of our supervisory resources.

Following the restructure of the Supervision Division in 2018, the Division comprises five functional units that each have a specific focus: Authorisations; Conduct of Business (including the Financial Crime Prevention team); Prudential; Operational and Technology; and Infrastructure and Audit Oversight.

In order to further assist our regulated community, we set out below the priorities and initiatives being undertaken by the Supervision Division during 2019/2020.

### **1. Authorisation**

The Authorisation Unit engages with applicants, potential applicants, and third party advisers to ensure that entities seeking to carry out financial services activities in and from the DIFC are suitable. We carefully assess a range of criteria, including an applicant's governance, resources and systems and controls, We aim to reach an "In Principle" decision (after which an applicant need only complete its specific pre-licence formalities) in a time efficient manner, which will vary depending on the complexity of an applicant's business model and the speed of responses to any DFSA enquiries.

During 2019, we planned to host two outreach sessions addressing Authorisation matters and to issue two newsletters – all targeted towards the professional adviser community.

### **2. Conduct of Business**

For the majority of our Authorised Firms ("Firms"), our day-to-day interaction with them has changed since 2018. Instead of assigning a Relationship Manager to every Firm, we are able to improve our supervisory responses through the use of our supervisory portal, and by allocating work to available resources. For Firms in pooled supervision, we

allocate regulatory issues and inquiries to individual supervisors based on the perceived risk of the issue or inquiry, and the availability of supervisory resources. We also engage our subject matter experts who work in conjunction with other supervisors when issues or inquiries are of a more technical nature. Of course, we would welcome any feedback you might have with regard to this change.

### Financial Crime

Financial Crime risks remain a key regulatory priority for the DFSA and an important area of focus for the UAE with the upcoming FATF 4<sup>th</sup> Round Mutual Evaluation of the UAE scheduled for the first half of 2019.

2019 will be a busy year in terms of our Financial Crime Prevention program. We continue to conduct scheduled risk assessments (inspections) of financial institutions on a periodic cycle, which includes a focus on Financial Crime risks. We will continue to review data and trends from the online annual AML Returns; as well as conducting AML risk assessments of our DNFBP population; conducting targeted financial crime specific risk-assessments of higher impact regulated entities; and thematic reviews across one or more sectors.

The DFSA has made further changes to its AML regime in 2018, which builds on changes implemented in 2013 and 2017 to ensure the AML regime aligns with the 2012 version of the FATF Recommendations.

In relation to future changes to the AML Module due to the new Federal AML law, the DFSA is working with the UAE Government on its Implementation Regulations. Concurrently, the DFSA is reviewing its AML regime, including the AML Module, against the Federal AML regime. Once this review is complete, the DFSA will communicate to stakeholders whether any changes are necessary.

### Other Conduct of Business priorities

Besides Financial Crime risks, the Conduct of Business Unit has identified the protection of client assets, suitability, market conduct, asset managers and brokerage business models to be priority areas of focus for 2019. Details of these priority areas of focus are included in the **Appendix** to this letter.

In terms of other initiatives, importantly at a national level, the DFSA has achieved a successful outcome with its regulatory counterparts across the country in regard to the implementation of the Funds Passporting Protocol. The Supervision Department engaged with their peers at the Securities and Commodities Authority (SCA) and Abu Dhabi Global Market (ADGM) to establish the operational implementation of this initiative. The Funds Passporting Protocol is now live and we are able to accept online applications from DFSA regulated Fund Managers to register DIFC domiciled Funds as Passporting Funds.

To support the continued growth in our funds sector, we have also recently released our online forms for licensing of Fund Managers and registering Funds in the DIFC.

### **3. Prudential**

We will continue our focus on the financial stability of the financial system across the DIFC and the financial soundness and robustness of all Firms. We have recently developed an enhanced Key Prudential Risk Indicators monitoring framework that allows us to monitor closely and continuously the financial performance and the financial position of all Firms. The new framework will detect signs of emerging financial vulnerabilities so that we can proactively engage with Firms and initiate appropriate actions, when necessary.

#### Banking sector focus:

Our supervisory priorities with respect to the banking sector include ensuring adequate implementation of enhanced liquidity requirements – such as the liquidity coverage ratio and net stable funding ratio – by DIFC banks. Closer attention and scrutiny will be applied to those entities considered systemically important either locally or regionally. In addition, we will seek to complete the implementation of IFRS 9, including the classification of non-performing loans and the impact on capital. We will continue to monitor asset quality and concentration risk while also seeking to make more use of improved monitoring and analytics of the banks we regulate, and of potential risks.

A key aim of our banking supervisory regime will be to focus our examinations on emergent risks. This includes new technologies used in the banking sector, as we strive to provide a balance between fostering innovation in the sector and minimising potential risks that financial innovation may pose. Finally, we will continue our efforts to strengthen our relationships with other key regional banking regulators, so as to foster a cooperative approach when dealing with regional issues, and encourage greater information sharing amongst regulators.

#### Insurance sector focus:

Our key supervisory priorities for the DIFC insurance sector include the implementation of IFRS 17 and a review of the professional indemnity insurance requirement. Despite the introduction of IFRS 17 being deferred by one year, it remains a key change for the insurance industry. During the transition period, we will work closely with the insurers that are subject to IFRS 17 to minimise disruption to their business operations.

We will also be focusing on the appropriateness of the professional indemnity insurance requirement for prudential category 3 and 4 Firms as a mitigant for operational risk, and review the adequacy of coverage.

Finally, in light of the large insurance losses in the region, the adequacy of governance and controls around underwriting standards will receive greater scrutiny.

#### **4. Operational & Technology**

For 2019, a key priority will be to ensure that Firms have in place appropriate frameworks for the governance and management of IT/cyber risk; and are appropriately prepared to detect, respond, and recover from a cyber-incident. We will effect this priority by: (1) conducting an IT/cyber risk thematic review that will include all Firms and will focus on governance, cyber hygiene, and resilience; (2) developing an infrastructure for cyber incident reporting and threat intelligence sharing; and (3) developing industry level guidelines and stakeholder engagement.

Additionally, we will continue to prioritise supporting innovation in financial services by further developing and enhancing the Innovation Testing License (ITL) program. Within this context, we will seek to improve the regulatory preparedness of FinTech firms and strengthen our relationship with other key regulators, so as to foster a cooperative and collaborative approach to FinTech supervision and information sharing. A key element of fostering cooperation and collaboration among regulators will be our continued participation in the Global Financial Innovation Network (GFIN) cross-border trials initiative.

#### **5. Infrastructure and Audit Oversight**

The Infrastructure and Audit Oversight Unit provides oversight for registered auditors and Credit Rating Agencies (CRAs). This group is also responsible for providing financial reporting and analytic support for the Supervision Division.

##### Audit and CRAs focus:

The DFSA's audit inspection cycle runs from January to December each year. The DFSA will conduct follow-up inspections of Registered Auditors (RAs) of Public Listed Companies, Domestic Firms, Authorised Market Institutions and Domestic Funds. In the event we have identified any significant issues in our previous audit inspections, we will escalate follow-up inspections to ensure the relevant RAs are taking appropriate action to address our observations and findings.

On 24 February 2019, the DFSA issued its Audit Monitoring Focus Report for 2019 which includes, but is not limited to an auditor's obligation to:

- 1) consider laws and regulations that are relevant to, and impact on, an audit of financial statements; and
- 2) evaluate misstatements identified during an audit.

We will continue to supervise DIFC-based CRAs through onsite inspections and annual desk-based reviews. We plan to undertake a review of our CRA regime to ensure it remains aligned with the leading international jurisdictions.

### New Regulatory Reporting Forms:

We continue to improve regulatory submissions through online forms which are designed to be read and analysed by our business intelligence software and that are programmed to assist with identifying risks and aiding our decision making. 2019 commenced with a number of new online forms being published including: Suspicious Activity Report (SAR); Professional Indemnity Insurance submission template; Funds Passporting Form; and 2019 Annual Report submission template.

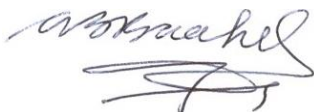
The 2019 Annual Report submission template was designed to adapt to the circumstances of a particular firm and only request reports that are required to be submitted by that firm.

In 2019, we introduced our revised Prudential Reporting Regime (PIB Forms) following the changes made to PIB Module Rule A2.4.1 earlier in the year. The revised forms are already available on our Electronic Prudential Reporting System (EPRS). A revised Prudential Return Module (PRU) has been also released containing comprehensive instructional guidelines. Authorised Firms in all Prudential Categories (PIB) have to start using the revised reporting forms for the submission of their periodic returns with immediate effect, including the 2018 annual returns. Further information was shared with Firms and External Auditors in a series of targeted outreach sessions held at the DFSA. A specific Dear SEO Letter detailing the new EPRS requirements will also be communicated.

### **Concluding Remarks**

In this letter, we have endeavoured to provide further information and insight on our intended supervisory priorities and other initiatives for 2019/20. Please keep in mind that the highlighted activities and focus areas are not all encompassing. The DFSA may change its approach and focus areas during the course of the year as a result of events or issues concerning our regulated community, specific Firms or persons falling within the remit of DFSA administered laws and rules that may arise. We look forward to your continuing engagement and cooperation.

Yours sincerely,



Arvind Baghel  
Acting Managing Director, Supervision

## Appendix

### Other Conduct of Business priorities

1. Safeguarding client assets: In regards to the protection of client assets, more than half of the Firms in the DIFC have activities that give rise to a client asset obligation. The Conduct Unit has commenced projects to examine Firms' efforts to safeguard client assets and related audit practices which will run throughout 2019 and into 2020. In particular, the focus will be on various aspects of the client asset regime and how Firms, and their auditors, comply with the requirements of the regime.
2. Market abuse systems and controls: In regards to market conduct, we are focusing our attention on the effectiveness of systems and controls deployed by Authorised Firms to detect and prevent market abuses. Additionally, we propose to roll out processes to triage notifications of suspected market abuse lodged by Firms and to investigate client and firm conduct, where appropriate.
3. Suitability: Following on from the thematic work on suitability performed in 2016-2017, we will perform a more focused review based on a detailed transaction-by-transaction analysis of suitability at a sample of Firms.
4. Brokerage business models: Given the increase in the number of authorised brokerage firms operating in the DIFC, we will undertake a closer analysis of the various business models utilised by these Firms and the risks each pose.
5. Asset Managers: We also intend to undertake a thematic review of Asset Managers with a particular focus on those Firms acting as an investment manager or advisor, or providing related services to Foreign Funds. This thematic review is intended to provide us with a greater insight of group cross-border structures and commonalities, including nature of delegations between the DIFC entity and Fund Managers, Operators and Funds domiciled in foreign jurisdictions.