



ABU DHABI GLOBAL MARKET
سوق أبوظبي العالمي

CONSULTATION PAPER
NO. 2 OF 2023

**PROPOSED ENHANCEMENTS TO
CLIENT CLASSIFICATION, CLIENT
ASSETS AND CONDUCT
REQUIREMENTS**

30 MARCH 2023

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Introduction

Why we are issuing this paper

1. The Financial Services Regulatory Authority ("**FSRA**") of the Abu Dhabi Global Market ("**ADGM**") has issued this consultation paper to invite public feedback and comments on its proposed amendments to the Conduct of Business Rulebook ("**COBS**"), the General Rulebook ("**GEN**") and the Glossary ("**GLO**"), accompanied by concurrent changes to the Financial Services and Markets Regulations ("**FSMR**") concerning Client classification, marketing materials, the disclosure of fees and charges to Retail Clients, treatment of Client Assets and the Regulated Activity of Providing Custody. Capitalised terms contained in this consultation paper have the meanings attributed to them in GLO, unless otherwise defined in this paper.
2. This consultation, follows a review of the current framework and benchmarked jurisdictions, proposes additional Client protection measures in relation to Investment Business, specifically relating to Client classification, marketing materials, the disclosure of fees and charges to Retail Clients and safekeeping of Client Assets.
3. While most of the proposed amendments to Rules governing Client classification are structural in nature and should not result in a change in classification for the majority of existing Professional Clients, the FSRA has formed the view that certain assessment standards for Professional Clients should be further aligned with comparable jurisdictions.
4. These proposed changes include a marginally narrower scope of the Regulated Activity of Providing Custody, to align the perimeter of regulated custody activities with current practice in leading benchmarked regimes.
5. The FSRA also notes the expanding number of firms which hold, control or engage in Providing Custody in relation to Virtual Assets. While the proposed amendments included in this paper seek to clarify the current responsibilities of such firms, the FSRA is also considering possible additional changes to its regulatory regime applicable to Virtual Assets this year.
6. Finally, the FSRA seeks to incorporate a number of consequential and miscellaneous amendments to FSMR, COBS, GEN and GLO.

Who should read this paper

7. This Consultation Paper should be of particular interest to all Authorised Persons including those engaged in Investment Business or Providing Custody, potential applicants, as well as investors, individuals and organisations active in the investment management industry, and their respective professional advisors.

How to provide comments

8. All comments should be made in writing and sent to the mail address or email address specified below. If sending your comments by email, please state the Consultation Paper number in the subject line. If relevant, please identify the organisation you represent in providing your comments. The FSRA reserves the right to publish, including on its website, any comments you provide, unless you expressly request otherwise at the time of making any comments. Comments supported by reasoning and evidence will be given more weight by the FSRA.

What happens next

9. The deadline for providing comments on this proposal is 25 May 2023. When we receive your comments, we will consider whether any modifications are required to the proposed amendments discussed in this paper. The Board of ADGM and the FSRA will then proceed to enact the proposed amendments. You should not act on these proposals until the relevant amendments to FSMR and the Rulebooks are issued, we will issue a notice on our website when that happens.

Comments to be addressed to:

Consultation Paper No. 2 of 2023
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ADGM Square
Al Maryah Island
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Proposed amendment of Conduct of Business Rules

Client Classification

1. The FSRA's statutory objectives importantly include the protection of investors. Amongst the methods by which the FSRA meets this responsibility is by distinguishing the typical "retail" investor from those "professional" investors who possess a greater level of investing knowledge, experience and expertise, coupled with greater financial resources, thereby enabling them to absorb potentially greater losses that might arise from taking on additional risk.
2. The FSRA addresses the risks inherent with some financial products and services in multiple ways, including by placing a restriction within the Financial Service Permissions of Authorised Persons which do not possess the systems, controls and resources necessary to serve Retail Clients, and by restricting those Regulated Activities and financial products which by their nature or risk profile are not suitable for Retail Clients.
3. After considering how Authorised Persons apply Client classification methods in practice, the FSRA conducted a review of COBS and determined that certain Rules used for Client classification are either unnecessarily complex or more appropriately constitute Guidance. Additionally, following benchmarking of other relevant jurisdictions, including those applying Client classification standards contained in MiFID II¹, the FSRA proposes to amend its Professional Client classification Rules to further align ADGM's standards with international best practice.

"Deemed" Professional Clients

4. "Deemed" Professional Clients are, due to a combination of their size or the nature of their underlying business, considered to be able to appreciate and absorb the risks inherent in those financial products and services which are only suitable for Professional Clients.
5. In general, the FSRA has found its description of "deemed" Professional Clients to be consistent with comparable financial regulatory regimes. Given the nature of the market which ADGM firms serve, one amendment which the FSRA proposes is the reclassification of single-family offices ("**SFOs**") from the "deemed" category of Professional Clients to the "assessed" category. It is apparent to the FSRA that not all SFOs are of the size or possess the level of

¹ Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets and financial instruments

sophistication such that their automatic inclusion in the “deemed” Professional Client category is warranted. Notably, SFOs which meet other “deemed” Professional Client criteria, such as having a balance sheet with more than \$20 million in assets, will continue to qualify as “deemed” Professional Clients without the need for assessment.

6. The FSRA has also noticed that Regulated Financial Institutions, namely firms located outside ADGM authorised to carry on financial services activities, are not identified as “deemed” Professional Clients and proposes to include such firms within the category.

ISSUES FOR CONSIDERATION

Question 1

Do you agree with the FSRA’s view that single family offices which do not otherwise qualify as a “deemed” Professional Client should be required to be assessed before qualifying as a Professional Client?

“Assessed” Professional Clients

7. Common to benchmarked jurisdictions both within and outside the UAE, clients which do not qualify as “deemed” Professional Clients must meet specified criteria prior to being accepted as a Professional Client. “Assessed” Professional Clients must possess knowledge, experience and expertise to qualify as a Professional Client but are not considered to possess such attributes to the same level as a “deemed” Professional Client.
8. In addition to the knowledge, experience and expertise requirement, the current Client classification Rules require demonstration of net assets exceeding US\$ 500,000 for both individuals and undertakings, such calculation excludes, in the case of an individual, a Client’s primary residence and insurance and pension related assets.
9. This monetary requirement has not increased since the FSRA commenced operations in 2015 and, while comparable, for example, to the € 500,000 minimum amount referred to in MiFID II, these figures do not lend themselves to direct comparison, given that the net assets which can be counted towards meeting the EU threshold are limited to cash and financial instruments.
10. In comparison, other UAE financial services regulators require minimum demonstrable net assets of US\$ 1,000,000 or greater, a level already applied by current COBS Rules in the case of Domestic Exempt Funds and Qualified Investor Funds which may be promoted in the State as Passported Funds. The FSRA is of the view that an increase to verifiable net assets from US\$ 500,000 to US\$ 1,000,000 for both individuals and undertakings is warranted. Given the characteristics of investors broadly that FSRA firms engage with, the FSRA does not propose to restrict the calculation of net assets to cash and financial

investments such as securities as in the EU, but rather to continue to permit a broader range of assets.

11. The FSRA expects to receive comments from Authorised Persons concerning existing Professional Clients that may be affected by the proposed change to the net asset requirement. While not intended to compel Authorised Persons to terminate existing engagements with Professional Clients who may no longer satisfy that part of the assessment requirements, the FSRA would expect Authorised Persons to assess the continuing eligibility of existing Professional Clients prior to providing new types of services or products, particularly where the Authorised Person has reasonable grounds to believe that the Professional Client may no longer qualify.

ISSUES FOR CONSIDERATION

Question 2

Do you agree with the FSRA's proposed increase of the verifiable net assets requirement for "assessed" Professional Clients from US\$500,000 to US\$1,000,000 for both individuals and undertakings?

Question 3

Do you agree with the FSRA's view that that the assets which may be counted to meet the net assets test for prospective "assessed" Professional Clients should remain broader than cash and securities-type investments?

"Service-based" Professional Clients

12. COBS currently includes the additional specific category of "Service-based" Professional Clients. Such Clients are undertakings which are considered to be Professional Clients despite not qualifying otherwise as a "Deemed" or "Assessed" Professional Client. Professional Client status is permitted by COBS for the narrow purpose of enabling such undertakings to obtain services or engage in transactions for Corporate Finance purposes, for themselves or for a member of their Group.
13. Given the limited range of Regulated Activities which a "Service-based" Professional Client may engage in, the FSRA is of the view that the client classification Rules in COBS should be simplified by eliminating the "Service-based" class of Professional Client. In its place the FSRA proposes to amend those Rules governing lending and arranging related Regulated Activities undertaken for the purposes of Corporate Finance Business, by deeming undertakings seeking such services as Professional Clients, but only for those Regulated Activities which are within the scope of Corporate Finance Business.
14. The intention of the proposed amendment is structural in nature and the scope of Regulated Activities falling under Corporate Finance Business will remain the same. Such an amendment would also not require affected Authorised Persons

to be able to serve Retail Clients as undertakings would be considered as Professional Clients for the narrow purpose of Corporate Finance Business.

ISSUES FOR CONSIDERATION**Question 4**

Do you agree with the FSRA's proposed simplification of the Client classification Rules in respect of Clients seeking corporate finance-related services?

Rights and duties of Professional Clients

15. Consistent with benchmarked regulatory regimes, including MiFID II, the proposed amendments to COBS clarify that Professional Clients may always opt to be treated as Retail Clients prior to the delivery of a financial product or service, either generally, or in respect of a specific Regulated Activity or Transaction. In addition, the FSRA proposes to add an additional provision which obliges an Authorised Person to inform each "assessed" Professional Client of the need to keep the Authorised Person informed of any changes which may affect such client's classification, e.g. where a client may fall below the net assets threshold.
16. Whilst the FSRA does not regulate Professional Clients, the intention of the proposed amendment is to inform Professional Clients of the need to keep Authorised Persons apprised of changes in their circumstances. While the FSRA expects Authorised Persons to periodically reassess "assessed" Professional Clients as good practice, especially where reasonable grounds for doubt exist, or new products or services are being offered with which the Client may not have significant experience, the FSRA has not imposed a requirement to conduct scheduled reassessments of Clients, consistent with other benchmarked jurisdictions.

ISSUES FOR CONSIDERATION**Question 5**

Do you agree with the FSRA's proposed addition of a duty to inform Professional Clients of the need to advise Authorised Persons of relevant changes to their circumstances which may impact their ability to retain their Professional Client classification?

Market Counterparties

17. In order to match the graduated levels of protection to Clients possessing appropriate levels of understanding and risk absorption, COBS permits a "deemed" Professional Client to waive certain additional protections, including those pertaining to suitability of investments, best execution, reporting and protection of Client Assets. Once such a Client is notified by an Authorised Person that they will be treated as a Market Counterparty, they will be considered

to have consented to such treatment in the absence of providing formal rejection of such classification in response.

18. In the spirit of simplifying the client classification Rules in COBS, the FSRA proposes to refine COBS to clarify that the Market Counterparty classification does not exist as an alternative to being a Professional Client, but is rather a subset of the Professional Client classification. As with the other amendments to the Client classification Rules noted above, the purpose of these proposed amendments is to simplify the Rules and they are merely structural in nature; the amendments are not intended to alter the qualifications required of a Market Counterparty or affect the classification of any existing Market Counterparty.

Additional Client protection measures related to Investment Business

19. The FSRA has examined conduct of business rules in a number of leading financial service jurisdictions to determine whether additional Client protection measures may be warranted. The FSRA notes that the some of the benchmarked Client protection requirements reflect the relative size of the retail investor market and thus may not be warranted in ADGM. However, the FSRA proposes to adopt a number of changes, consisting of:
- (i) requiring Marketing Material intended for Retail Clients to include a warning that it is Marketing Material and not to be considered investment advice;
 - (ii) mandating that an Authorised Person which provides investment advice disclose whether such advice was given on an independent basis;
 - (iii) whether Financial Instruments recommended by an Authorised Person have been restricted to those issued or provided by an entity having Close Links to the Authorised Person;
 - (iv) whether the Authorised Person will provide the Client with a periodic assessment of the suitability of the Financial Instruments recommended to the Client;
 - (v) entitling Clients to obtain price information for each tranche of a transaction where the execution of a transaction investment has been performed in multiple tranches; and
 - (vi) disclosure of itemised management and execution fees and charges incurred by a Retail Client in each periodic statement, with an obligation to provide a more detailed breakdown of fees and charges upon request by the Client.

ISSUES FOR CONSIDERATION

Question 6

Do you agree with the FSRA's proposed additional Retail Client protection measures?

Question 7

Are there additional measures which the FSRA should consider adopting?

Client Asset requirements

20. In respect of Client Assets, comprising Client Money and Client Investments, the FSRA currently imposes the following requirements:
- (i) Client Assets must be identified, segregated and placed with qualified Third-Party Agents, which the Authorised Person must initially assess and continue to monitor as to their ability to provide ongoing and secure safeguarding of those assets;
 - (ii) Clients must be informed of the protections offered by the FSRA's Client Assets regime;
 - (iii) Reconciliations must be performed periodically by persons not subject to conflicts of interest and both the Client and the FSRA must be periodically made aware of the status of such Client Accounts; and
 - (iv) A detailed and up-to-date set of records must be maintained such that, in the event of the failure of an Authorised Person, an insolvency professional may return Client Assets to Clients.

Amendments to Client Money Rules

21. The purpose of the Rules concerning the safekeeping of Client Money is to ensure that Client Money is clearly identifiable and secure and may therefore be returned to Clients expeditiously in the event of failure of the Authorised Person.
22. Following earlier thematic reviews undertaken by the FSRA on how Authorised Persons implement the Client Money Rules and a subsequent detailed review of Client Money protections, the FSRA proposes to simplify those Rules and add further guidance concerning the duties and obligations of Authorised Persons which hold or control Client Money.
23. The FSRA proposes streamlining the Client Money Rules set out in Chapter 14 of COBS to provide a clearer and easier to apply set of obligations. Specific features of the proposed amendments include the following:
- (i) Distinguishing the obligations placed on Authorised Persons which hold Client Money from those that merely control Client Money pursuant to a mandate over an account which is maintained by a Client;
 - (ii) Incorporating references to the obligations in relation to Relevant Money held by a Payment Service Provider, which are contained in Chapter 19;
 - (iii) Providing additional Guidance on considerations when selecting a Third-Party Agent for the provision and maintenance of a Client Account;

- (iv) Replacing the concept of a Statutory Trust with a simplified Deemed Trust concept, whereby Client Money held in the name of an Authorised Person is acknowledged to be beneficially owned by the Clients of the Authorised Person in the event of insolvency of the Authorised Person;
- (v) Combining the concepts of a Primary Pooling Event and a Secondary Pooling Event to be considered as a Pooling Event, which would trigger the application of the Client Money Distribution Rules and the return of Client Money to Clients; and
- (vi) Amending the Client Money Distribution Rules, which operate as an alternative to the distribution procedure in the Insolvency Regulations 2015, to create a priority for creditors who are Clients to the extent of the amount of Client Money held by an insolvent Authorised Person.

24. The FSRA also proposes to clarify the obligation to submit a 'nil' Client Money Auditor's Report annually in accordance with GEN Rule 6.6.6 if the Authorised Person has not held any Client Money as at the date the Authorised Person's audited financial statements were prepared. While such a requirement may impose a burden upon some firms, the FSRA is of the view that such independently verified information is necessary when contemplating any potential failure of an Authorised Person which holds a Financial Service Permission enabling it to hold Client Assets. This amendment aligns the requirement for an annual Client Money Auditor's Report with the existing requirement to file a Safe Custody Auditor's Report set out in GEN Rule 6.6.7.

ISSUES FOR CONSIDERATION

Question 8

Do you have any observations relating to the proposed amendments to the Client Money rules?

Question 9

Are there any additional safeguards for Client Money which the FSRA should consider including?

Safe Custody Rules and Resolution Planning

25. The objective of the Rules governing the safekeeping of Client Investments is to enable the timely return of Client Investments to Clients in the event of the failure of an Authorised Person. The FSRA is proposing a number of amendments to Chapters 15 and 16 of COBS, the intention of which is to:
- (i) clarify the obligations for those firms which merely control Client Investments held by the Client in the Client's own account pursuant to a mandate;

- (ii) refer to the additional obligations which apply in the event that an Authorised Person holds or controls Client Assets which are Virtual Assets, in accordance with Chapter 17 of COBS;
- (iii) clarify the obligations of an Authorised Person which holds Collateral on behalf of a Client; and
- (iv) impose a prohibition upon title transfer collateral agreements involving Retail Clients and introduce duties owed by Authorised Persons to Professional Clients which enter into such agreements.

ISSUES FOR CONSIDERATION**Question 10**

Do you agree with the FSRA's proposed amendments to the Safe Custody Rules in COBS and the restrictions placed upon title transfer collateral agreements?

*Proposed Amendments to Financial Services and Markets Regulations****The Regulated Activity of Providing Custody***

26. The current description of the Regulated Activity of Providing Custody includes the safeguarding of Financial Instruments, Virtual Assets, Spot Commodities or other assets belonging to another. The FSRA proposes to amend FSMR by removing the reference to "other assets" within the description of Providing Custody on the basis that custody of non-financial service-related assets, e.g. art or real estate, is not typically subject to regulation by a financial services regulator such as the FSRA, which is also in accordance with our observations of the practices in this area of other financial services regulators. It should be noted that the FSRA considers that the safekeeping of Client Money in accordance with Chapter 14 of COBS is not in itself a Regulated Activity.

ISSUES FOR CONSIDERATION**Question 11**

Do you agree with the FSRA's proposed approach to the scope of the Regulated Activity of Providing Custody?

Miscellaneous Amendments to FSMR, COBS, GEN and GLO

27. The FSRA also proposes a range of miscellaneous amendments within FSMR, COBS and GLO, including, but not limited to the following.

Financial Services and Markets Regulations (FSMR)

- Removal of the Regulated Activity of Fund Administration from the list of Regulated Activities identified in FSMR, Schedule 1, paragraph 60 which

may be performed in a Shari'a compliant manner, as the Islamic Finance Rules place no specific additional obligations upon the administrators of Shari'a compliant funds.

- Amendment of FSMR section 226(9) in order to clarify that proceedings before the Appeals Panel shall be public unless the Appeals Panel orders otherwise.
- Updating cross references within FSMR to commercial legislation and correcting other cross-references.

Conduct of Business Rulebook (COBS)

- Substitution of “day” for references to “Business Day”, in accordance with the Interpretation Regulations 2015.
- Reclassification of Rules intended to be Guidance.
- Inclusion of US\$ 50 dollar reference to the gift limit threshold for Credit Rating Agency analysts.

General Rulebook (GEN)

- Include a consequential amendment to Rule 6.6.6 reflecting proposed changes to GLO.

Glossary (GLO)

- Inclusion of a definitions for the terms “Approved Assets” and “Eligible Bank” used in conjunction with the investment of Insurance Monies in accordance with Chapter 7 of COBS, as well as the addition of new definitions related to the proposed COBS amendments, including “Credit Rating”, “Credit Rating Subject”, “Deemed Trust” and “Title Transfer Collateral Agreement”; and
- Harmonisation of definitions between FSMR and GLO in relation to the defined terms “Assets Requirement”, “E-Money or Electric Money”, “Eligible Custodian”; “Non-ADGM Financial Service Regulator” and “Skilled Person”.

Issues for Consideration

Question 12

Do you have any additional comments on the draft legislative amendments to FSMR or the COBS and GLO Rulebooks?

The draft legislative amendments to FSMR, COBS, GEN and GLO are set out as follows.

- **Annex A:** Financial Services and Markets Regulations 2015 (FSMR)
- **Appendix 1:** Conduct of Business Rulebook (COBS)
- **Appendix 2:** General Rulebook (GEN)
- **Appendix 3:** Glossary (GLO)