

UAE's SCA consults on its new rulebook

On 29 June 2020, the UAE's Securities and Commodities Authority (SCA) published a consultation draft of its first "rulebook" (Rulebook). The new SCA rulebook compiles all of the SCA regulations into a single document. In this article, we provide a high-level overview of the Rulebook and discuss some of the changes it introduces to the SCA's regulatory framework.

The draft Rulebook is published on the SCA's website and, at the time of writing this article, is only available in Arabic. The consultation period ends on 28 July 2020.

The SCA's consultation on the draft Rulebook is a very welcome development. It is a clear departure from the SCA's current fragmented regulatory approach, and hopefully signals a more accessible and coherent approach to financial regulation which aligns with international standards and best practice.

We set out below a high-level overview of the Rulebook's main highlights. Note that we have not set out the totality of the changes introduced by the Rulebook, just a taste of some of the key issues.

How is the Rulebook structured?

The Rulebook consists of 3 parts which are titled:

- "Part One – General Provisions";
- "Part Two – Licensing Financial Activities and Approving Functions"; and
- "Part Three – Conduct of Business".

Each part is divided into chapters which contain "articles".

Included in the SCA consultation is a "Glossary" and an appendix titled "Licensing Categories and Approved Functions for Every Financial Activity" (**Appendix**).

Scope of application

The licensing requirements under the Rulebook apply to all legal and natural persons who carry on any of the financial services activities and approved functions described under the Rulebook. However, only activities which are carried on in a certain manner (which is similar to the "by way of business" criteria

used in the UK, DIFC and ADGM) would be deemed to be carried on as regulated activities and, therefore, would trigger the SCA's licensing requirements.

"By-way-of-business" criteria

In an important development, the draft Rulebook now adopts a kind of "by-way-of-business" threshold test according to which an activity would need to be carried on for it to trigger the SCA's licensing requirement. This consists in carrying on regulated activities (or an approved function):

- for a commercial purpose, with the exclusion of activities carried on the person's own account; or
- by holding oneself out to the public as being capable of carrying out an activity or transaction in relation to a financial activity or an approved function.

Absence of an express general financial services prohibition

The draft Rulebook does not contain an express general prohibition from carrying on regulated activities without a license. Instead, this seems to be implied through the SCA's power to order the closure of non-regulated businesses, seizure of assets and the referral to public prosecution.

We also note that the "*carrying on of any financial activities or approved functions without receiving a license or the consent or approval of the [SCA]*" is defined in the Glossary as one of the "Gross Breaches" (alongside market manipulation, insider dealing, suspicion of money laundering, among others). However, it is not clear whether persons carrying on activities into the UAE on a cross-border basis would be found to have committed this breach.

List of regulated activities and new license categories

The SCA's approach to regulated activities is still fragmented, with the introduction of a central list which includes a mix of 21 SCA-regulated financial activities (e.g. promotion, introduction, fund administration), which also features types of regulated entities (i.e. broker, dealer, financial advisor). We cannot provide an overview of these since the section of the Glossary where these activities should be defined, is currently left blank.

New license categories and capital requirements

We set out below a summary table of the 5 categories of SCA licenses provided for under the draft Rulebook and the Appendix:

	Category types	Types of firms	Minimum capital (in AED)
Category 1	Dealing in securities	Brokers (trading, clearing and trading, international markets, trading in OTC derivatives contracts and spot currency), and securities dealers	50,000,000
Category 2	Dealing in investments	Investment managers, and fund managers and administrators	50,000,000
Category 3	Custody, clearing, and registration	Firms providing custody and clearing activities, and acting as the registrar of private joint stock companies	100,000,000
Category 4	Credit rating	Firms engaging in credit rating activity	5,000,000
Category 5	Arranging and advising	Financial advisors, issuance and listing advisors, and firms carrying on financial promotions and introductions	n/a

Applicants to category 5 licenses are required to be either licensed by the SCA under a different license category, or a branch of a company regulated by a "similar regulatory authority", or a bank or a branch of a foreign bank licensed by the UAE Central Bank.

We note that in a 6 July press release the SCA expressly refers to the licensing of traders in "*unregulated derivatives contracts and currency trading brokers in the spot market*", in what we suspect to be a reference to the licensing of CFD and Forex traders in Onshore UAE. This was followed by a press release on 8 July which mentions talks between the SCA and the Onshore UAE exchanges around the introduction of "*new financial instruments and products*".

Approved functions

The Appendix sets out in table form (and in great detail) the mandatory approved functions for each of the firm categories as well as their minimum capital requirement. The full list of the 19 approved functions is found in article 1 of Chapter 6 of Part 2 of the Rulebook, with the detailed descriptions of the functions, and the eligibility criteria, set out under article 5. The approved functions consist of core functions which are common to all firms within the same category, and designated approved functions which are specific to the type of firm. The core functions consist of:

- "General Director";
- "Compliance Officer";
- "Risk Officer"; and
- "Discipline Employee" (which amounts to a Money Laundering and Reporting Officer).

The specified approved functions are too many to list here, but we mention by way of example that an SCA-licensed firm carrying on promotion activities would only be required to appoint a "Promotions Director" (in addition to any other mandatory functions) while an SCA-licensed fund manager is required to appoint an 1) Investments Director; 2) Promotions Director; 3) Chief Financial Analyst; 4) Financial Analyst; and 5) Investment Operations Director.

A person nominated to any of these functions (**Approved Person**) would need to be approved by the SCA who would assess the person's fitness and propriety according to the criteria set out in article 3 of Chapter 6 of Part 2 of the Rulebook which include a person's: 1) capacity; 2) experience and skill; 3) integrity and honesty; 4) compliance; and the 5) absence of a rejection or withdrawal of approved status from another regulatory body.

Approved Persons are also expected to abide by the following principles: 1) integrity and honesty; 2) skill and diligence and due care; 3) good conduct; 4) dealings with the regulatory authority; 5) effective management; and 6) compliance.

Definition of "Securities"

The draft Rulebook provides a central definition of securities which includes: shares, subscription warrants, bonds, sukuk, fund units, certificates of deposit, covered warrants, derivative contracts, and any other financial instrument designated as a security by the SCA.

However, the draft Glossary contains a different definition which broadly refers to any "*tradable security accepted by the* [SCA]". This can potentially be confusing. Hopefully the SCA will adopt a single definition in the final Rulebook.

Financial promotions

The scope of financial promotion is unchanged

The activity of financial promotion remains largely the same as its current definition under the SCA's Promotion and Introduction Regulations (**PIRs**). Promotion still covers the marketing of "Financial Products" which include securities and foreign securities, and commodities contracts and structured products (although the definition of the latter is missing in the draft Glossary).

The SCA has not expanded the scope of its financial promotions regime to include the promotion of financial services. More importantly, we note that the draft Rulebook does not contain the express prohibition on promoting investment management services which is found under the current SCA regulations.

Promotions to regulated firms are no longer exempt

Under the Rulebook Glossary definition of a "Qualified Investor", promotions to firms which are regulated by the SCA or by another similar regulated authority (e.g. DFSA-licensed firms) would no longer be exempt. It is not clear whether this rather unorthodox outcome was intended. However, this would further restrict the scope of exempt financial promotions, especially following the SCA's latest amendments to the definition of a "Qualified Investor" which made it difficult for private investment vehicles to qualify into this category.

Financial introductions

The scope of financial introductions is unchanged

The activity of making introductions remains the same as it currently is under the PIRs and still only covers the introduction of a person to a regulated firm to obtain a financial service.

Introduction exemptions slightly tweaked

The exemptions from the regulated activity of introduction (now found under their own separate rule) remain largely unchanged. We note that drafting of the main exemption has been slightly tweaked to read as follows: "*the introduction between a company and its financial group, or related parties or parties which are related to investment funds, or associated parties among themselves*". However, the improvement here is the introduction of the following relevant new definitions in the Glossary which shed some light around the scope of this exemption:

- "financial group" (i.e. group of companies) which is defined as "*the holding company or the mother company and their branches the affiliates and sister and allied companies of any of them, in line with the general international principles on financial supervision and the policies and procedures on anti-money laundering*";
- "associated parties" which is defined to include, among others: a) persons who have an arrangement in place whereby they directly or indirectly hold, influence or control (the voting rights?) of 30% of shares; and b) the legal person where a natural person and his underage children hold at least 30% of shares; and
- "related parties" which is given the same meaning under the UAE Companies Law, i.e. the chairman and board members and members of senior management of a company, and any company where such persons hold at least 30% of share capital; and
- "parties which are related to investment funds" are defined to include the fund manager, the fund's board of directors, the fund's administrator, custodian, promoter, auditor, and the chairman and board members and members of senior management of any of them, and their employees and spouses and underage children and direct relatives.

Financial advisory

"Financial Advice" is defined in the draft Glossary to include:

- the "provision of financial recommendations", which means the provision or publication of opinions and recommendations based on financial research and analysis and the prediction of future value of securities and commodities and companies, with a buy/hold/sell recommendation;
- "financial analysis", which means the collection and analysis of an issuer's financial data for carrying a sectoral comparison and performance so that an investment decision can be made; or

- "financial planning", which means the comprehensive assessment of a client's current and future financial situation so that an investment strategy can be put in place to achieve the client's financial objectives.

These more orthodox and precise definitions are helpful, and set a much clearer perimeter around these activities, which are often conducted on an unregulated basis in the UAE.

Fintech and virtual assets, or the absence thereof

The draft Rulebook completely omits any Fintech regulated activities such as operating an investment crowdfunding platform, or asset brokerage or exchanges. This is unexpected given the UAE government's emphatic support of Fintech, and the SCA's earlier enactment of its "Fintech Regulatory Framework" (sandbox) back in 2018 and its public consultation on the regulations of the issuance and offering of crypto assets in 2019.

The new draft Rulebook is far from perfect, but is a first step in the right direction towards the consolidation of the SCA's fragmented regulations. While it still needs to mature, we expect the more substantive changes would likely be introduced after the (long overdue) SCA law is enacted. If you have any questions on the draft Rulebook, please contact a member of our specialist team.

Source: <https://www.clydeco.com/en/insights/2020/07/uae-s-sca-consults-on-its-new-rulebook>