

Should your Firm apply for a Retail Endorsement?

The majority of Authorised Firms in the DIFC do not hold a Retail Endorsement on their licence. As such, it is necessary for these Firms to perform client classification procedures in accordance with DFSA regulations to confirm that the prospective client meets the requirements to be classified as a professional client. These include the following:

- Ascertaining that the client's net worth (excluding principal private residence) is in excess of \$1m, and obtaining documentary proof of same;
- Ascertaining the extent and nature of the client's experience in relation to the products and services being offered on a product by product basis. This analysis requires consideration of the client's own ability to determine the risks and rewards of each product on a standalone basis without regard to the fact that the client may have utilised the services of a financial advisor in prior dealings. The assessment needs to be documented in detail with evidential support;
- Obtaining the client's consent to classification as a professional client, explaining the protections that would be foregone as a result of that classification.

In our experience as a consultant operating in the DIFC for over 10 years, the DFSA is increasingly critical of the analysis performed by Authorised Firms in this regard. In particular, they have indicated that they consider that firms are not maintaining sufficient documentary support for such classification. Several firms have therefore been subject to Risk Mitigation Programmes to remediate client files to improve the quality of supporting documentation, often at significant incremental expense, or in some cases the cessation of client relationships.

In addition, operating with a non-retail licence provides the following challenges:

- Where a client is considered to possess sufficient expertise to be considered a professional in one product class but lacks the requisite expertise in other product classes, the firm would be unable to offer products and services in those other product classes. This would additionally require the firm to implement procedures to ensure that it could identify affected product classes and restrict the ability to provide affected financial services;
- Where a client account is a joint account comprising one client who meets the definition of professional client and a client (typically a spouse) who does not, the firm has to implement procedures to ensure that it does not conduct financial services with the person who fails to meet the professional client criteria;
- It is difficult to obtain hard data on a client's NET worth. This requires a process to verify the prospective client's borrowings and exposures which is often only obtainable from self-disclosure from the prospective client.

In our opinion, many of these challenges can be addressed by obtaining a Retail Endorsement.

This, in short, would mean that the firm is free to deal with whomever it chooses without having to assess whether the client meets the professional client criteria. **It does not require the Authorised Firm to open its doors to general 'retail' business – it remains at the complete discretion of the firm as to whom it wishes to offer financial services**, including for example having minimum investable assets criteria that prospective clients need to satisfy.

Certain additional requirements under COB become applicable for firms dealing with Retail Clients compared with those which only provide services to Professional Clients. These are set out in the table on the next page. However, in our experience the additional requirements are typically those that would be performed in the ordinary course of Wealth Management business and therefore ought not to be an additional burden.

Additional requirements under the DFSA's Conduct of Business Rules for the conduct of financial services with Retail Clients

RULE	REQUIREMENT
COB 3.2.6 Marketing Material	An Authorised Firm must ensure that any information or representation relating to past performance, or any future forecast based on past performance or other assumptions, which is provided to or targeted at Retail Clients : (a) presents a fair and balanced view of the financial products or financial services to which the information or representation relates; (b) identifies, in an easy to understand manner, the source of information from which the past performance is derived and any key facts and assumptions used in that context are drawn; and (c) contains a prominent warning that past performance is not necessarily a reliable indicator of future results.
COB3.3.3 Changes to Client Agreement	If the Client Agreement provided to a Retail Client allows an Authorised Firm to amend the Client Agreement without the Client's prior written consent, the Authorised Firm must give at least 14 days' notice to the Client before providing a Financial Service to that Client on any amended terms, unless it is impracticable to do so.
*COB 3.4.2 Suitability	An Authorised Firm must not recommend to a Client a financial product or financial service, or execute a Transaction on a discretionary basis for a Client, unless the Authorised Firm has a reasonable basis for considering the recommendation or Transaction to be suitable for that particular Client. For this purpose, the Authorised Firm must: (a) undertake an appropriate assessment of the particular Client's needs and objectives, and, financial situation, and also, to the extent relevant, risk tolerance, knowledge, experience and understanding of the risks involved; and (b) take into account any other relevant requirements and circumstances of the Client of which the Authorised Firm is, or ought reasonably to be aware.
COB 3.5.3 Inducements	An Authorised Firm must, before recommending a financial product to or Executing a Transaction for a Retail Client, disclose to that Client any commission or other direct or indirect benefit which it, or any Associate or Employee of the Authorised Firm, has received or may or will receive, in connection with or as a result of the firm making the recommendation or executing the Transaction (not applicable to discretionary portfolio management or execution-only transactions).
COB App 2.1.2(d) Additional disclosures in Client Agreements	Sufficient details of the service that the Authorised Firm will provide, including where relevant, information about any product or other restrictions applying to the Authorised Firm in the provision of its services and how such restrictions impact on the service offered by the Authorised Firm . If there are no such restrictions, a statement to that effect.
COB App 2.1.2(f) Additional disclosures in Client Agreements	Details of any conflicts of interests for the purposes of disclosure under COB Rule 3.5.1(2)(b);
COB App 2.1.2(g) Additional disclosures in Client Agreements	Details of any Soft Dollar Agreement required to be disclosed under Rules COB 3.5.6 and COB 3.5.7
COB App 2.1.2(g) Additional disclosures in Client Agreements	Key particulars of the Authorised Firm's Complaints handling procedures and a statement that a copy of the procedures is available free of charge upon request in accordance with GEN Rule 9.2.11.
COB App 5.10.1	In relation to a Client to whom the Client Money Provisions are applicable, an Authorised Firm must send a statement to a Retail Client at least monthly.
COB App 6.8.1	An Authorised Firm which Provides Custody or which holds or controls Client Investments for a Client must send a statement to a Retail Client at least every six months.

**The suitability requirement also applies to Professional Clients, although by virtue of COB3.4.2(2) it is theoretically possible to limit the extent to which an Authorised Firm considers suitability for Professional Clients provided that such limitation is disclosed to the client in advance and the Professional Client provides written consent. In practice the DFSA are challenging Authorised Firms who seek to rely on this clause to exclude completely any suitability obligations to professional clients, particularly in the case of Wealth Management business for which provision of suitable investment recommendations ought to be considered a basic tenet of the service.*

Process for obtaining a Retail Endorsement

In order to obtain the DFSA's Retail Endorsement, Firms must apply to the regulator using the SUP5 Application Form and pay a \$20,000 application fee. Prior to making the application, however, Firms should ensure that they are in a position to demonstrate the adequacy of their systems and controls for carrying on financial services with a Retail Client (ultimately the capacity to offer the Retail Client a higher level of protection). Procedural and client related documentation should be updated to demonstrate the operating procedures in place to ensure compliance with the additional COB requirements set out above.

For further information and assistance with applying for a Retail Endorsement or for implementing any updates to your systems and controls, as necessitated in order to become retail compliant, please contact:

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