

DIFC: client assets rules

Client assets rules (CASS) apply to firms that hold or control client money or safe custody assets. Their objective is to ensure the safety of client money and assets in the event that such firms fail and leave the market, thereby avoiding lengthy litigations that considerably delay repayments to investors (e.g. Lehmann Brothers insolvency lawsuits).

Like other free zones in the United Arab Emirates, the Dubai International Financial Centre (DIFC) has established an own CASS regime. As noted in the 2019/2020 Business Plan adopted by the Dubai Financial Services Authority (DFSA), “[a] heavy focus will continue on how our regulated firms manage client assets. As we have no tolerance or misappropriation or mismanagement of client assets and monies, we expect all regulated firms to maintain proper systems and controls for the safeguarding and segregation of client assets [...] We will prioritise investigations and enforcement actions towards certain activities. This includes [...] Misappropriation and mismanagement of client assets.”

The present article points to some challenges that the DIFC’s CASS regime has faced over the last few years.

1. CASS applicability

According to the DFSA, more than 50% of the authorised firms in the DIFC undertake activities that give rise to CASS obligations. However, companies are frequently unaware that part of its business is subject to CASS. This occurs especially when a firm does not realise that it is, in fact, “holding” or “controlling” client money.

2. Category 4 Firms

So-called Category 4 Firms are companies that conduct any of the following activities: arranging credit or deals in investments; advising on financial products or credit; arranging custody; engaging in insurance intermediation or management; providing fund administration and other trust services. Under CASS, the Category 4 Firms are not allowed to hold client money.

3. Opting-out by banks

Banking institutions may opt out of the CASS regime. In the DIFC, money is not deemed client money if it is held by a firm “as a bank” and “in an account with itself”, provided the firm notifies the client in writing that it holds the client money in such a manner and not in accordance with CASS. However, in practice, this opting-out regime has often been misunderstood. What is more, its scope of application is relatively narrow in that it is only available for banks holding money as a deposit.

4. Client accounts

As regards client accounts, frequent problems include the failure:

- to undertake any, or any adequate, prior evaluation of the appropriateness of the bank at which the firm holds its client account(s), including assessing whether bank can provide protections equivalent to the protections conferred by CASS;
- to assess the ongoing appropriateness of the bank at which the firm holds its client account(s) (e.g. by means of a periodic review);

- to ensure that the client account includes the term “Client Account” in its title;
- to obtain written acknowledgement from the bank at which the firm holds its client account(s) stating that all money standing to the credit of the account is held by the firm as agent and that the bank is not entitled to combine the account with any other account or to exercise any charge, mortgage, lien, right of set-off or counterclaim against money in that account in respect of any sum owed to it on any other account of the firm; and
- by a non-DIFC firm (e.g. a branch of a foreign firm) to ensure that its client accounts are maintained in the name of a nominee company controlled by the firm.

4. Reconciliation issues

Some common issues with respect to reconciliation of client accounts are a failure by firms to:

- to carry out the reconciliation procedure in a timely manner;
- to ensure that the reconciliation draws on a comparison between the firm’s internal ledger balances and the firm’s external bank account balances at the correct point in time and applies the correct FX rates; and
- to compensate any reduction in the client money account while any disagreements are being resolved.