

Dubai financial market

Taking stock
of rules &
regulations

Some degree of regulation is necessary particularly in the area of financial services, says Ian Johnston, Chief Executive of Dubai Financial Services Authority (DFSA), in an exclusive interview with ANMI Journal



The Dubai Financial Services Authority (DFSA) is the independent regulator of financial and ancillary services conducted in or from the Dubai International Financial Centre (DIFC), a purpose-built financial free-zone in Dubai. The DFSA's regulatory mandate covers asset management, banking and credit services, securities, collective investment funds, custody and trust services, commodities futures trading, Islamic finance, insurance, an international equities exchange and an international commodities derivatives exchange.

In addition to regulating financial and ancillary services, the DFSA is responsible for supervising and enforcing Anti-Money Laundering (AML) and Counter-Terrorist Financing (CTF) requirements applicable in the DIFC. The DFSA has also accepted a delegation of powers from the DIFC Registrar of Companies (RoC).

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DFSA performs a number of functions from policy making, enforcement, supervision and international co-operation across all financial sectors. How does this integration work?

The DFSA's day-to-day management structures and corporate governance ensure that the different activities the organization carries out are well integrated. This starts with the DFSA Board agreeing to the organization's strategy and business plans, and continues with the Chief Executive overseeing the day-to-day delivery of those business plans.

For example, a major piece of policy and rulemaking will involve not only staff from the Policy and Legal areas, but also staff from other areas, such as Supervision and Enforcement, who will need to use the rules in their everyday work of supervising firms and taking action against them if they breach the rules. In this way the DFSA ensures that our different functions are, to the extent necessary, effectively and efficiently integrated.

"To be a risk-based regulator and to avoid unnecessary regulatory burden" is DFSA's stated approach. With regulators pre-occupied with so many challenges like investor protection and corporate mis-governance for example, how does implementing such an approach work?

Taking a risk-based approach allows the DFSA to focus on those areas that seem to us to be most important, in that they pose the greatest risk to us achieving our objectives as set out in the law. By looking at the extent of risk posed by particular issues, we can prioritize addressing certain issues and seek to align the level of regulation with the level of risk (so that higher risk areas face more regulation).

The level of regulation means both the nature and extent of the rules that firms have to comply with and the supervisory approach to monitoring the activities of firms.

The DIFC has been one of the key hubs for intermediaries' world over. What are the immediate focus and strategies to remain effective in the near future?

For a financial hub to function effectively the spokes are critically important. The connectivity of the DIFC with other markets around the world is defined by ensuring that the regulatory outcomes for the DFSA are broadly equivalent to home jurisdictions. Equivalence has emerged as a key theme in the last few years and is in my view here to stay.

I will mention two key elements of the DFSA's approach.

First, the DFSA continues its focus on regulatory change in other markets and is adapting to the changing regulatory landscape. We implement this strategy by a high level of engagement with the international standard setters IOSCO, the Basel Committee and the IAIS, and the subsequent adoption of globally accepted reforms.

An important second element of our strategy is to develop policy initiatives on our own accord. These policy and legislative initiatives may be in particular areas that may not be a prominent focus of more developed markets, but are highly relevant for the regulation of the emerging DIFC market.

An example of this is the rapid development of the Islamic Finance industry. Aided by the support of the Dubai government's Islamic Economy initiative the DFSA has seen 7 of Islamic debentures (Sukuk) in 2014 alone.

Recently, many initiatives have been taken by the DFSA like changes in category of market traders, curbing volatility and attracting new products. Would you like to share your experience?

There are many changes in the regulatory landscape proposed by regulators around the world that are sensible and that are consistent with the DFSA's risk-based approach. Most of those were a direct effect of the financial crisis. Increasing capital ratios for banks and the global introduction of OTC derivatives reporting and clearing are just two examples. However the speed of regulatory reform has slowed down and I believe we are well into the implementation phase. The drafting and implementation puts a lot of pressure on a small organization like the DFSA, but I believe we have successfully implemented the most important changes. This enables us to continue to meet

International Interview

international standards.

The DFSA's policy initiatives are always founded in a consultative process. This process is executed by way of soft-consultation with key affected firms, in formal consultations with the public at large and, where appropriate, by publishing feedback statements on the comments received. We open ourselves up to public scrutiny of the proposals and assume accountability to the market participants. This is a core principle for a fair and reasonable regulator acting in a transparent manner.

Do you think that global standard needs to be established for facilitating capital formation particularly in developing economies?

The transfer of savings from individuals or households as a catalyst to growth is a critical component of any economy. For developing economies where foreign investors may be demanding a higher premium than local investors, local capital formation can create strong efficiencies to the cost of capital. Traditionally local commercial banks played a central role in this process.

As a result of the financial crisis regulators of larger international banking conglomerates will seek assurance that countries in which the bank has branches or subsidiaries operate under similar standards. Adopting international standards as a jurisdiction and achieving regulatory equivalence with home jurisdictions may then cause banks to consider a presence. The DIFC may be a good example of this approach

Laws, regulations and growth go hand in hand - one follows the other. Your comments please.

If there were no regulation of financial services activity, then there would undoubtedly be growth in activity, but in a way that led to clients being disadvantaged and in a way that would not lead to a sustainable and stable financial centre.

So, particularly in the area of financial services, some degree of regulation is necessary, both to protect clients of regulated firms and to assist financial markets to develop in an orderly and sustainable manner.

And there is plenty of evidence to support the notion that good corporate governance attracts capital to markets.

But it is important that the framework of laws and regulations allows firms to develop their businesses, in a legitimate way, by providing services and products that their clients need. So we aim to have a regulatory framework that facilitates growth and provides space for firms to develop, and also provides the appropriate degree of protection to the different clients that firms have.

Developed and developing countries have different sets of regulatory framework. Would you like to suggest what kind of regulatory framework would be ideal for emerging economies?

International standards for financial sector regulation apply to both developed and developing economies. However, each of the standard setters has recognized the concept of proportionality in their evaluation processes for compliance.

Developing economies should have a long-term vision of full compliance with international standards, but at a pace and at a level of complexity that matches the market participants and the capacity to regulate and supervise those entities.

Adopting layers of complex regulation, without sufficient staff preparedness and enforcement capability, might actually increase the risk in a developing economy's financial sector, rather than reduce it. As per an IMF Report, dated May 2010, titled ~ The Making of a Good Supervisor: Learning to Say 'No' ~ "To be effective, supervision needs to be intrusive, adaptive, sceptical, proactive, comprehensive, and conclusive.

For this to happen, the policy and institutional environment must support both the supervisory will and ability to act." This is an important message to all supervisors, in both developed and developing markets, in their design of the proper regulatory framework for their respective jurisdictions.

What values and experiences can the DIFC and the Indian securities markets bring for the common benefit of these markets, globally?

The differences in the size and complexity of the Indian securities markets and those in the DIFC make it difficult to make a fair comparison between the two. However, an interesting feature of the Indian securities markets is the very large number of small and medium enterprises that have publicly raised capital by offering securities to the public.

Enabling SME's to raise capital in a public market could be another catalyst for economic growth. It is certainly the topic of discussion in the UAE and the DIFC, though it comes with substantial regulatory challenges as well.

For example, how are investors informed at the offering stage, and how are they kept informed thereafter? What accounting principles are to be adopted without making it too costly for the issuing companies to list their securities?

So far the DFSA has not seen a strong interest among SME's to become listed in the DIFC. This may be caused by the large capacity in the U.A.E. for private loans. If it does occur I believe our listing framework is well designed to deal with these challenges.