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## Abu Dhabi Global Market: Financial Services Regulations and Rules

This note provides a brief overview of Abu Dhabi Global Market's new financial regulatory framework. This framework was established in 2015, following the publication of the ADGM's Financial Services and Markets Regulations 2015 and a series of rulemakings.

### Introduction

The financial services regulatory framework for the Abu Dhabi Global Market ("ADGM") aims to, taking the best of different models for regulation applicable in Europe, the US, Singapore, Australia and Hong Kong, reflect current international best practice. The regime was also tailored to local needs as necessary. The framework is derived primarily from the UK's financial regulatory framework, with influences from other jurisdictions. The aim is that the regulatory framework will support ADGM's potential status as a leading financial and commodities trading centre in the future.<sup>1</sup>

### Regulatory Framework

The Financial Services and Markets Regulations 2015 ("FSMR") is a piece of legislation adopted by the Board of ADGM. It is supplemented by various rulebooks as well as indicative, non-binding guidance, issued by the ADGM Financial Services Regulatory Authority (the "Regulator" or "FSRA").

### Regulatory Supervision

Two general restrictions, based on the UK regulatory framework, broadly set out the range of financial services that would trigger a licensing requirement for activities undertaken in and from the ADGM.<sup>2</sup> The first prohibits persons from carrying on a regulated activity<sup>3</sup> without either authorisation or exemption: the "General Prohibition." The second requires that all financial promotions,<sup>4</sup> must either be made by a firm that is licensed by the Regulator (a "Regulated Firm") or have its content approved by Regulated Firm<sup>5</sup> and is known as the "Financial Promotion Restriction." Unlike the UK, there is no exemption for financial promotions to high net worth individuals. Regulated firms are also prohibited from accepting deposits from the UAE markets or in the UAE dirham or undertaking foreign exchange transactions involving the UAE dirham.<sup>6</sup> The Regulator may take

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<sup>1</sup> You may like to see our client notes on other aspects of the ADGM framework: "Abu Dhabi Global Market: The Application of English Common Law," available [here](#); "Abu Dhabi Global Market: Establishing a Company," available [here](#); and "Abu Dhabi Global Market: Obtaining a Commercial Licence," available [here](#).

<sup>2</sup> Regulated activities are activities carried on by way of business which relate to a "specified investment." See Table A below for a list of "specified investments."

<sup>3</sup> As specified in Schedule 1 of FSMR.

<sup>4</sup> As defined in Schedule 2 of FSMR.

<sup>5</sup> A Regulated Firm is a legal person, other than a Recognised Clearing House or Recognised Investment Exchange, who is authorised under FSMR to carry out certain regulated activities in or from the ADGM.

<sup>6</sup> Chapters 4.2-3 of COBS.

disciplinary action, such as public censure or financial penalties, against any corporate or individual which breaches either restriction. There may also be further commercial consequences for breach of either restriction, such as agreements being rendered unenforceable.

There are two levels of regulatory supervision within the ADGM: one for Regulated Firms (known in the legislation as “Authorised Persons” although referred to in this note as Regulated Firms) and one for individuals employed by those firms. The first level comprises the assessment and authorisation by the Regulator of firms seeking to perform regulated activities in ADGM and the ongoing supervision of such firms. Once a firm is authorised, it will have permission to carry out its relevant regulated activities. The second regime relates to the individuals working within an authorised firm and has two layers. Individuals who perform certain “Controlled Functions” (i.e. chief executive officer and all directors) in the businesses of regulated firms are assessed and must be approved by the Regulator. Once approved, such individuals are known as Approved Persons. However, rather than having the Regulator police and approve other senior managerial appointments, the firms themselves are accountable for recognising and approving customer-facing and senior managerial staff who perform “Recognised Functions” (e.g. senior managers, customer-facing staff, the compliance officers, money laundering reporting officers). This approach places the responsibility on firms to initially assess the individuals that they employ in these roles and to continually assess their competence, fitness and propriety. It will also reduce the administrative burden of the Regulator compared to some other regimes.

**Table A: Regulated activities and specified investments**

<b>Regulated activities</b>	<b>Specified investments</b>
<ul style="list-style-type: none"> <li>● Arranging deals or dealing in investment as principal</li> <li>● Advising on investments or credit</li> <li>● Dealing in investments as agent</li> <li>● Accepting deposits</li> <li>● Providing custody</li> <li>● Providing or arranging credit</li> <li>● Money services, managing assets or collective investment funds</li> <li>● Operating a Multi-lateral Trading Facility, Organised Trading Facility, Credit Rating Agency or Representative office</li> <li>● Administering or providing information re. a specified benchmark</li> <li>● Shari-a compliant regulated activities</li> <li>● Effecting contracts of insurance</li> <li>● Insurance management</li> <li>● Agreeing to carrying on regulated activities</li> </ul>	<ul style="list-style-type: none"> <li>● Deposits</li> <li>● Shares</li> <li>● Sukuk</li> <li>● Government securities</li> <li>● Instruments giving entitlements to investments</li> <li>● Certificates representing certain financial instruments</li> <li>● Units in a collective investment fund</li> <li>● Options, futures and CFDs</li> <li>● Credit agreements</li> <li>● Rights to or interests in investments</li> <li>● Shari-a compliant specified investments</li> <li>● Contracts of insurance</li> </ul>

*Investigations and Enforcement*

The Regulator’s supervisory oversight is supplemented with suitably comprehensive information gathering and investigatory powers, balanced by appropriate procedural protections. The Regulator has a range of enforcement and remedial powers, which it may choose to exercise if any of the regulatory requirements are breached.<sup>7</sup> Although the Regulator may take enforcement action at various stages in the regulatory process, the

<sup>7</sup> Parts 19-21 of FSMR.

general structure of any formal enforcement action is to provide written notices: a warning notice,<sup>8</sup> followed by a decision notice<sup>9</sup> and where necessary, a final notice.<sup>10</sup> Measures the Regulator may take if a breach has occurred include issuing a private warning, public censure, imposing financial penalties, suspension or disqualification of auditors, prohibiting individuals from undertaking certain types of activities and enforceable undertakings. Various remedies are available to the Regulator or the Court (as applicable) for contravention of the FSMR, including injunctions, restitution, compulsory winding up and actions for damages.

To ensure due process and procedural fairness, two independent decision-making bodies have been created: the Regulatory Committee and the Appeal Panel. Any decision made by the Regulator under FSMR may be referred to these bodies for a full merits review.

### **Specific Rules**

#### *General Rules Applicable to All Authorised Firms*

The General Rulebook (“GEN”) applies to all persons to whom FSMR applies - regulated firms, Approved Persons and Recognised Persons (with the exception of recognised clearing houses and investment exchanges which operate outside of ADGM).

The GEN Rulebook expands on the breadth of the Regulator’s monitoring and supervisory powers, covering applications for amendment of permission, requests for information by the Regulator and the approval/notification requirements for change of control over regulated firms.<sup>11</sup>

General regulatory requirements (“Principles”) that regulated firms, Approved Persons and Recognised Bodies (i.e. recognised clearing houses and recognised investment exchanges) must adhere to have been introduced.<sup>12</sup> These track closely the UK’s “general principles. “ Designed to apply in conjunction with the Rules, the Principles are legally binding and must be adhered to at all times by regulated firms, Approved Persons and Recognised Bodies (although the latter two categories are exempt from the application of certain Principles). Breach of the Principles may result in disciplinary action, including a suspension or withdrawal of Regulated Firm, Approved Person or Recognised Body status.

Rules on systems and controls are also prescribed. In particular, responsibility for internal management, organisation and compliance must be entrusted to the senior managers of the Regulated Firm. Approved Persons must ensure appropriate allocation of management responsibilities and are required to ensure that effective systems and controls over the affairs of the Regulated Firm are implemented. Guidance on complaints handling, including acknowledgement and resolution of complaints is established.<sup>13</sup> The degree of protection afforded to clients of regulated firms varies depending on their classification (rules on which are found in in the

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<sup>8</sup> This is provided when the Regulator intends to take action that may be adverse to applicants for Regulated Firm status or regulated firms. The affected person has a right to respond, but this right must be exercised within a specified period.

<sup>9</sup> This is provided when the Regulator decides to take action that may be adverse to applicants for Regulated Firm status or Regulated Firms. Following receipt of a decision notice, the affected person has the right to refer the matter to the Court. Further decision notices (in relation to different actions to be taken in respect of the same matter) may be provided.

<sup>10</sup> This is given following a decision notice by the Regulator on taking action to which the decision notice relates.

<sup>11</sup> Chapter 8 of GEN.

<sup>12</sup> Chapter 2 of GEN.

<sup>13</sup> Chapter 7 of GEN.

Conduct of Business rulebook, as discussed below). For example, a written complaints handling procedure for retail clients is prescribed.

Finally, there are rules and non-binding guidance on audits and accounts (including standards for auditors, standardised financial reporting, appointment and termination of auditors, filing of accounts and regulatory returns),<sup>14</sup> the operation of a representative office<sup>15</sup> as well as general interpretation, emergency procedures, disclosure requirements, complaints procedures and the maintenance of public records.<sup>16</sup>

### *Conduct of business*

Regulated firms and Recognised Bodies operating in the ADGM are required to adhere to additional rules of conduct which are contained in the Conduct of Business Rules (“COBS”). Building from the Principles, this Rulebook describes with greater precision the international standards of business and client treatment, based on a model taking into account obligations of regulated entities in sophisticated jurisdictions.

A three-tier client categorisation structure comprising “retail clients,” “professional clients” and “market counterparties” has been adopted, under which different levels of protection are given to different categories of clients. Within this, there are three sub-categories of professional clients:

- “deemed” professional clients - who those assessed as professional by virtue of the fact that they meet certain financial thresholds to qualify as a “Large Undertaking,” clients who are a Recognised Body, clients who are a Regulated Firm, etc. The full list of entities who are “Deemed” Professional Clients is set out in COBS;
- “service-based” professional clients - deemed clients who those assessed as professional by virtue of the fact that they provide certain services; and
- “assessed” professional clients - clients who are assessed as professional based on their net assets.

Detailed guidance on how and when regulated firms should make these classifications is set out in the COBS Rulebook. Retail clients are afforded higher levels of protection as detailed in Table B below. For example, a Regulated Firm will be held to a higher standard in assessing whether marketing material it produces is appropriate (i.e. clear, fair and not misleading) where such material is aimed at retail clients, whereas communications aimed at professional clients and market counterparties may be presented differently and may include less information.<sup>17</sup> Similarly, although suitability assessments must be undertaken for retail clients, they do not need to be undertaken in relation to market counterparties.<sup>18</sup>

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<sup>14</sup> Chapter 6 of GEN.

<sup>15</sup> Chapter 9 of GEN.

<sup>16</sup> Chapter 4 of GEN.

<sup>17</sup> Although the Regulated Firm is nevertheless required to ensure that all communications are clear, fair and not misleading. Chapter 3.2 and 7.3 of COBS.

<sup>18</sup> Chapter 3.4.2 of COBS.

**Table B: Protections for different categories of clients**

Rules	Level of Protection		
	Retail clients	Professional Clients	Market Counterparties
<b>Marketing material</b>	Must be fair, clear and not misleading.		
<b>Suitability assessment</b>	Must undertake appropriate assessment of needs, objectives, finances, risk appetite, knowledge etc.	Assessment may be limited or dispensed with depending on agreement with client.	
<b>Best execution</b>	Must provide best execution under prevailing market conditions and deal at price/conditions no less advantageous to client.	Must provide best execution under prevailing market conditions and deal at price/conditions no less advantageous to client.*	Not applicable.
<b>Aggregation and allocation of orders</b>	Aggregation only allowed in line with the firm's written policy if there is (a) no disadvantage to any clients; (b) disclosure in writing to clients.	Aggregation only allowed in line with the firm's written policy if there is (a) no disadvantage to any clients; (b) disclosure in writing to clients.*	Not applicable.
<b>Record keeping</b>	Must make and retain recordings of voice and electronic communications in relation to transactions from the Regulated Firm's equipment.		
<b>Investment management and contingent liability investments</b>	Periodic statements must be provided at suitable intervals in relation.	Periodic statements must be provided at suitable intervals in relation.*	Not applicable.
<b>Confirmation notes for investment transactions for clients</b>	Must be sent within two business days from when the transaction is executed.	Must be sent within two business days from when the transaction is executed.*	Not applicable.
<b>Miscellaneous dealing rules</b>	Regulated Firms are required to comply with additional dealing rules relating to churning, timely execution and allocation, averaging of prices, direct electronic access etc.	Regulated Firms are required to comply with additional dealing rules relating to churning, timely execution and allocation, averaging of prices, direct electronic access etc. *	Not applicable.

\* Unless the transaction is in relation to managing a Fund of which it is the Fund Manager, then this is not applicable.

Additionally, a separate regime is applicable to credit rating agencies<sup>19</sup> which implements rules that bring the regulation of such agencies in the ADGM in line with the relevant International Organization of Securities Commissions ("IOSCO") standards.<sup>20</sup>

### *Prudential Requirements*

New rules on regulatory capital have been developed. The Prudential - Investment, Insurance Intermediation and Banking Rules ("PRU") are closely based on the Basel Committee on Banking Supervision's ("Basel Committee") prudential standards published in December 2010 and since revised (known as the "Basel III

<sup>19</sup> Operating a credit rating agency is a regulated activity (per art 65 of Schedule 1 of FSMA) and credit rating agencies are therefore within the Regulated Firm category.

<sup>20</sup> Code of Conduct Fundamentals for Credit Rating Agencies, available [here](#).

framework”). ADGM’s bank capital and related rules are therefore intended to meet global best practice standards.

Each Regulated Firm will be allocated to one of five “Categories,” primarily on the basis of the activities for which they are authorised.<sup>21</sup> Banking activities fall into Category 1, attracting stricter capital requirements than other activities. In contrast, certain fund management entities are placed in Category 5,<sup>22</sup> where, as a general rule, lower capital requirements apply. Firms must identify which Category they fall into, and calculate their capital requirements on the basis of their Categorisation.

**Table C: Prudential categories**

Category 1	Category 2	Category 3A	Category 3B	Category 3C	Category 4	Category 5
Accepting Deposits	Providing Credit	Dealing in Investments as Principal (only as a Matched Principal)	Providing Custody (only if for a Fund)	Managing a Collective Investment Fund	Arranging Credit	An Islamic Financial Institution Managing a Profit Sharing Investment Account which is a PSLAu
Managing a Profit Sharing Investment Account which is a PSLAu	Dealing in Investments as Principal (not as a Matched Principal)	Dealing in Investments as Agent	Acting as the Trustee of an Investment Trust	Managing Assets	Arranging Deals in Investments	
				Managing a Profit Sharing Investment Account which is a PSLAr	Advising on Investments or Credit	
				Providing Custody (other than for a Fund)	Arranging Custody	
				Providing Trust Services as a trustee of an express trust	Insurance Intermediation	
				Providing Money Services	Acting as the Administrator of a Collective Investment Fund	
					Administering a Specified Benchmark	
					Operating a Credit Rating Agency	
					Creating a Multilateral Trading Facility or Organised Trading Facility	
					Operating a Representative Office	
					Providing information in Relation to a Specified Benchmark	
					Providing Trust Services other than as a trustee of an express trust	

<sup>21</sup> As set out diagrammatically below at Table C, as well as at Appendix 1 of PRU.

<sup>22</sup> Regulated Firms are considered to be in Category 1 if they are authorised to accept deposits or manage profit sharing investment accounts. Conversely, Category 5 Regulated Firms are Islamic Financial Institutions which manage profit sharing investment accounts. Further guidance on these categories can be found at PRU 1.3.

**Table D: Minimal Capital Requirements**

<b>Prudential Category</b>	<b>Capital Requirements</b>	<b>Base Capital Requirement</b>	<b>Risk Capital Requirement</b>	<b>Expenditure Based Capital Minimum</b>	<b>Capital Conservation Buffer<sup>23</sup></b>
Category 1	Higher of applicable Base Capital Requirement (PRU 3.6) or Risk Capital Requirement (PRU 3.8).	US \$10 million	√	-	√
Category 2	Higher of applicable Base Capital Requirement (PRU 3.6), Risk Capital Requirement (PRU 3.8) or Expenditure Based Capital Minimum (PRU 3.7)	US \$2 million	√	√	√
Category 3A	Higher of applicable Base Capital Requirement (PRU 3.6), Risk Capital Requirement (PRU 3.8) or Expenditure Based Capital Minimum (PRU 3.7)	US \$500,000	√	√	√
Category 3B	Higher of applicable Base Capital Requirement (PRU 3.6) or Expenditure Based Capital Minimum (PRU 3.7). Must also maintain liquid assets which exceed its Expenditure Based Capital Minimum.	US \$4 million	-	√	-
Category 3C	Higher of applicable Base Capital Requirement (PRU 3.6) or Expenditure Based Capital Minimum (PRU 3.7). Must also maintain liquid assets which exceed its Expenditure Based Capital Minimum.	US \$250,000	-	√	-
Category 4	Higher of applicable Base Capital Requirement (PRU 3.6) or Expenditure Based Capital Minimum (PRU 3.7). Must also maintain liquid assets which exceed its Expenditure Based Capital Minimum.	US \$10,000	-	√	-
Category 5	Higher of applicable Base Capital Requirement (PRU 3.6) or Risk Capital Requirement (PRU 3.8).	US \$10 million	√	-	√

<sup>23</sup> The capital conservation buffer requirement is equivalent to 25% of a Regulated Firm's risk capital requirements in CET1 form. Risk capital requirement is the aggregate measures of the components of a firm's capital requirements relating to credit risk, market risk, operational risk and certain commercial risks.

The ADGM prudential rules do not seek to “front-run” any of the Basel Committee standards by implementing rules in ADGM ahead of any relevant timetables set out in the Basel III framework. The general approach is to follow closely the Basel III timeline for implementation. Therefore, certain items, such as the Liquidity Coverage Ratio (“LCR”) requirement, are provided for (according to the required level of phase-in by 1 January 2015, as set out in Basel III). However, some other items, such as a binding leverage ratio, are not yet included in the rules as these require implementation by a later date (in this instance, 1 January 2018).

Certain Basel III standards were considered not yet to be appropriate in the ADGM. Importantly, the Basel Committee recommend in the Basel III framework the introduction of a “counter-cyclical buffer,” applicable to banks. As the name indicates, the purpose of this buffer is to counteract the effects of the economic cycle on banks’ lending activity, thus making the supply of credit less volatile and lessening the probability of credit bubbles or crunches. However, the ADGM Board considered that the counter-cyclical buffer would have been inappropriate to implement in the ADGM, given that there is no history of economic cycles to draw from in the new free zone and as such, no counter-cyclical buffer is (as yet) required.

A review of the ADGM Prudential Rules is proposed to be on-going to ensure consistency with Basel III as the framework evolves and as the timeline for implementation of the various standards continues. New rules on Basel III-based counterparty credit risk, securitisation and the net stable funding ratio are absent from the current regime, for example.

#### *Market Infrastructure*

The rules for financial market infrastructures is modelled on IOSCO, European and English regulatory standards, enabling ADGM potentially to be “plugged in” to cross-border recognition regimes. The intention here is to set out the regulatory basis for the operation of financial market infrastructure. In particular, Part 13 of FSMR prescribes the requirements that investment exchanges and clearing houses must fulfil to become “Recognised Bodies” and therefore exempt from the General Prohibition. Equivalent risk mitigation techniques applicable to OTC derivatives in the EU have been imported into the ADGM, including the obligatory clearing of OTC derivatives that have been declared subject to clearing obligations and various other requirements applicable to non-cleared contracts, although these requirements are yet to be activated. Settlement finality provisions safeguard the integrity and finality of trades executed/cleared through market infrastructure by insulating contracts between market participants and exchanges or clearing houses from the impact of insolvency of other clearing members or of the exchange or clearing house itself. Primacy is given to the Recognised Body’s own default management rules and procedures, over any contrary insolvency or property laws, to ensure that market infrastructure can operate effectively to protect [counterparties] in times of economic turbulence.

FSMR is supplemented by the Market Infrastructure Rules (“MIR”) which are applicable to exchanges and clearing houses incorporated or operating in the ADGM. These rules prescribe special conduct and organisational rules for recognised investment exchanges or recognised clearing houses. Guidance is provided for investment exchanges and clearing houses incorporated outside of the ADGM wishing to obtain recognition to access users inside the ADGM. A recognition regime based on that applicable in Europe has been crafted.

Recognised investment exchanges and recognised clearing houses will be subject to notification obligations, supervisory powers of the Regulator, capital requirements and, in the event of non-compliance, disciplinary measures.



### *Funds*

FSMR establishes the framework for the regulation of collective investment funds (including investment trusts) and prescribes the rules that such entities must comply with, including creation, registration and notification requirements.<sup>24</sup>

To support this regulatory framework, the Fund Rules contain clear and concise guidelines on the management and marketing of funds which aim to provide a balance between effective and flexible regulatory oversight on the one hand, and certainty and investor protection on the other. Consideration was given to approaches taken in multiple other jurisdictions (including other free zones and the UK).

For example, in contrast to the approach taken in some other regional free zones, the Board of ADGM decided against the micro-categorisation of domestic ADGM funds (such as private equity funds, infrastructure funds etc.) since it was considered that such micro-categorisation and application of different rules to different categories could lead to uncertainty over which category might apply to any given fund and also result in unnecessary complication of the funds regulatory framework.

However, the Board of ADGM decided to follow the approach taken by other free zones in the region of categorising domestic funds into three broad categories (Public Funds, Exempt Funds and Qualified Investor Funds) with the level of regulatory requirements applicable depending on such categorisation.

To ensure that the level of fund regulation in the ADGM was sufficient for it to be regarded as robust, while not unnecessarily burdening fund managers, certain additional requirements that were similar in spirit to those recently introduced by European legislation are reflected, but some of the more bureaucratic, burdensome adjuncts are left out. For example, the following requirements form part of the Fund Rules:

- notification requirements (a fund manager must notify the Regulator when delegating a “critical management” function, such as portfolio and/or risk management);
- disclosure requirements (a fund manager must include certain minimum disclosure items in the prospectus of a foreign fund being marketed to investors in the ADGM); and
- a requirement for functional and hierarchical separation, and independence, between the functions of (i) risk management; and (ii) portfolio management.

A requirement to appoint an “eligible custodian” to perform custody services is also included to reflect the increased market practice of appointing a custodian following the Madoff scandal.

In contrast to some jurisdictions which have a separate and/or additional set of winding up procedures applicable to funds, the Fund Rules provide for only minimum circumstances in which an ADGM fund can be wound up separately from the generally applicable insolvency legislation. This ensures that the ADGM funds framework is simple and efficient.

### *Islamic Finance Rules*

The FSMRs include Islamic products among the list of financial instruments that are subject to regulation. The Islamic Finance Rules contemplate two categories of Shari’a-compliant financial institution: an Islamic Financial Institution (being a financial institution that undertakes all of its activities in compliance with Shari’a) and an Islamic Window (being a segregated business unit of a conventional financial institution with only that

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<sup>24</sup> Part 11 of FSMR.

segregated business unit undertaking Shari'a-compliant activities). This approach is reflective of the way in which the Islamic banking world operates and is consistent with the approach taken in other regional free zones.

The Islamic Finance Rules have been prepared as a supplement to the other rulebooks of the ADGM. What this means in practice is that an Islamic Financial Institution or Islamic Window is required to comply with all of the regulations that would apply to a conventional financial institution and, in addition, is required to comply with the Islamic Finance Rules. This level of overlap is necessary to ensure that financial institutions are subject to the same standards of regulation whether or not they are Shari'a-compliant. This harmonisation of regulatory approach is also intended to encourage the growth of Islamic banking by ensuring that a party is not adversely impacted by investing and banking in accordance with its conscience.

The additional regulatory compliance obligations set out in the Islamic Finance Rules address the key issues for Islamic banking: Shari'a supervision and accounting and audit. Shari'a is not a codified body of law and, as such, is open to interpretation by the different schools of Islamic jurisprudence. The Islamic Finance Rules allow Islamic Financial Institutions and Islamic Windows to adhere to whichever school of thought that institution elects prescribing only the need for an Islamic Financial Institution or an Islamic Window to maintain an appropriately qualified Shari'a board. Questions as to Shari'a compliance will be the responsibility of that Shari'a board.

The Islamic Finance Rules allow for ADGM to establish a central Shari'a board, should it wish to do so in order to harmonize interpretations. There is currently no intention to establish such a central board but flexibility has been included to allow for this if there is demand in the market for it. The concept of a central Shari'a board reflects the practice in Malaysia as opposed to the general practice in the Middle East where this concept is not currently used.

In terms of the accounting treatment for Islamic Financial Institutions and Islamic Windows, the standards of the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) should be followed for the most part and this requirement is reflected in the Islamic Finance Rules. The Islamic Finance Rules also prescribed certain regulatory capital requirements that should be adhered to for Islamic Financial Institutions and Islamic Windows. The main point of difference for the Islamic Finance Rules versus its conventional equivalent concerns Profit Sharing Investment Accounts (PSIAs). There is no conventional equivalent of a PSIA which gives rise to the need for a specific set of rules to govern how they operate. A PSIA is an investment account that a depositor holds with an Islamic Financial Institution or an Islamic Window which provides for the sharing of profits from that account but which, in contrast to a deposit, is not capital protected i.e. an investor may lose the full amount that it invests. However, as a result of market forces, it is common for banks to nevertheless over-pay profit on PSIAs so as to replicate the returns that would have been payable on a commercial deposit including the return of principal in full (notwithstanding any losses that may have been incurred). This gives rise to a specific category of regulated activity which is governed by a regime that is found only in the Islamic Finance Rules.

Islamic Collective Investment Funds are also subject to regulation under the Islamic Finance Rules. Similar to the approach taken to Islamic Financial Institutions and Islamic Windows, the Islamic Finance Rules augment the Collective Investment Rules by prescribing certain additional conditions with which an Islamic fund must comply—mostly relating to Shari'a supervision. Again, the approach has been to ensure that all collective investment funds comply with the same level of regulation in order to be classed as such with Islamic funds

being subject to certain additional rules. The Islamic Finance Rules similarly prescribe additional requirements for securities to be marketed as Islamic securities and for insurance to be marketed as Takaful.

### *Insurance Businesses*

All insurers (i.e. persons authorised to carry on the regulated activity of conducting insurance business) are required to comply with the “Prudential – Insurance Businesses” module (“PIN”) for insurance business. However, in relation to reinsurance business, insurers are restricted to risks outside ADGM but situated in the UAE.

The rules set prudential requirements for insurers in key areas, including capital adequacy, risk control, long-term insurance business, measurement of assets and liabilities, reporting, and actuarial activity. There are additional rules regulating captive insurance business in ADGM.

### *Securities*

FSMR prescribes an extensive set of rules on the listing of securities in ADGM.<sup>25</sup> In particular, the Regulator has responsibility for maintaining the official list, the admission of securities to listing, the discontinuance and suspension of listings and the approval of prospectuses and sponsors.<sup>26</sup> Listed entities will be subject to disclosure requirements, any disciplinary measures the Regulator make take for misleading statements and omissions in prospectuses.<sup>27</sup> Provisions made for the legal effect and procedure of business transfer schemes and the powers and duties the ADGM court has in approving such a scheme.<sup>28</sup> Finally, the rules on listing have been complemented with rules on suspension and removal of financial instruments from trading.<sup>29</sup>

More specific rules on securities listing are set out in the Market Rules module (“MKT”), which is substantively based on current EU Prospective Directive requirements. The Market Rules cover offers of securities to the public, the appointment and obligations of sponsors, market abuse, market disclosure, and governance, should therefore be broadly familiar to businesses with experience of dealing in the London and other European securities markets. There are however, certain divergences from EU listing rules, such as the minimum free float requirement, which states that a certain number of shares must be held by public hands at the time of admission of securities in ADGM. The precise free float amount is calibrated according to the size of the issuer’s market capitalisation at the time:

- Smaller issuers with a market capitalisation of under \$500 million: at least 20% of the shares in relation to which the application for admission is made must be held in public hands;
- Issuers with market capitalisations between \$500 million or more, and under \$1 billion: 15% of the shares for which the application for admission is made must be held in public hands; and
- Issuers with a market capitalisation of \$1 billion or more: at least 12% of the shares in relation to which the application for admission is made must be held in public hands.

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<sup>25</sup> Parts 6-7, 10-12 and 15 of FSMR.

<sup>26</sup> Part 6 of FSMR.

<sup>27</sup> Part 6 of FSMR.

<sup>28</sup> Part 7 of FSMR.

<sup>29</sup> Part 15 of FSMR.

This approach is influenced by the methodology used in Singaporean listing rules, which avoids a one-size-fits-all 25% minimum float requirement, as applies in the EU, in favour of a more tailored calibration taking into account the market capitalisation of the issuer as the relevant benchmark for the minimum float requirement. It is hoped that a relatively low float requirement for smaller issuances may attract regional companies to list their securities in ADGM, provided that they are able to comply with the other ADGM listing criteria.

### *Market Abuse*

FSMR prescribes the general framework for market abuse protections in the ADGM.<sup>30</sup> In particular, Part 8 of FSMR provides protections equivalent to the present EU regime for market abuse. Its drafting is a tailored amalgamation of Part VII of the UK Financial Services Act 2012 updated to reflect the EU Market Abuse Directive. The approach has been not to “front-run” any forthcoming European legislation (including the Market Abuse Regulation, which comes into force in mid-2016) to ensure consistency with current international standards. Part 9 of FSMR similarly contains more general rules on misleading statements and impressions and related defences.

The Rules of Market Conduct (“RMC”) provide more detailed guidance on the market abuse regime. RMC does not have legally binding force but are intended to assist persons in determining whether conduct amounts to market abuse in ADGM and to provide guidance to persons subject to the market abuse regime in FSMR on whether certain market practices, in the Regulator’s view, would ordinarily amount to market abuse. The Rules are substantively based on the UK’s Code of Market Conduct (the “UK Code”). This approach captures the benefit of the extensive UK jurisprudence available in the complex area of market abuse.

### *Anti-money Laundering and Sanctions*

The Anti-Money Laundering and Sanctions Rules and Guidance rulebook (“AML”) is intended to provide a single reference point for all persons and entities that are supervised by the Regulator for the purposes of their anti-money laundering and sanctions compliance. Persons subject to Anti-Money Laundering and Sanctions Rules and Guidance include regulated firms, Recognised Bodies, Representative Offices. However, unlike the rest of the financial regulatory framework, the AML rules also apply to real estate developers or agencies, law firms, notary firms, accounting firms, and dealers in precious metals or stones.

AML is drafted to reflect key international standards in this area, most importantly, the Financial Action Task Force (“FATF”) Recommendations of February 2012,<sup>31</sup> the FATF Guidance on Transparency and Beneficial Ownership of November 2014,<sup>32</sup> and Basel Committee standards on the “Sound Management of Risks Related to Money Laundering and Financing of Terrorism” of January 2014.<sup>33</sup> The EU Money Laundering Directives, specifically the Fourth Money Laundering Directive 2015, have also been taken into account in drafting the rules to ensure that best practice levels of anti-money laundering compliance are present in ADGM.

“Know-your-customer” rules are set out, based on FATF standards. This requires look-through to ultimate

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<sup>30</sup> Parts 8-9 of FSMR.

<sup>31</sup> FATF Recommendations of February 2012 available [here](#).

<sup>32</sup> FATF Guidance on Transparency and Beneficial Ownership of November 2014 available [here](#).

<sup>33</sup> Basel Committee standards on the “Sound Management of Risks Related to Money Laundering and Financing of Terrorism” of January 2014 available [here](#).

“beneficial owners.” For example, the rules on dealing with politically exposed persons (so-called “PEPs”) broadly mirror EU requirements.

The AML rulebook explicitly states that persons subject to AML must adhere to sanctions imposed by the United Nations Security Council (“UNSC”). Persons subject to AML must also establish and maintain effective systems and controls to make appropriate use of UNSC Sanctions and resolutions.<sup>34</sup> The rulebook also references FATF guidance on specific UNSC Sanctions and resolutions regarding the countering of the proliferation of weapons of mass destruction. In relation to unilateral Sanctions imposed in specific jurisdictions (e.g. the European Union, HM Treasury and the United States Office of Foreign Assets Control sanctions), the Regulator expects persons subject to AML to take positive steps to ensure compliance where required or appropriate.

### *Fees*

A Fees Rulebook has been drafted to ensure transparency of regulatory processes. In addition to fees for applications, there is an annual fee to be paid in full to the Regulator.

### *Forms*

Further to the rules, forms have been developed for applications for Regulated Firm status, Approved Person status, change of control approval, waivers or modifications, registration of collective investment funds and other supplementary forms.<sup>35</sup>

### **Our Role**

Shearman & Sterling advised ADGM on its establishment as an international financial centre. Working closely with the leadership team at ADGM, Shearman & Sterling helped develop ADGM's world-class legal and regulatory regime to be in line with international standards to provide the sophistication and certainty found in the world's top financial centres. Shearman & Sterling has played a key role in ADGM's adoption of English common law by applying it in its jurisdiction for civil and commercial law. The application of English common law will govern matters such as contracts, tort, trusts, equitable remedies, unjust enrichment, damages, conflicts of laws, security and personal property. Additionally, Shearman & Sterling drafted all legislation governing matters such as companies, insolvency, interpretation, commercial licensing, arbitration, courts, employment, limited liability partnerships, real property, financial regulation and strata title.

Shearman & Sterling advises its clients on ADGM laws out of its Abu Dhabi, Dubai, London and US offices, and has unique insights as a result of its role in developing the legislation.

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<sup>34</sup> Chapter 11 of AML.

<sup>35</sup> Available [here](#) in a non-editable and reference only format. To receive editable versions, please contact the FSRA at [authorisation@adgm.com](mailto:authorisation@adgm.com) or +971 2 333 8548.

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This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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