



Innovation & Technology Risk Supervision

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31 May 2023

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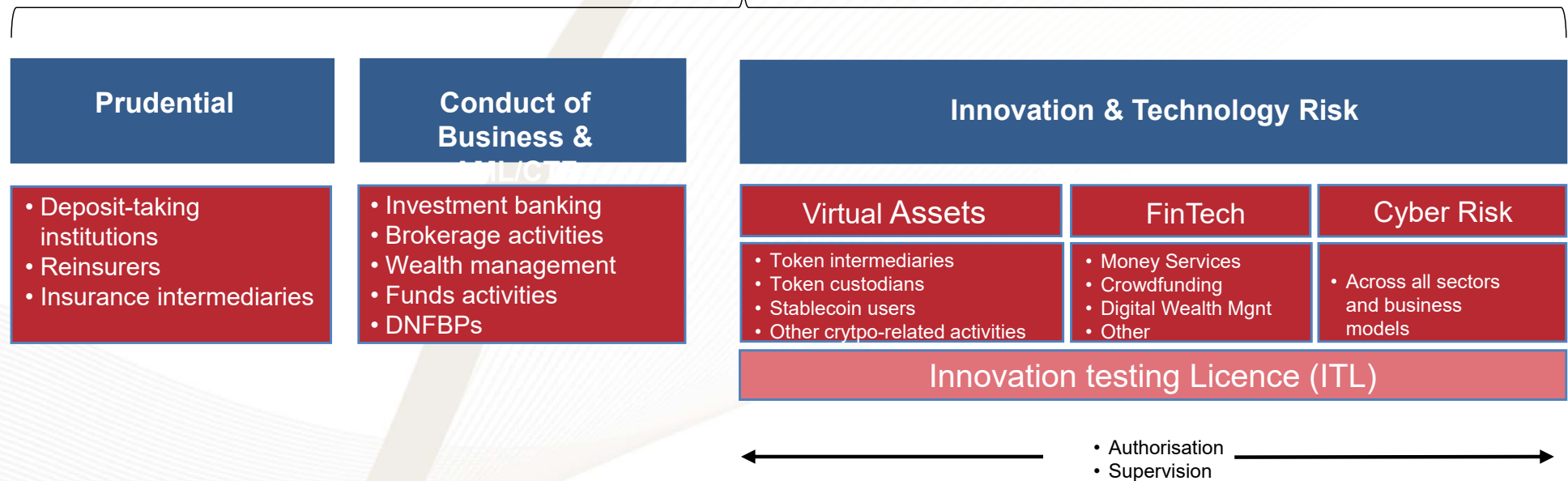
Introduction – Innovation & Technology Risk Supervision 2023

- Innovation Supervision Programme
 - Innovation Testing Licence (ITL)
 - Crypto Assets Supervision
 - Cyber Risk Supervision

Innovation & Technology Risk Supervision



Supervision





Innovation Testing Licence General Approach and Updates

Sujoy Sen - Associate Director, Innovation & Technology Risk

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Agenda

1. ITL Objectives and How it works
2. Eligibility Criteria
3. Typical Business Models in the ITL
4. Key Trends
5. Our Experience & Lessons Learnt
6. Feb 2023 Consultation: Clarifications & Proposed Changes
7. Expectations from ITL applications

ITL Objectives

The objectives of the ITL

The ITL is intended to:



1. enable a firm to **conduct live testing**, in or from the DIFC, of a technology enabled financial service that is offered in an innovative way or via an innovative technology; and
2. **support the testing** of the technology's **viability, interoperability, and security**.

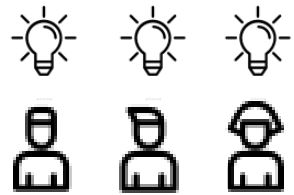
The ITL is NOT intended to:



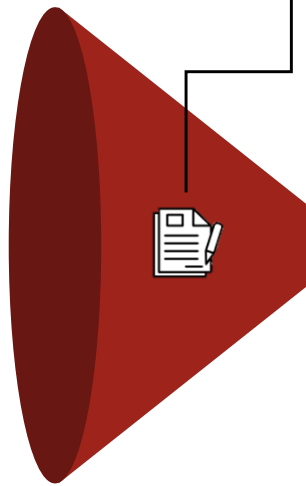
1. give a **competitive advantage** over regulated competitors;
2. be **utilised solely for the purpose of gauging or promoting user or market acceptance** for regional expansion; and
3. be **utilised by a firm solely for the purpose of testing regulatory** (a.k.a. RegTech) technologies (e.g. AML/KYC, DLT platforms, client identification and on-boarding tools, transaction monitoring and other such technology enabled regulatory and compliance tools).

How does the ITL work?

1. Firms / Entrepreneurs with new and innovative ideas **apply for the ITL through the Pre-application Form**. They explain their business model and why it is innovative.



3. Successful applicants are **invited to begin the detailed ITL Application**. This includes a detailed Regulatory Testing Plan, setting out what will be tested during the Testing Period.



5. In-Principle ITL holders obtain their DIFC **business license, bank account**, and complete operational set-up requirements.



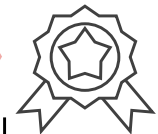
TESTING



PERIOD



Unrestricted
Licence



2. The **DFSA Reviews the ITL Pre-application Forms** and selects the applicants that meet the criteria. They are then invited to begin the ITL Application process.

4. Successful ITL applicants are **granted an In-Principle Licence under the ITL framework** that will include certain business activity restrictions.

6. ITL holders enter **the Testing Period** and test their business model and the areas set out in the Regulatory Testing Plan. They are closely supervised by the DFSA.

8. The ITL holder may apply to the DFSA to **exit** the ITL Programme.

What is the Innovation Testing Licence (ITL)?

Full DFSA Financial Services Licence

Regulatory Requirements

AML/CFT requirements apply

Client / market protection requirements apply

Flexible 2nd & 3rd line of defence requirements

Waivers / Modifications

Business Restrictions

Conditions

Authorised Individuals

Clients

Testing Disclosure

Policies / Procedures

Transactions

Exit Strategy

Auditors

Value

ITL Eligibility

It is important to note that not all firms will fall within the remit of the DFSA's regulatory approach, nor will they qualify for the ITL. The following requirements are in place for companies wishing to enter the ITL Programme.

ITL Eligibility Criteria

- 1 Requirement to involve technology or business-led innovation.
- 2 Requirement to involve an activity that, if carried on in the DIFC, would amount to a Financial Service (or combination of Financial Services).
- 3 Requirement to be ready (or soon be ready) to start testing with customers or industry.
- 4 Requirement that the firm must intend to roll out its business on a broader scale in or from the DIFC after successful testing.

Typical business models in the ITL

Since its inception in 2017, have seen a range of business models that have tested or could be eligible for testing in the ITL. These include:

1

Money Services

2

Crowdfunding – Loan, Investment and Property

3

Robo-Advisors & Digital Wealth Firms

4

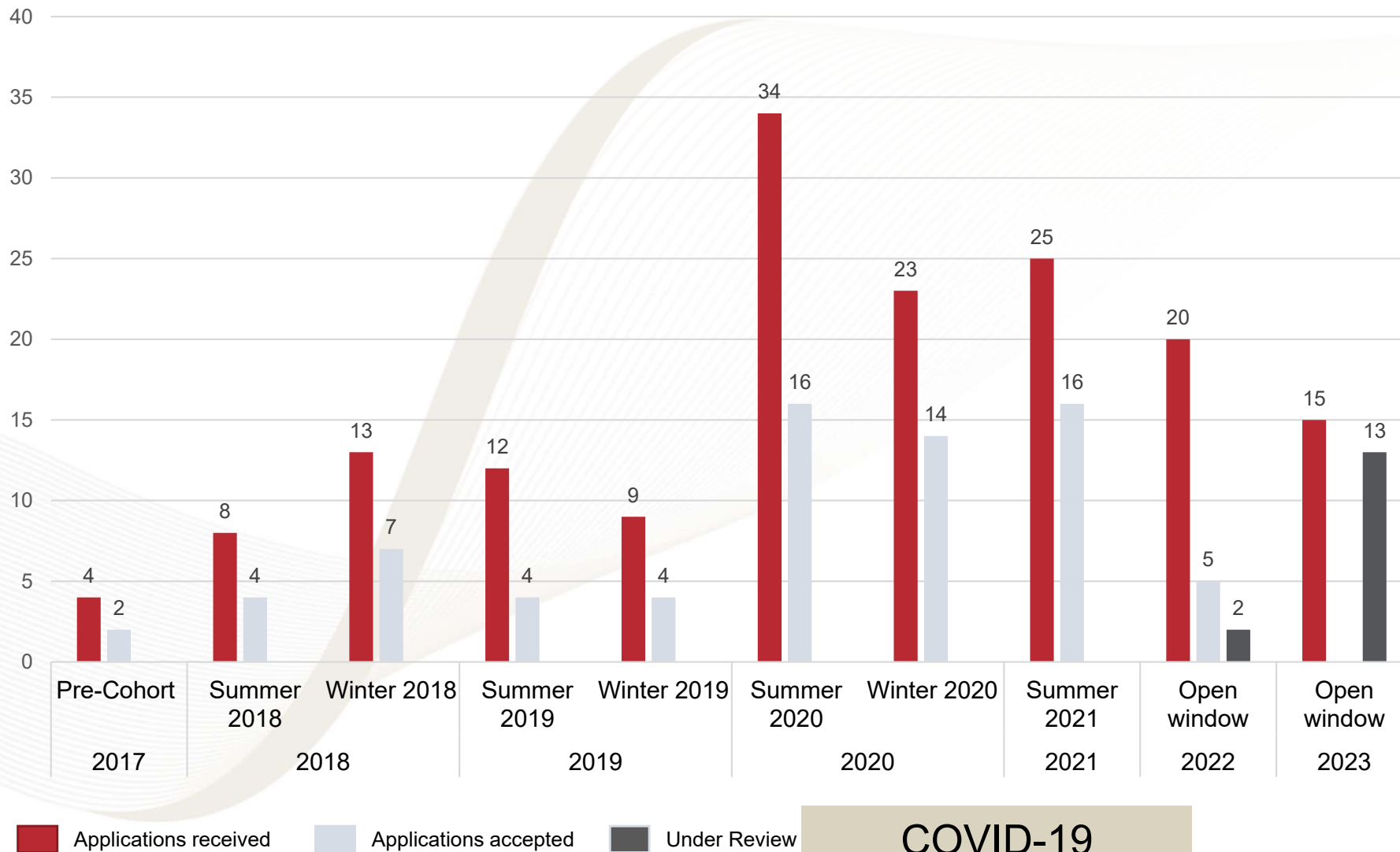
Blockchain/ DLT based business models covered by the DFSA's Investment Token and Crypto Token Regime

Every application is assessed on its own merit (based on the business model and underlying technology) to determine whether there is an 'innovative' element.

Since the introduction of DFSA's Investment Token Regime in 2021 & Crypto Token Regime in 2022, blockchain/DLT based applications could be tested in the ITL, if they meet the Eligibility Criteria.

ITL Applications: Key Trends

Cohort / Pre-applications 2017- 2023



Snapshot

- To date we have received **163 applications for the ITL since 2017, of which 72 applications** have been accepted.
- **6 firms have successfully graduated from the ITL** and are operating as Authorised Firms, while a further **8 firms are currently testing in the ITL.**
- We have **c.13 firms in the Pre-applicant stage**, with ongoing discussion to assess whether the firms meet the ITL Eligibility Criteria.

Our experience: Lessons Learnt

- The ITL caters to innovative technologies/ business models. **If a product or service is not innovative**, the DFSA may not entertain the application.
- At times, firms approach the DFSA with an idea/concept that is **not yet ready for testing**.
- Inadequate awareness of **regulatory expectations and DFSA Rules**.
- Some firms use the ITL **to obtain modifications/ waivers from key DFSA requirements**. The ITL does not offer an avenue for reducing regulatory oversight.
- Instances where firms are **unable to meet basic minimum requirements**, for e.g. governance arrangements, capital, client money obligations.
- **Embryonic risk management framework, inadequate systems and controls**, limiting the firm's ability to successfully exit the ITL.
- **Insufficient skills/ capabilities relevant to the business model**, including **sub-optimal AML knowledge/framework**.
- Firms occasionally request that their **ITL testing period ends sooner than 12 months, although they may not be ready to operate without restrictions**.
- **Instances where a firm needs more than 12 months, resulting in multiple extensions**. For example, where the firm's systems and controls are not sufficiently mature to operate in an unrestricted environment.
- The ITL does not offer **a quick 'route to market'** for incumbents (i.e. its purpose is not to assess commercial feasibility of new products/ services).

Feb 2023 Consultation: Overview

The DFSA issued *Consultation Paper No. 147 – Technology: Cyber Risk Management and Innovation Support* on 24th February that seeks public comments on proposed changes relating to the DFSA's role in supporting innovation in financial services.

Clarifications on the ITL application process

- Application process
- Application withdrawal
- Waiver of, and modifications, to Rules
- Exiting the ITL programme

Changes to the existing programme

- Application criteria
- The testing period
- Changing or modifying business model
- Use of DFSA resources to support innovation
- Wording changes

Feb 2023 Consultation: Proposed Clarifications

Application Process

Guidance is proposed to be updated to clarify that **application is a two-stage process**, including: 1) Pre-application stage; 2) Licence application and test plan

Application withdrawal

DFSA expects applications to be **withdrawn, when an applicant can no longer proceed with their application** or when they are **not able to adequately respond** or engage meaningfully with the DFSA

Waiver of, and modifications, to Rules

DFSA will work with the applicant to understand its business proposal and to **establish, on a case-by-case basis, whether any waivers of or modification to Rules should apply**

Exiting the ITL Programme

Amend Chapter 13 of GEN to clarify that firms in the ITL Programme will **continue to operate their business as per the terms of their restricted Licence until the application to vary or remove any restriction** or conditions has been determined by the DFSA

Feb 2023 Consultation: Proposed Changes

Application Criteria

The proposed additional criteria include:

- **Genuine need to test technology** in a way that involves the carrying on of one or more Financial Services
- **Applicant understands the applicable requirements in the DIFC**
- Applicant has **adequate financial and non-financial resources** such as financial services know-how

Testing Period

- **Testing period to be extended up to 24 months** which is currently set at 6 to 12 months

Changing Business Model or Test Plan

- ITL Firms to obtain **DFSA consent** before modifying their **Business Model or Test Plan**

Use of DFSA resources to support innovation

- Updated ITL Pre-application and Application forms to contain explanation of the information required by the applicant and propose to **remove GEN 13 provision for having the applicant to discuss its proposal at an early stage**

Wording changes

- **Remove references to “Fintech” to not tie the programme to a term that has many and ambiguous meanings and focus on innovative technology** and the firms that wish to use it to **provide regulated financial services from or within the DIFC**

Expectations from ITL Applications

While applicants may be diverse in terms of business models & technology and can vary in nature, scale and complexity, some baseline expectations include:

Pillars

Business Model

Financials

Op Risk

Conduct of Business

AML

DFSA Expectations

- Define the business model clearly and succinctly
- Identify the 'innovative' technology or business model being tested in the Programme
- Client numbers are realistic for operating in the ITL, rather than to gauge business interest/viability
- Appoint Authorised Individuals with relevant financial services experience
- Sufficient capital and clearly defined capital raising plans (SAFE/KISS agreements are not to be used as part of a firm's capital assumptions)
- Realistic financial projections with clear assumptions
- Clarity in transactional flows, including customer journey
- Safeguarding and Client Money Reconciliation procedures
- ITL Exit plan
- Clearly defined AML Policies including Customer Risk assessment, Customer Due Diligence, Sanctions Screening and on-going monitoring
- Ensuring applicant's AML risk tolerance is aligned to Federal Law/DFSA Rules



Crypto Assets Authorisation General Approach and Updates

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31 May 2023

Crypto Assets

Investment Tokens

Crypto Tokens

Updates	Business models	Tips for applicants
<ul style="list-style-type: none"> • Transition period ended 1 May 2023 • 50+ entered the application process • Application process <ul style="list-style-type: none"> – No more Token pre-application – Initial inquiry – Business model assessment – Materiality check 	<ul style="list-style-type: none"> • Digital asset custody • Alternative crypto trading systems • Stablecoins • Crypto intermediaries • Tokenised funds • Crypto derivatives • Crypto-enabled payments 	<ul style="list-style-type: none"> • Business model clarity • Rules awareness • Regime perimeter • Human / financial resources • Unrealistic timelines



Cyber Risk Supervision General Approach and Updates

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Cyber Risk

Approach

Governance

Hygiene

Resilience

- Improve cybersecurity awareness in the DIFC
- Promote sharing of cyber threat intelligence among Firms in the DIFC
- Support continued development of cyber resilience within Firms in the DIFC

Updates	Assessing cyber risk	Common control issues
<ul style="list-style-type: none"> • Rules <ul style="list-style-type: none"> – July 2023 publication – 1 January 2024 enforcement • Authorisation expectations • Supervisory for the next 12-18 months • Upcoming outreach • Industry level cyber simulation 	<ul style="list-style-type: none"> • Dependency on IT systems • Complexity of IT systems • Data/client assets • Delivery channels • Critical services outsourced • Total Clients • Assets under Mgmt • Previous assessments 	<ul style="list-style-type: none"> • Policies/procedures • Incident response plans • Roles/responsibilities • Cyber risk assessments • Incident mgmt v. cyber risk mgmt



Questions?

The background is a solid olive green color. It features several large, flowing, wavy lines in a lighter shade of green, creating a sense of movement and depth. These lines are composed of many thin, parallel strokes that follow a similar path, giving them a ribbon-like appearance. They sweep across the lower half of the image, with one prominent wave rising from the bottom left towards the center, and another rising from the bottom right towards the center, meeting in the middle.

Thank you!