

23 October 2023

To: PRU Investment Firms supervised by the AFSA

Re: Outcomes of On-site Inspections

Dear PRU Investment Firms,

In line with its regulatory objectives, the Regulatory Office of the Astana Financial Services Authority (AFSA) has conducted a number of on-site inspections of PRU Investment Firms (Firms). The purpose of this letter is to share some of the observations deriving from the inspections conducted by the Regulatory Office so far.

The scope of conducted inspections covered, inter alia, the conduct of business of Firms as per the AIFC Conduct of Business Rules (COB).

Unless the context requires the contrary, capitalized terms used in this letter have the meaning defined in the AIFC Glossary (for instance, the term “PRU Investment Firm”).

Background

In 2021-2023 the AFSA has led several inspections. Results of inspections, including all relevant findings and observations, were then reflected in inspection reports. Some of the inspections resulted in supervisory measures for the violation of regulatory norms.

This letter summarises the key findings and observations of conducted inspections, more details of these findings are set out in the Annex to this letter.

The AFSA suggests that all Firms get acquainted with this letter, consider findings and observations contained herein in the context of the scope of their respective licences, as well as follow recommendations provided by the AFSA with the aim of avoiding a breach of COB when carrying on its licenced activities.

Key Findings

The following is an outline of key observations. Further details as well as recommended mitigation actions are contained in the Annex hereto.

Please note that this letter summarises the findings of several inspections and, therefore, outlines violations conducted by a number of, although not all, Firms.

Common COB Violations:

1. Client Classification

- Firms assess either net assets or experience as opposed to assessing both sets of requirements;
- Firms omit the following steps: to request documentary evidence of experience, requesting the source of funds and the source of wealth.

2. Conduct of Investment Business

- Firms omit the following steps: to request all required data and assess all necessary characteristics;
- Firms fail to execute assessments in relation to each type of Investment and Transaction;
- Firms do not provide Clients with suitability reports.

3. Client Assets

- Firms do not conduct accurate reconciliations of Client Accounts;
- When using Third Party Account Providers for keeping Clients' money and Investments, Firms do not conduct proper due diligence of Third Party Account Providers and do not obtain written acknowledgement of the applicable rules (segregation, protection, etc.) from such providers.

4. Order Execution and Order Handling

- Firms violate the best execution rule.

5. Communications with Clients and Financial Promotions

- Firms do not disclose all conditions and risks in an unambiguous and comprehensive manner;
- Firms do not communicate changes to a client agreement in a diligent way.

Conclusion

We recommend that Firms consider the findings outlined in this letter and in the Annex hereto and perform a self-check of their compliance vis-à-vis their obligations under COB. This exercise will be beneficial to all Firms.

If you have questions or thoughts about any findings outlined or issues raised in this letter, please do not hesitate to contact your Relationship Managers at the AFSA. Your feedback is welcome and appreciated.

With Respect,

Acting Chief Regulatory Officer

 **Valikhan Gusmanov**

Annex - Outcomes of On-site Inspections

The following information describes the key and most critical findings of inspections conducted by the Financial Conduct Division of the AFSA.

Issue 1

- a. Firms do not assess net assets AND experience (tend to assess net assets only).
- b. Firms tend to omit the following steps: to request documentary evidence of experience (employment contracts, professional qualification certificates, etc.) and to request the source of funds and the source of wealth.
- c. Firms conduct poor record-keeping.

Rules concerned: Rule 2 COB: Client Classification



Firms must pay particular attention to the proper classification of Clients.

It is essential that Firms assess net assets AND experience and understanding of prospective Clients in the course of classification.

Firms must not omit the following steps:

1. Request documentary evidence of experience (employment contracts, professional qualification certificates, etc.) and assets (account statements; evidence of ownership of real estate (except dwelling where a Client resides) and other property, etc.);
2. Assess assets, knowledge and experience by analysing employment record, educational background, professional qualification (certificates), brokerage agreements, etc. in order to ensure that a Client has sufficient knowledge and understanding of the nature and risks associated with particular investments/transactions;
3. As a result of the assessment notify a Client of its classification as a Retail Client, Professional Client, or Market Counterparty;
4. Record keeping - Firms must keep a copy of all documents related to Client classification assessment in a client dossier for six years from the date when its relationship with this particular Client has been terminated.

Issue 2

- a. Firms do not conduct suitability assessment and appropriateness assessments in a diligent manner.

Firms do not provide their Clients with suitability reports.

Rules concerned: Rule 5.2 COB: Suitability Assessment; Rule 5.3 COB: Appropriateness Assessment



Firms must pay particular attention to the proper execution of the Suitability Assessment and Appropriateness Assessment.

1. It is essential that Firms request all required data and assess all necessary characteristics in the course of assessment.
2. Assessment shall be made in relation to each type of Investment and each transaction as characteristics such as risk appetite, purpose etc. of each particular Client may change from time to time.
3. Firms must ensure that their questionnaire (or a similar document) used during the client classification process includes all relevant and appropriate questions that would allow them to assess the Client comprehensively.

Questionnaires should include, inter alia, the following questions:

- (1) types of Investment Service, Investment and Transaction the Client is interested in;
 - (2) experience in dealing in the Investment Service, Investment and Transaction the Client is interested in and acknowledgement of attributable risks;
 - (3) frequency of the Client's past Transactions;
 - (4) volume of past Transactions;
 - (5) academic qualification of the Client;
 - (6) professional qualification of the Client;
 - (7) past work experience of the Client;
 - (8) Client's investment objectives (long-term/short-term; preservation of capital; retirement; education; etc.);
 - (9) Client's risk appetite and tolerance.
4. When offering Advising on Investments services to a Retail Client, Firms **must provide a Client with a suitability report** that must include:
 - (1) an outline of the advice given,
 - (2) an explanation of why the recommendation is suitable, including how it meets the Client's objectives and
 - (3) a statement bringing to the Client's attention the need for periodic review of suitability, where relevant.
 5. It is also essential that Firms keep records of assessments as stipulated in COB – for at least six years from the date on which the business relationship with the Client ended.

Issue 3

- a. Firms do not pay sufficient attention to ensuring accurate reconciliations of Client Accounts (\neq Bank Accounts);
- b. When using Third Party Account Providers for keeping Clients' money and Investments, Firms do not conduct due diligence of Third Party Account Providers and obtain written acknowledgement of the applicable rules (segregation, protection, etc.) from such providers.

Rules concerned: Rule 8 COB: Client Assets



Reconciliation

Firms must pay particular attention to a system that ensures accurate reconciliations of the Client Accounts at least once in every calendar month in accordance Rules 8.2.21., 8.2.22., and 8.2.23. of COB. In particular,

1. Firms must ensure that their systems and controls are designed in a way that allows to maintain separate accounting records for each Client and to evidence the ownership of money and assets to particular Clients;
2. Client Accounts should be established for the purpose of holding Clients' money and Investments, maintained in the name of the PRU Investment Firm or its nominee company, include the words "Client Account", and must be distributed strictly in the order stated in Rules 8.2.16 of COB;
3. When using Third Party Account Providers for keeping Clients' money and Investments, a Firms shall conduct due diligence of Third Party Account Providers and obtain written acknowledgement of the rules stated above (segregation, protection, etc.) from such providers;
4. Firms should notify the AFSA where there has been a material discrepancy with the reconciliation which has not been rectified. A material discrepancy includes differences which have the cumulative effect of being material, such as longstanding differences.

Issue 4

- a. Firms violate the best execution rule.

Rules concerned: Rule 6.1 COB: Best Execution



When providing Financial Services and Financial Products Firms must not put their Clients into relatively unfavourable and disadvantaged positions, and eventually place the interests of one group of Clients above those of other groups of Clients.

For instance:

- charge different fees for the same service or product;
- provide more sophisticated service to one Client compared to another Client in the course of providing the same service;
- Firms shall not prioritize in any possible way Clients holding its securities over the Clients who do not hold such securities when providing services to Clients.

Issue 5

- a. When preparing Financial Promotions Firms do not disclose all conditions and risks in an unambiguous and comprehensive manner, including the risk of capital loss;

- b. Firms do not communicate changes to a client agreement in a diligent way and do not obtain Clients' consent to proposed changes before effecting such changes.

Rules concerned: Rule 3 COB: Communications with Clients and Financial Promotions



1. Firms ensure that any Financial Promotions they approve or communicate contain the information outlined in Schedule 5 of COB;
2. Firms ensure that the terms and conditions of a client agreement (Terms and Conditions) include all relevant requirements, obligations, liabilities, and rights of the parties;
3. Firms ensure that Terms and Conditions do not put a Client in an unfair or unreasonable position and do not seek to absolve the Firm's responsibilities that it is not entitled to absolve itself of.
4. Firms ensure that Terms and Conditions are not heavily weighted towards the interests of a Firm rather than the interests of a Client, and do not seek to allow a Firm to provide services to a Client that a Client may not want or need or not have requested or permitted.
5. Firms ensure that all significant matters and details are disclosed in full to a Client to avoid a Client placing unreasonable and unacceptable expectations on the Firm and its operations.
6. Firms ensure that all material and significant changes to the Terms and Conditions must be communicated directly to a Client and accepted by a Client in a diligent way.