
TO : Cyprus Investment Firms

FROM : Cyprus Securities and Exchange Commission

DATE : November 30, 2016

CIRCULAR NO. : C168

SUBJECT : Updated version of ESMA's Q&A document relating to the provision of CFDs and other speculative products to retail investors under MiFID

1. The Cyprus Securities and Exchange Commission ('the CySEC') wishes, with this circular, to inform the Cyprus Investment Firms that ESMA published on October 11, 2016, an updated version of its [questions and answers document \(the 'Q&A'\)](#) on the application of the Markets in Financial Instruments Directive (MiFID) to the marketing and sale of financial contracts for difference (CFDs) and other speculative products to retail clients (such as binary options and rolling spot forex).

The Q&A is targeted at competent authorities. However, the answers are also intended to help firms by providing clarity on MiFID rules.

2. The Q&A includes 5 new questions and answers in sections 6 to 9, which address the following topics:

- i. the use of trading benefits when offering CFDs or other speculative products;
- ii. the withdrawal of funds from trading accounts;
- iii. the use of leverage when offering CFDs or other leveraged products to retail clients; and
- iv. best execution obligations for firms offering CFDs or other speculative products to retail clients.

3. Special attention is drawn to the following parts of the Q&A:

i. Offering bonuses (section 6, answer 1)

a. **CIFs must avoid the practice of offering bonuses** that are designed to incentivise retail clients to trade in complex speculative products such as CFDs, binary options and rolling spot forex **as it is unlikely that a firm offering such bonuses could demonstrate that it is acting honestly, fairly and professionally and in the best interests of its retail clients** [article 36(1) of the Investment Services and Activities and Regulated Markets Law, 'the Law'].

- b. CySEC anticipates that **CIFs will not launch any new bonus schemes to retail clients from now and onwards and let the existing ones lapse or expire or in any way cease to exist.**
- c. **All** CIFs are requested to declare to CySEC whether they are offering such bonuses by completing and submitting the attached table to the electronic address supervision@cysec.gov.cy by **December 14, 2016**. In case where a CIF does not offer such bonuses, it should also fill in and send the attached table, indicating 'N/A'.
- d. As for the offering of other trading benefits, CIFs must notify CySEC of any new type of trading benefits that intend to offer to retail clients. It is provided that the notification will take place before the trading benefit is launched to the market. CIFs must be able to demonstrate to CySEC that such trading benefit is not designed to encourage behaviors that are not in the best interests of clients.

ii. Withdrawal of funds (section 7, answer 1)

In case of a positive cash balance in the retail client's trading account, CIFs must **process the client's request to withdraw funds on the same day** that the request to withdraw funds was made, or the next working day if the client's request is received outside of normal trading hours.

iii. Use of leverage (section 8, answer 1)

It is unlikely that a CIF offering excessive leverage to retail clients can demonstrate to CySEC that this is in the best interests of retail clients [article 36(1) of the Law].

CIFs should:

- a. Design their trading systems in a way that offer their retail clients as a **default** the lower leverage limit determined in the leverage policy (see point d below) and give them the option, if they choose, to change the default to a higher leverage. It is provided that the lower leverage limit is reasonable and does not exceed the cap of 1:50 (default).
- b. Limit the level of leverage available to retail clients that do not pass the **appropriateness test**¹ or limit the sum that the client can invest, in any one transaction for a period of time (relevant are paragraphs 19, answer 3, section 4 and 7, answer 1, section 8 of the Q&A).
- c. Ensure that the maximum loss for the clients at any point in time never exceed the clients' available funds (negative balance protection).
- d. Establish a leverage policy which is approved by the board of directors of the CIF and included in its internal procedures manual. Through this leverage policy, CIFs should identify how leverage ratios are established having regarded to factors like:
 - The capital base and financial strength of the CIF.

¹ It is noted that CIFs must keep statistical records with the outcome of the appropriateness assessment performed to clients (e.g. how many clients have pass, or not, the appropriateness test, how many clients have proceeded, or not, with transactions, despite the failure).

- The risk appetite and risk management of the CIF.
 - The asset class and instrument characteristics, including among others liquidity and trading volumes, volatility and standard deviation, market cap, country of issuer, hedging capabilities, general economic climate and geopolitical events.
4. Moreover, CySEC reminds CIFs the sections 1-5 of the Q&A published in the past, which are equally important in assessing and applying.

The issues covered from sections 1-5 of the Q&A are the following:

- i. **Authorisation** of firms offering CFDs and other speculative products to retail investors (articles 18 and 28 of the Law).
 - ii. **Conflicts of interest** arising from business models that may be adopted by firms offering speculative products to retail investors (articles 18, 28 and 29 of the Law).
 - iii. Information provided to clients and potential clients about the functioning of CFDs or other speculative products, including **marketing communications** (article 36 of the Law).
 - iv. Assessment of **appropriateness** when offering CFDs or other speculative products to retail investors (article 36 of the Law).
 - v. Factors to take into account when considering **commercial arrangement** between two authorised firms that result in the offer of CFDs or other speculative products to retail clients (Part III and article 28 of the Law).
5. It is expected that CIFs have already assessed in depth the Q&A and took, or are in the process to take, appropriate measures and actions in order to operate in line with the Q&A.

In case where a CIF needs to amend its trading system so as to be in line with the provisions of the Q&A and of this circular (e.g. point 3(iii) above), this should be done the soonest and not later than two months from the date of this circular (**30 January 2017**).

6. CySEC intends, in the near future, to conduct thematic reviews to CIFs in order to ensure that they are acting in line with the Q&A and in general that they are in compliance with the relevant provisions of the Law. In case of infringement, CySEC will take the necessary supervisory actions provided in the Law.

Sincerely,

Demetra Kalogerou
Chairman of Cyprus Securities and Exchange Commission

CIF name	
Authorisation number	

Analysis of bonus schemes provided

a/a	General description of the bonus schemes	Expiry date (if applicable)
1.		
2.		
3.		
4.		
5.		