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BY EMAIL ONLY

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To the Senior Executive Officers ("SEO") of DFSA Authorised Firms

Re: Retail Over-The-Counter Derivatives ("OTC Derivatives") in the DIFC

Dear SEO,

Increases in the numbers of firms offering and promoting OTC Derivatives¹ have led regulators globally to assess their policy positions in respect of these products. The complex, speculative and high-risk nature of OTC Derivatives and increased offerings of them to Retail Clients, particularly through online trading platforms operating on a cross-border basis, give rise to questions about the levels of consumer protections that are necessary.

Regulators, including the DFSA, remain concerned that Retail Clients may not adequately understand the nature, features, and risks of OTC Derivatives. These include, but are not limited to, the risks inherent to the use of significant leverage, the accelerated manner in which substantial trading losses can accumulate, and the potential for losses of 100% or more of the initial capital outlay.²

In light of the growth in firms offering OTC Derivatives to Retail Clients in or from the DIFC, and continued inquiries from firms seeking to become licensed to do so, the DFSA has reviewed its regime and now seeks to clarify its positions on these products. While the DFSA intends to engage in a formal public consultation in the future, it has prepared this letter to set out certain of its supervisory expectations for firms offering OTC Derivatives in or from the DIFC.

To assist in formulating its views, the DFSA conducted extensive benchmarking, including with Authorised Firms and applicants by way of an informal soft consultation. The supervisory expectations set out in this letter reflect feedback received during that soft consultation.

Noting the above, the DFSA seeks to achieve two primary objectives: (i) to implement appropriate Retail Client protections in relation to OTC Derivatives; and (ii) to align the DFSA with the regulatory approaches and policies of other reputable jurisdictions, regulators and international market standards.³

¹ OTC Derivatives include Contracts for Difference ("CFDs"), spread bets, rolling spot FX contracts ("FX"), binary options, and other similar products.

² This is supported by certain Retail Client performance data recently reported by Firms to the DFSA which suggests that losses in accounts trading OTC CFDs are more likely to be incurred than profits.

³ See, for example, [ESMA Questions and Answers Relating to the provision of CFDs and other speculative products to retail investors under MiFID](#); [ESMA Warning about CFDs, binary options and other speculative products](#); [FCA CP16/40: Enhancing](#)

Further to these objectives, the DFSA has set out its supervisory expectations and supporting explanations in the Appendix to this letter (the "Expectations"). The DFSA requests that you consider these Expectations carefully and adopt them as part of your operations and related systems and controls.

In particular, the DFSA draws your attention to certain Expectations, which:

- a. extend the scope of applicable leverage limits;
- b. limit the offering of binary options;
- c. prohibit the use of credit cards to fund accounts;
- d. require enhanced product governance and account-level appropriateness determinations; and
- e. impose new standards for risk disclosure in marketing and other communications.

These Expectations are relevant to all Authorised Firms carrying on any Financial Services activities with or on behalf of Retail Clients in relation to OTC Derivatives, including but not limited to Dealing (whether as Agent or Principal), Arranging and Advising. Arranging also includes circumstances where firms arrange for Retail Clients to access and trade OTC Derivatives via platforms offered by third parties, irrespective of whether the third party is connected to the firm.

Please note, this letter replaces and supersedes the previous SEO Letters issued by the DFSA on 13 March 2014 and 19 April 2015, which alerted firms to certain issues concerning retail foreign exchange transactions and other highly leveraged products offered to Retail Clients in or from the DIFC, including the marketing thereof.

The DFSA encourages firms to raise any material concerns regarding these Expectations in connection with the forthcoming public consultation. You may also contact your Relationship Manager if you wish to discuss this letter further or to seek additional information.

Yours sincerely,



Ian Johnston
Chief Executive

Appendix – Expectations

The DFSA sets out below certain of its current supervisory expectations concerning OTC Derivatives offered or provided to, or transacted with, for, or on behalf of, Retail Clients in or from the DIFC.

A. Enhanced Margin Requirements

1. All Authorised Firms (“Firms”) offering Retail Clients the ability to trade OTC Derivatives – CFDs and FX, in particular - should limit the leverage made available to those Retail Clients to the following:
 - a. 50:1 (2%) for those with major currency pairs, major indices, and gold underlying;
 - b. 10:1 (10%) for those with shares of individual stocks underlying; and
 - c. 20:1 (5%) for those with any other underlying, including minor currency pairs and oil.
2. Firms should implement systems and controls to monitor rolling losses realised by Retail Clients in respect of their income, wealth or account funding levels and include mechanisms to prevent excessive losses.

B. No Use of Credit Cards to Fund Trading Accounts

1. No Firm should make available or arrange to make available to Retail Clients the ability to use a credit card to fund an account to trade OTC Derivatives. Use of debit cards to fund trading accounts is permissible provided Firms have systems and controls to distinguish and verify debit cards from credit cards.

C. Limitations on Range of OTC Derivative Products to be Offered to Retail Clients

1. No Firm should offer or otherwise make available to Retail Clients the ability to trade OTC Derivatives with a non-financial instrument or non-commodity underlying (for example: election results, economic data or other events).
2. No Firm should offer binary options or similar products unless that Firm:
 - a. provides two-sided price quotes on such products until expiry and those quoted prices are based on or otherwise reflect the probability of expiry in-the-money;
 - b. allows Retail Clients to trade into or out of a binary position at those quoted prices throughout the life of the product until expiry; and
 - c. offers a contract term of not less than one week.

D. Product Governance and Front-end Account Appropriateness Requirements

1. All Firms offering or intending to offer OTC Derivatives and related services to Retail Clients are expected, in connection with their Product Governance for each such product,

to define the target Client profile (the "Target Client Profile") for which it has determined each OTC Derivative to be appropriate.

2. The Target Client Profile for each OTC Derivative product should be documented, approved by senior management and address the following, amongst other things:
 - a. the purpose or function of the product for a Client or as part of a Client's portfolio;
 - b. a Retail Client's ability to understand the nature and risks of the product;
 - c. the nature and extent of an individual's employment and education;
 - d. whether or not a Retail Client has any experience in trading financial products, generally, and the specific OTC Derivative product(s) contemplated for that Retail Client; and
 - e. the Retail Client's financial profile, including but not limited to, income level, household savings, other holdings and ability to sustain a total loss of capital outlay (loss absorption capacity).
3. Prior to accepting or taking on a Retail Client, Firms must perform and document an assessment of the appropriateness of an account to trade the relevant OTC Derivatives for that Retail Client. This assessment should consider the extent to which the person's circumstances satisfy the Target Client Profile for the specific types of OTC Derivatives offered or intended to be offered to that person together with any other relevant information about that person that the Firm knows or would reasonably be expected to know in such circumstances.
4. No Firm can rely upon any proposed education or training it expects but has yet to provide to a prospective Client in conjunction with any appropriateness assessment. Additionally, no Firm may rely solely on a prospective Client having participated in training provided by the Firm or being provided access to a demonstration account in connection with its assessment of that prospective Client's ability to understand the nature and risks of OTC Derivatives.
5. Where a Firm determines an account to trade OTC Derivatives is not appropriate for a particular prospective Retail Client, the Firm must provide that prospective Retail Client with a written notice setting out that determination, and the Firm must either:
 - a. refrain from accepting or engaging with that prospective Retail Client as a Client; or
 - b. escalate that prospective Retail Client's application and the results of the appropriateness assessment to a duly authorised member of the senior management of the Firm who, if that prospective Retail Client is accepted as a Client, must approve the trading account for that prospective Retail Client and document its rationale for doing so.

6. Where an account to trade OTC Derivatives is determined by a Firm to be appropriate for a particular Retail Client, the Firm is expected to reassess that Retail Client and the appropriateness of the OTC Derivatives offered to or proposed to be offered to that particular Retail Client if the Firm is or becomes aware of material changes to any of the factors upon which the Firm relied in connection with its initial assessment of that Retail Client.
7. The expectations to perform an appropriateness assessment, as explained in this section, do not obviate, and are no substitute for, any other obligations of the Firm to perform other types of appropriateness and/or suitability assessments, such as those promulgated under the Markets in Financial Instruments Directive (“MiFID”) or any other regulatory requirements that may apply to the Firm or a third party in connection with their offering of these trading services/accounts/OTC Derivatives.

E. Expanded Track Record and Experience Requirements

1. All Firms proposing to offer OTC Derivatives or related services in or from the DIFC should demonstrate five years of experience in providing OTC Derivatives and related services under the supervision of a recognised financial services regulator. In addition, all Firms offering OTC Derivatives or related services should have competent compliance and client-facing staff with OTC Derivative product and related services experience of not less than three years.

F. Expectations Related to Marketing and Educational Materials; Content Standards

1. All Firms must implement systems and controls to ensure that all marketing, educational materials and other communications (collectively, “Communications”) regarding OTC Derivatives and related services are clear, fair and not misleading. Communications must clearly distinguish the products being offered from the underlying instruments and markets.
2. On websites, Firms should present a prominent risk warning or risk disclaimer at or near the top of each page. This expectation does not preclude Firms from providing the same or additional risk disclosure or other disclaimers at the bottom of, or elsewhere on, their web pages.
3. Where Communications refer to possible returns or other positive benefits derived from trading OTC Derivatives, they must also present a fair and balanced view of the risks associated with the same and must do so in a manner no less prominent than, and within a reasonable proximity of, any statements regarding possible benefits or returns.

G. “Copy” or “Mirror” Trading and Discretionary Portfolio Management

1. All Firms intending to offer or to arrange for Clients to subscribe to “copy trading,” “mirror trading,” or similar services, which result in the automatic execution in a Client’s account of transactions in OTC Derivatives (i.e., without prior notification to or intervention by the Client), will be treated by the DFSA in the same manner as Firms offering discretionary portfolio management services. Accordingly, all Firms are expected to have robust systems and controls and governance to identify and manage the risks (including, but not limited to, suitability) related to these copy trading, mirror trading or similar service offerings.
2. Before a Firm offers or markets any “copy trading,” “mirror trading,” or similar services in or from the DIFC, the Firm must consult with the DFSA and be able to demonstrate to the satisfaction of the DFSA that the Firm has in place sufficient systems and controls and governance for these types of service offerings.

H. Prohibition on Promotions

1. No Firm may offer or arrange for offer to Retail Clients promotions or bonuses (e.g., trading credits, deposit bonuses, redeemable points) or other similar inducements, benefits or advantages or incentives of any kind (whether direct or indirect, monetary or otherwise or tangible or intangible) in connection with OTC Derivatives.

I. Representative Offices

1. Applications to establish a Representative Office in the DIFC will not be accepted for any Person that proposes to undertake marketing of OTC Derivatives or related services to any person who may meet the definition of a Retail Client.

J. Risk Disclosure Statement

1. A separate OTC Derivatives risk disclosure statement should be provided to all persons who have the potential to be classified as a Retail Client or are an existing Retail Client.
2. It is the responsibility of all Firms to prepare an appropriate risk disclosure statement that addresses the matters set out in this section J and any other risks relevant to the Firm, its Clients, the relevant markets, products and services and jurisdictions relevant to its business undertakings and activities, including any relevant risk disclosures required under relevant laws and regulations.
3. The risk disclosure statement should, amongst other things, address the following:
 - a. Highlight that the risk statement may not identify or address all risks associated with OTC Derivatives;

- b. It is the responsibility of the Client to consider whether the products are suitable for them and whether they can afford to risk all of their capital outlay;
 - c. It is the responsibility of the Client to consult with its own legal and other professional advisers before committing to any transaction, signing any documents and/or entering into any legally binding arrangement in relation to these products;
 - d. The Client is at risk of losing all of their capital outlay and incurring losses beyond this, where such losses may be substantial;
 - e. The Client is at risk of losing money and accumulating losses rapidly;
 - f. Margin trading and use of leverage amplifies losses when they occur;
 - g. Margin trading limits, stop-loss limits or other systems and controls designed to mitigate or limit loss exposures may not be effective or may fail;
 - h. Most Retail Clients transacting in OTC Derivative products lose money;
 - i. The Client may be exposed to legal and court action where the Firm seeks to recover amounts owed to it (by reason of the Client's losses);
 - j. Prominently display performance data for each relevant OTC Derivative product⁴ that clearly identifies, for the four most recently completed calendar quarters, the percentage of Active Retail Client accounts that were profitable. For the purposes of this disclosure:
 - i. "Active Accounts" include the total number of Retail Client accounts in which that specific OTC Derivative was traded or held during that period;
 - ii. "Profitable Accounts" include each Active Account for which net trading activity resulted in a realised profit for that period;
 - k. Where the Firm has any conflicts of interest with its clients (including placing the client's interest first), clearly identify what the conflicts of interest are, associated benefits for the Firm, the Client's right to object to conflicts of interest and request a positive written affirmation from the Client as to whether or not its accepts the conflicts of interest; and
 - l. Whether or not the relevant trading platform is regulated and the implications or risks of this to the Client.
4. The risk disclosure statement must be provided by each Firm to all of its Retail Clients:
- a. as a stand-alone document at the time of on-boarding as a Client;
 - b. distributed⁵ on an annual basis thereafter; and
 - c. be published and available at all times on the Firm's websites.

⁴ Percentages of profitable accounts should be presented for each category of products offered by the Firm, including CFDs, FX (including CFDs with currency pair underlying), and binary options.

⁵ Firms may fulfil this expectation by issuing a mass-email containing this disclosure to all of its Clients. Having this disclosure published on the Firm's website, which is expected pursuant to 4c, is not sufficient also to satisfy this annual distribution expectation.

5. At the Client on-boarding stage, all Firms should:
 - a. obtain the Client's written acknowledgement of receipt of the risk disclosure statement;
 - b. provide a signed copy of the written acknowledgement to each Client;⁶ and must
 - c. maintain an original record of the written acknowledgment in (a) in accordance with applicable record retention requirements.⁷
6. A Client's written acknowledgement is not required in connection with each annual distribution (see J(4)(b), above). However, Firms should be able to demonstrate that the risk disclosure statement was issued to all Retail Clients.
7. In respect of online publication, there must be clear labelling and sufficiently prominent links to the risk disclosure statement on the main page of the Firm's website and as part of each risk warning or disclaimer throughout the website.
8. Where Firms are aware that a Retail Client is not sufficiently proficient in English to understand the nature of this disclosure, Firms should make all reasonable efforts to communicate these risk disclosures to them in a language they are more likely to comprehend.

⁶ Reliance upon a Client's electronic signature is permissible provided the Firm can demonstrate its authenticity and that a copy of the electronically signed risk disclosure statement was provided to each Client. To the extent this disclosure statement is expected to be made as a stand-alone document, any electronic presentation of it to Clients or prospective Clients should not be commingled with other information.

⁷ COB 3.6.1(f)