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Re: Themed Inspection – CFD/Spread Betting Firms’ Compliance with the European Communities (Markets in Financial Instruments) Regulations 2007 (“MiFID Regulations”)

Dear «Greeting»,

The Central Bank of Ireland (“the Central Bank”) carried out a themed inspection earlier this year to examine CFD/spread betting firms’ compliance with certain conduct of business requirements of the MiFID Regulations. The purpose of this letter is to provide feedback in relation to the findings from the themed inspection. We request that you consider the issues highlighted below in the context of your firm and incorporate them into your firm’s procedures as appropriate. A number of firm-specific compliance issues were identified during the inspections and these are being addressed individually with the firms concerned.

The inspection focussed on the following MiFID Regulations:

| Regulation |
|-----------------------------------------------------------------------------------------------|
| Regulation 76 – Conduct of business obligations when providing investment services to clients |
| Regulation 80 – Information for clients and potential clients |
| Regulation 84 – Information about nature and risks of financial instruments |
| Regulation 94 – Assessment of suitability and appropriateness (where applicable) |

Four firms were inspected and approximately 80 client files were reviewed. In general, the Central Bank was concerned by the lack of compliance with some of the above Regulations. In this context, the Central Bank is considering enforcement action for a number of the firms inspected. Please see below a summary of the main findings for consideration.

1. Appropriateness test (Regulation 76)

We were concerned to find that some of the assessments carried out by the firms were inadequate. We would like to draw firms' attention to their obligations in assessing the appropriateness of the service/product for their clients. Each firm should ensure that their application process obtains sufficient information regarding a client's knowledge and experience as required to assess whether the service/product provided/offered is appropriate for the client (Regulation 76(4)). The firm must then assess whether the product/service is appropriate for each client. If the firm deems the service/product is not appropriate, it **must** warn the client or potential client of this under Regulation 76(5). We noted a number of instances where clients were not warned that the service was not appropriate for them.

Each firm should have criteria by which they assess the appropriateness of the service/product for each client.

2. Knowledge and Experience (Regulation 94)

We were disappointed to find that a significant proportion of the application forms used by firms were inadequate and did not obtain sufficient information as is required under Regulation 94. The Central Bank considers that where complex instruments such as CFD/spread betting are being used, it is appropriate to gather at least all of the information set out in Regulation 94(9) in relation to retail clients. We also noted that many forms were not fully completed by clients.

- Online application forms should be set out in such a way that an application cannot be submitted if any fields have been left empty.
- Hard copy application forms should be checked by relevant personnel to ensure completeness.
- The questions contained within the application form should ensure an adequate level of information is gathered regarding knowledge and experience in compliance with Regulation 94(9):

The application form should obtain the following information from clients/potential clients (Regulation 94(9)(a)):

1. Type of service with which the client is familiar;
2. Type of transaction with which the client is familiar; and
3. Type of financial instrument with which the client is familiar.

In relation to the transactions which the client has carried out, information should be obtained on each of the following (Regulation 94(9)(b)):

1. The nature of the transactions the client has carried out;
2. The volume of the client's financial transactions;
3. The frequency of the financial transactions carried out; and
4. The period over which the transactions were carried out.

In relation to education and profession (Regulation 94(9)(c)) the firm should obtain at least one of the following:

1. The education level of the client; or
2. The profession or former profession of the client.

3. *Information should be fair, clear and not misleading (Regulation 76(2))*

Marketing material containing claims using superlatives must be capable of substantiation in order to be fair, clear and not misleading.

The Central Bank was concerned to see that some firms referred to trading in CFD/spread betting as "easy". References to CFD/spread betting being "easy" are not appropriate given that CFD/spread betting is complex and high risk.

Additionally where CFD/spread betting is referred to as "tax free" it should be clarified what is meant by this, i.e. that spread betting is free from capital gains tax and that there is no stamp duty. It should also be explicitly stated that tax treatment is dependent on individual circumstances and that tax laws are subject to change.

4. *Information for clients and potential clients (Regulation 80)*

Regulation 80 states:

80 (2)(c) does not emphasise any potential benefits of an investment service or financial instrument without also giving a fair and prominent indication of any relevant risks.

Improvement is required with regard to the provision of information to clients/potential clients. Firms should ensure that:

- There is a **prominent** risk warning on the home page;
- The risks should be stated on the application form;
- The wording of the risk warning should include a warning that the client's capital is at risk;
- The wording of the risk warning should state (where applicable) that losses could exceed the initial investment, and also note that they may be incurred rapidly and substantially;
- Information is provided on what CFD/spread betting is or there is a clear description of what CFD/spread betting involves; and
- An explanation of leverage in CFD/spread betting is provided including the downside i.e. this can magnify losses.

80 (2)(e) does not disguise, diminish or obscure important items, statements or warnings

The overall layout of a firm's website should be in a clear format with easy to follow links. The risk warning contained on websites should assume a prominent position on the webpage. It should not be any smaller than the standard text of the website or in a colour that is difficult to see. Where risk warnings appear consistently outside the main body of text, or otherwise lacking prominence due to their size, colour, position or surroundings they fail to comply with Regulation 80(2)(e).

5. Promotional/marketing material – balance (Regulation 80)

Regulation 80 states:

80 (2)(f) if it compares investment or ancillary services, financial instruments or persons providing investment or ancillary services, that –

- (i) the comparison is meaningful and presented in a fair and balanced way,*
- (ii) the sources of the information used for the comparison are specified,*
- (iii) the key facts or assumptions used to make the comparison are included.*

Where a firm uses marketing material through advertisements, seminars and on its website it should be sufficiently balanced outlining both the benefits and risks of CFD/spread betting. In our review we encountered a number of promotions that did not sufficiently achieve this balance.

Many promotions set out the relative benefits of CFD/spread betting in comparison with share trading, without setting out the relative disadvantages. For example, that investors will not own the shares and will not receive any of the benefits accruing from that ownership.

Similarly, where the tax benefits are promoted, any key disadvantages of that feature should also be disclosed. For example, where spread betting being free from capital gains tax is mentioned as an

advantage, it should also be stated that the investor is also unable to offset any losses against capital gains tax.

It is of particular concern that we also noted a tendency to promote the benefits of trading on margin without disclosing any of the risk associated with it. For example that trading on margin increases risk by magnifying the extent of potential losses. Further warnings about the risk to a client's capital may be necessary as well as reference to any other disadvantages that may be relevant. It is of considerable concern to the Central Bank that clients are not being adequately informed of the risks attached to these investments.

6. Key Risk Summary

CFD/Spread betting is a high risk financial product and therefore the key risks should be highlighted. Where the key risks are not highlighted for clients and potential clients, or where they must read several documents, i.e. terms and conditions, risk disclosure documents and client agreements to get a full understanding of the key features and risks of CFD/spread betting, a summary should be available to clients/potential clients outlining the key features and risks.

Such a document could include an explanation or description of but not be limited to:

- Gearing and leverage;
- Ownership of underlying instruments/voting rights;
- Risks such as currency risk, volatility of underlying market, gapping, market liquidity etc;
- Risks of going short;
- Risk of losing more than initial investment and possible unlimited losses; and
- Tax treatment and implications.

The Central Bank expects firms to have robust and fair procedures for ensuring compliance with the MiFID Regulations. It is the responsibility of senior management and boards of directors to ensure that their firms have the necessary controls in place. The Central Bank expects all firms to take immediate action to:

- Review their existing processes and procedures to ensure they are in full compliance; and
- Identify any weaknesses or deficiencies and rectify same immediately.

By highlighting the issues above, the Central Bank is seeking to set out some of the key areas for compliance with the relevant MiFID Regulations/best practice. We appreciate that not all of the issues referred to in this letter may be applicable to your firm. We expect that these findings will be incorporated into your firm's ongoing compliance with the MiFID Regulations.

The areas highlighted do not represent all MiFID conduct of business requirements. These are merely some of the key areas of focus from our inspection. Issues raised in this industry letter may be considered during the conduct of other inspections.

Should you have any queries in relation to the contents of this letter, please contact Danielle Rooney at danielle.rooney@centralbank.ie.

Yours sincerely,

A handwritten signature in black ink that reads "Sharon Donnery". The signature is written in a cursive, flowing style.

Sharon Donnery
Head of Consumer Protection Codes