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1 December 2022

Dear Chief Executive,

Our Contracts for Difference (CFD) Strategy

The FCA takes a strategic view towards sectors or 'portfolios' of firms with similar business models and regulatory permissions. You are receiving this letter because we supervise your firm in the 'CFD providers'<sup>1</sup> portfolio alongside other UK & EEA firms predominantly marketing CFDs, spread bets or rolling spot foreign exchange to retail consumers.

The CFD portfolio includes substantial providers, including some listed firms, but also contains many smaller firms mainly focused on FX CFDs. Both product ranges and business models vary across the portfolio, so the issues raised in this letter need to be considered in this context and may not all be relevant to your firm.

CFDs are high-risk derivative products which can pose risks to both our consumer protection and market integrity objectives. We have previously acted to mitigate these risks but have ongoing concerns. This letter builds on, and should be read in conjunction with, the past Supervision and Policy communications referenced in Annex 1 and in the FCA press release accompanying this letter.

Your firm's Board or Executive Committee should consider which of the risks we highlight are applicable to your business and how to address them. We expect you to take action to mitigate these risks and ensure that your firm meets our requirements. You should be prepared for scrutiny of your response to this letter and any actions you have taken. Firms, and where applicable their wider groups, can expect us to take swift and assertive action where necessary to protect consumers or to ensure market integrity. We have recently done so in a number of enforcement cases, most recently [our £530k fine for Sigma Brokers Ltd](#) and have taken other actions referenced in Annex 1.

As CEO, the Senior Managers and Certification Regime (SMCR) means you must take reasonable steps to ensure that your firm complies with FCA rules and principles. If you are not meeting these, you must notify the FCA and ensure any breaches are rectified.

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<sup>1</sup> The criteria for inclusion in this portfolio are that your firm has retail client permissions *and* predominantly generates revenue from CFDs; for these purposes, CFDs include not just actual CFDs, but also spread bets and rolling spot forex. The portfolio includes both CFD 'providers' (principals) and 'distributors' (agents). The portfolio includes both fully authorised UK incorporated firms and EEA incorporated firms which, on 1 January 2021, entered, and remain within, the UK's Temporary Permissions Regime (TPR) or have opted to enter Supervised Run Off (SRO).

Our priorities for work across this area should be read alongside the priority public commitments made in our [3-year strategy](#), which sets out the key areas of focus for the FCA as a whole across all of our regulatory activity.

## Dealing with problem firms

A significant minority of firms in the sector operate business models that cause significant consumer harm. In some cases, consumers have lost life-changing amounts of money. We have seen three core, often concurrent, poor behaviours:

1. *Scam/churn activities*: a small number of firms in the UK's Temporary Permissions Regime (TPR) have targeted consumers for whom CFDs are inappropriate and use scam/churn techniques to directly profit from their clients' losses. Typically, the following methods are used:
  - i. Financial promotions purporting to advertise products other than CFDs which fail to highlight the risks CFDs pose. These commonly involve fake celebrity endorsement and/or content designed to attract consumers to a 'rising market' for a relatively small sum (typically £250).
  - ii. Once the client is onboarded, the use of pressure-sales tactics to persuade them to invest increasing amounts of money, including via credit cards and loans, often to avoid realising open losses.
  - iii. The charging of excessive or inappropriate fees.
  - iv. The refusal to process requested withdrawals.

In some cases, we also identified:

- a. Investment advice being given to clients without authorisation.
  - b. Inducements to 'upgrade' to 'elective professional' status despite clients not meeting the requisite criteria, sometimes in the form of initial margin credit 'bonuses' which results in such clients losing the protections FCA rules provide retail consumers.
  - c. The use of compensation or settlement agreements, typically involving the client having to sign a non-disclosure agreement (NDA) to receive substantially lower compensation than the client's investment loss.
2. *Circumvention of FCA Rules*: as mentioned above, some firms circumvent our rules by inappropriately 'opting-up' retail consumers to 'elective professional'<sup>2</sup> status, sometimes using incentives banned under our rules. Other firms circumvent our rules by redirecting retail customers to associated CFD providers incorporated in third country jurisdictions without equivalent consumer protections. These third country entities illegally provide regulated activities to UK clients outside of the provisions in the Overseas Persons Exclusion (OPE)<sup>3</sup>. Both these practices mean consumers lose the protections our rules provide, in particular leverage restrictions designed to minimise client losses.
  3. *Affiliate marketers/ introducers*: many firms use unauthorised affiliates to introduce clients, paying them for their introductions. Firms' oversight of affiliates is often inadequate and sometimes part of a deliberate strategy to exploit consumers, especially when combined with the poor behaviours mentioned above. In addition, some affiliates have been identified as conducting regulated activities without authorisation. Many are social media 'influencers' who target younger consumers with lower levels of financial literacy for whom CFDs are inappropriate. Some affiliates market themselves as FX 'educators' and 'signals providers'.

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<sup>2</sup> <https://www.handbook.fca.org.uk/handbook/COBS/3.pdf>

<sup>3</sup> <https://www.handbook.fca.org.uk/handbook/PERG/2/9.html>

We regularly see overlap between these two groups. We have issued numerous investor warnings about inappropriate behaviours by affiliates and taken enforcement action in the most serious cases. All firms should consider their use of affiliates and must have robust due diligence for their onboarding and ongoing monitoring. All firms should rapidly off-board affiliates which are suspected to be operating illegally or engaging in poor conduct. Firms should not rely on the FCA to identify these issues and where we need to do so, we will question firms' competence.

We are aware that these practices do not exist in all firms in the sector. Nevertheless, we expect your Board's consideration of this letter to include taking steps to assure yourselves that they do not apply at your firm. Where any such behaviours are ongoing, firms should cease them immediately. Our ongoing strategy to deal with these issues is to:

- a. *Identify*: we will continue to use internal and external data, intelligence and regulatory tools to identify and substantiate poor behaviours. We are investing heavily in IT and staff training to increase our capabilities and effectiveness.
- b. *Intervene*: we will continue to intervene to stop or limit ongoing consumer losses where we see harm. In the most urgent cases, we require firms to cease regulated activities immediately. In less urgent cases, we restrict firms' activities until the issues are sufficiently remediated. Examples can be seen in Annex 1.
- c. *Enforce*: once ongoing harm has been minimised/ stopped, and where we judge the poor behaviour serious, we will consider formal enforcement action. Such action could lead to fines, public censure and the removal of firms/individuals from the UK regulated market. Enforcement outcomes are usually publicised.

At our regulatory gateway, we have an enhanced risk appetite for all applications in this sector, including for new authorisations, changes-in-control and senior managers. We expect all firms seeking authorisation to be Ready, Willing and Organised at the point of application. We will not accept applications where key elements are not yet in place.

On 1 January 2021, 100 EEA-authorized CFD firms entered the UK's Temporary Permissions Regime (TPR), allowing them to continue UK business while preparing for full UK Authorisation. A significant minority of these firms were engaging in the poor behaviours mentioned above. As mentioned in an FCA [Press Release](#) on 18 October, we have intervened to cease the UK business of 16 of these firms. Fifty other TPR firms have already fully exited the UK regulated market, some following publicised Enforcement action. Of the remaining TPR firms, only one has been fully authorised. Except for one other firm, whose application we are currently assessing, all other TPR firms are being closely supervised as they wind down their remaining UK business, return client money and finalise their exit from the UK market.

All TPR firms are required to submit an application for full UK Authorisation by 31 December 2022. Any TPR firm that has not applied by end-2022, or which has withdrawn its application, will be removed from TPR using formal powers if it does not voluntarily cancel.

### **Putting customers' needs first**

CFD firms' business models often involve inherent *Conflicts of Interest* (CoIs). The majority of CFD firms generate revenue primarily from the spread clients cross when trading CFDs, with additional income derived from other associated charges such as those levied to fund a position overnight. The drive to maximise revenue sets up CoIs in respect of the targeting of clients, the size and frequency of client trading and the charges levied on that trading activity. This is because firms profit when customers are persuaded to trade more frequently and/or in larger volumes than they would otherwise have done. Where the market risk from firms' customer

activity is under-hedged, firms also directly profit from customer losses, further incentivising them to encourage excessive customer trading. Current market volatility and the cost-of-living crisis could also be used to encourage excessive trading not in customers' best interests. We expect all firms to have analysed all relevant CoIs inherent in their business model and to comply with and consider all relevant FCA rules and guidance respectively. We will take action where we see inadequate managing, or exploitation, of CoIs.

More generally, all firms should consider their obligations under the [Consumer Duty](#) (the Duty) which sets higher standards of consumer protection across financial services and requires firms to act to deliver good outcomes for retail customers. The Duty comes into force for new and existing products and services that are open to sale on 31 July 2023. We expect all firms to already have their implementation plans agreed and to be working to ensure they are compliant with the Duty by this date. This will include developing metrics to demonstrate that consumers are getting good outcomes, particularly in the four key outcome areas (products and services; price and value; consumer understanding; and consumer support). Firms should expect us to probe and test their readiness and preparation for meeting the implementation deadlines and must alert us if they might not be compliant with the Duty by the deadline.

The specific areas of the Duty likely to be most relevant to CFD firms include:

- our cross-cutting rules on acting in good faith – relevant but not limited to the CoI issues mentioned above;
- our rules on price and value – relevant to ensuring the target market for CFD products is appropriate, particularly given the high levels of customer losses generally experienced by consumers investing in CFDs;
- our rules on customer service – this will be relevant to how consumers engage with you when investing in CFDs, including whether there is an appropriate degree of friction to ensure consumers do not put money at risk that they cannot afford to lose; and
- our rules on communications – relevant to how you advertise and market your products to consumers, including the negative impacts of gamification highlighted in [our recent work on behaviours around high-risk investing](#).

A separate communication will be sent in the coming months explaining further the impact of the Duty on CFD providers.

### **Delivering assertive action on market abuse**

Poor systems and controls often result in firms being used as conduits of financial crime, primarily insider dealing. Some firms have revised policies and monitoring and exited clients of concern. However, we remain concerned at the level of suspicious transaction activity in the CFD sector and the weakness of some firms' controls. We expect firms to comply with, and to consider, all relevant FCA Rules and Guidance respectively. We also expect firms to have due regard to our recently-published [Market Watch 69](#).

We have recently conducted on-site visits to assess market abuse controls at some firms. As well as firm-specific feedback, we will consider publishing wider feedback and holding a roundtable to share common themes with a wider selection of firms. We will seek to ensure minimum standards and best practice are clearly communicated across the sector and will consider Enforcement action where we identify firms operating materially below our minimum standards. We expect all firms to consider firm-specific and industry-wide feedback and take appropriate action.

### **Reducing harm from firm failure**

*Financial resilience:* inadequately mitigated prudential weaknesses risk disorderly firm failure. We have seen this risk both crystallise and nearly crystallise following market shocks and/or firms'

rapid growth. An example of a market shock that crystallised prudential risks was the market dislocation following the January 2015 Swiss National Bank's decision to cease defending the Swiss Franc peg against the Euro. More recently, some firms actively and successfully targeted new customers during the COVID pandemic which led to rapid growth that outstretched their control environment, capital and/ or liquidity. All firms should have implemented the Investment Firms Prudential Regime (IFPR), which came into force on 1 January 2022, and considered our recently-published [observations on wind-down planning](#). Firms' boards should test the adequacy of their firm's IFPR implementation, including their internal capital adequacy and risk assessments (ICARA), as well as their recovery and wind-down plans. Where we identify material prudential weaknesses, we will take action. This has recently included imposing capital/liquidity scalars, business restrictions and skilled persons reports.

*Protection of client assets:* sub-standard oversight and control of client assets and/ or monies could lead to financial losses for investors and/or an inability to recover assets efficiently in the event of a firm failure. This is because, where controls are sub-standard, client assets/ monies might not be adequately segregated from the firm's assets and so might not be effectively ring-fenced in the event of an administration. We continue to see weaknesses in firms' adherence of our client money and assets Rules. The root causes of these weaknesses are often poor governance and oversight, under-investment in systems, failure to consider client asset impacts fully when managing change and an overall lack of adequate knowledge of the client assets regime within the firm. These issues can be exacerbated where relevant processes are outsourced to other group entities. We expect all firms to comply with our client asset rules and consider all relevant FCA Guidance. We also draw your attention to our recent [Dear CEO Letter on inappropriate use of Title Transfer Collateral Agreements](#) to firms in our wholesale brokers portfolio, as this is also relevant to CFD firms. We continue to scrutinise firms' compliance in this area closely and will act where we see material weaknesses.

*Operational Resilience:* CFD firms' business models are highly dependent on stable and resilient IT platforms and are especially vulnerable to operational weaknesses such as cyberattacks and customer volume spikes. We remind relevant firms of their obligations to ensure operational resilience<sup>4</sup>, in order to minimise preventable harm to consumers and markets. Firms not formally in scope for these rules should also consider them as good practice.

#### Next steps

By end-January 2023, we expect all CEOs to have discussed this letter with their fellow directors and/or Board and to have agreed actions and/or next steps.

If you have any queries about this letter, please contact our dedicated Supervision Hub on 0300 500 0597. This is the primary contact for your firm's day-to-day interactions with the FCA. Further details of how we can be reached are available on our website at <https://www.fca.org.uk/contact>. We recognise there may be occasions when your firm faces urgent issues of strategic importance. In such circumstances, please contact the Manager of the CFD Supervision Team, Malcolm Peters at [malcolm.peters@fca.org.uk](mailto:malcolm.peters@fca.org.uk).

Yours faithfully

Simon Walls - Director, Wholesale Sell-Side

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<sup>4</sup> <https://www.fca.org.uk/publications/policy-statements/ps21-3-building-operational-resilience>

## Annex 1: Key Past Supervisory, Policy and Intervention Communications to the Sector

1. 02/02/2016 Dear CEO letter: [Client take-on review in firms offering contract for difference \(CFD\) products](#)
2. 29/06/2017 Press release: [CFD firms fail to meet our expectations on appropriateness assessments](#)
3. 10/01/2018 Dear CEO letter: [Providers and distributors of CFD products: resolving failings which may cause significant consumer harm](#)
4. 01/07/2019 Press release: [FCA confirms permanent restrictions on the sale of CFDs and CFD-like options to retail consumers](#)
5. 01/06/2020 Press release: [FCA bars Cypriot firms that used unauthorised celebrity endorsements](#)
6. 15/06/2020 Press release: [Cyprus CFD firms Maxiflex Ltd, Maxigrid Limited and Reliantco Ltd](#)
7. 16/04/2021 Press release: [FCA stops FXVC offering CFDs to UK customers](#)
8. 26/05/2021 Press release: [FCA stops EverFX offering CFDs to UK customers](#)
9. 02/07/2021 SUP Notice: [Second Supervisory Notice FXBFI Broker Financial Invest Ltd](#)
10. 05/08/2021 Press release: [FCA stops BDSwiss offering contracts for differences \(CFDs\) to UK customers](#)
11. 14/09/2022 Publication: [Consumer Investments: Strategy and Feedback Statement](#)
12. 16/10/2022 Publication: [Consumer investments data review April 2021 – March 2022](#)