FCA CFD strategy summary

High level

- **Timeline:** focus on two-year cycle
- Reduce the potential harm CFDs present when marketed inappropriately or with inadequate controls

Key dated and deadlines

- **31 January 2025:** FCA expects all CEOs of CFD firms "***to have discussed the Dear CEO letter with their fellow directors and/or Board and to have agreed next steps***"

1. **<u>Consumer duty</u>**

- FCA will continue to test the embedding of the Consumer Duty in firm-specific work
- Plan to conduct a multi-firm review focusing on the Duty's 'price and value' outcome and fair value assessments
- Consider whether firms are able to demonstrate consideration and delivery of fair value in areas including spreads, overnight funding charges and commissions
- FCA to publish general findings, including examples of good and poor practice
- CFD firms should ensure that:
  - Only target consumers who are able to absorb losses
  - Consumers fully understand and accept the risks they face trading CFDs
  - Consumers are not inappropriately opted-up to 'elective professional' status and, where firms do opt-up, those consumers have fully understood the regulatory protections they will have lost
  - Vulnerable consumers are identified and well-supported, given the potentially addictive nature of some types of CFD trading

2. **<u>Market integrity – market abuse</u>**

- Most STORs received relate to potential insider dealing activity, involving lone individuals or Organised Criminal Gangs (OCGs) potentially routing suspicious trades through mule accounts
- As explained in recently-published Market Watch 80, some firms have unwittingly facilitated further suspicious trading for previously off-boarded clients who route trades through 'Obfuscated Overseas Aggregated Accounts (OOAAs)'
- CFDs used for market spoofing activity such as narrowing the spread on an illiquid stock
  - FCA has seen this done via copy trading, with multiple accounts copying the master account initiating the activity

- Firms should consider this when designing their surveillance arrangements and parameters

- FCA will continue to act assertively against perpetrators of market abuse and ensure firms have robust systems in place to identify and report trade activity of concern
  - Will include work designed to improve the identification of market abuse in the portfolio
  - Firm-specific targeted reviews of surveillance arrangements will continue
  - Also focus on transaction reporting
  - Firms should monitor relevant updates in Market Watch
  - FCA will consider further market abuse specific round tables as necessary

3. Reducing harm from firm failure

- Focus both on the adequacy of firms' capital and liquidity and the arrangements for holding client funds deposited to support trade activity, whether in client money segregated accounts or under Title Transfer Collateral Arrangements (TTCA)
- FCA will continue to assess firms' implementation of IFPR, using regulatory returns and targeted data requests to identify outliers, and will act where they identify prudential weaknesses or misreporting
- Oversee the progress of smaller firms on their MIFIDPRU capital glide paths and take action where firms have inadequate plans to increase capital in line with minimum glide path expectations
- FCA will also act where they identify material weaknesses in firms' consideration of their capital and liquidity needs; this may include the setting of Individual Capital Guidance ('ICG') and Individual Liquidity Guidance ('ILG') and Board effectiveness reviews
- During recent work on firms with deficient liquidity risk management frameworks:
  - FCA identified inadequate consideration and quantification of liquidity risks and a failure to implement dynamic forward-looking daily stress testing
    - This means some firms are failing to capture the next day's business-as-usual and stressed liquidity requirements, such as margin calls and rapid client money outflows
    - Such inadequacies resulted in underestimated Liquid Assets Threshold Requirements ('LATR'). Liquidity risks are exacerbated when firms' business models are dependent on TTCA funding and/or where firms do not promptly return excess TTCA funds

4. Client assets and TTCA

- Client assets arrangements remain a priority to FCA
- FCA has identified that around 40% of firms in the portfolio hold 'professional' client money under TTCAs
    - Concerned about potential over-reliance on TTCA monies to fund hedges in a manner which is non-compliant and/or creates counterparty risk that is not properly considered in the firm's ICARA
    - This concern is exacerbated when Retail clients are opted-up to Professional client status inappropriately, signed up simultaneously for TTCA, and/or high percentages of their funds are placed with offshore counterparties which may be connected 'group' entities
    - FCA has seen two recent firm failures that led to shortfalls in TTCA funds held, and one of these had all funds placed with an offshore counterparty
    - Firms should ensure they are not using TTCAs/opting up clients in a way that breaches or circumvents FCA Rules
    - FCA to scrutinise all aspects of the use of TTCA, including the client journey relating to both opt-up and TTCA agreements

5. Halo firms

- According to FCA, around 20% of firms in the portfolio appear to be conducting little or no activity, and thus not using their permissions enough to justify continued authorisation
- Some of these firms appear to exist purely to provide an FCA 'halo' to wider 'groups'
- This gives false comfort to global retail clients who see the FCA association but contract with an offshore 'group' entity rather than the UK authorised firm, without UK regulatory protection
- Where FCA identify UK firms that do not conduct material regulated activity, FCA will continue to invite them to cancel their permissions and robustly challenge them on their future plans where they do not accept this invitation
- Continue to maintain a strong gateway to all entry routes into the CFD portfolio, including changes-in-control ('CiC')
- FCA will also use the next regulatory cycle to challenge 'halo' firms still in the portfolio and expect them either to apply to cancel their authorisation or to demonstrate that they are ready, willing and organised to start meaningful regulated activity
- FCA will continue to scrutinise loss-making, largely inactive firms that meet minimum prudential requirements via 'last minute' injections of funds from controllers and consider whether this amounts to renting an FCA 'halo'

6. Diversification, innovation, and fast-growing firms

- A small number of firms in the portfolio have diversified their product offerings in recent years, moved into stocks, often including fractional shares, as part of moves to provide lower minimum-account-size access to investment markets
- FCA notes that many of these new customers have been younger investors with lower levels of financial literacy and resilience
- FCA become concerned where they see inappropriate marketing of ‘zero commission’ without transparency on other costs, the use of ‘gamification’ and/ or other digital engagement practices to encourage short term speculative trading, and/ or inadequate consideration of Consumer Duty obligations, including those under the ‘price and value’ outcome when firms/’groups’ internalise pricing of client trades
- Prudential risks increase and more capital and liquidity are generally needed where firms expand rapidly, by growing customer numbers and/or adding a diverse range of additional features such as stock lending, Investment and Cash ISA wrappers, stock options and high interest rates on cash ISAs and uninvested cash in Investment ISAs
- Where the pace of expansion of client take-on and product diversification is not matched by commensurate increases in firms’ financial and non-financial resources, this can lead to excessive risks of consumer harm in the event of firm failure, particularly when consumers are not aware that a product or offering is not, or may not be, covered by the Financial Services Compensation Scheme (e.g. some e-money accounts)
- FCA will continue to ensure that fast-growing firms hold adequate capital and liquidity
- FCA will monitor whether such firms’ wider systems and controls are commensurate with growth or anticipated growth
- FCA exploring the business models of a sample of firms – not just CFD providers - that use mobile apps to facilitate trading by retail clients

7. Distributors and Appointed Representatives (ARs)

- Previous work by FCA on Distributors and ARs and an accompanying Dear CEO Letter published in 2018 led to a significant off-boarding or deregistering of Distributors by CFD providers and of ARs by Principal firms. Since then, FCA has focused on the inappropriate use of ARs, and intervention action resulted in the deregistration of most of the small number remaining in the portfolio
- FCA continue to focus on Distributors, with four firms cancelled in the last year
- FCA still concerned that some of the remaining Distributor firms may either be ‘halo’ firms, or not sufficiently adding value to justify consumers’ additional costs when accessing CFDs through them
- FCA to conduct deep-dive business model analysis on all remaining Distributors to identify those not meaningfully using their Permissions or delivering good consumer outcomes, and will act to mitigate material risks identified

- FCA remind CFD providers/Principal firms of their responsibilities to conduct adequate due diligence and provide oversight, at both onboarding and periodically, of their Distributors and/or ARs. This must include a focus on how they are meeting relevant Consumer Duty obligations

8. <u>Operational Resilience and Outsourcing</u>

- CFD firms' business models are highly dependent on stable and resilient IT platforms and are especially vulnerable to operational weaknesses that fail to mitigate the impact of cyberattacks and customer volume spikes
- FCA remind firms of their obligations to ensure operational resilience (where applicable), in order to minimise preventable harm to consumers and markets
- Firms not formally in scope for PS 21/3 are encouraged to consider it as good practice
- Some firms in the portfolio rely heavily on outsourcing arrangements both with third-party providers and/or other 'group' affiliates
- Firms are reminded of their responsibilities to conduct adequate due diligence and oversight of all outsourced operations
- FCA expect ICARA processes and documentation to reflect adequately the additional complexities of outsourcing arrangements (related: FG 20/1)
- Firms should also assess the adequacy of financial resources to mitigate operational resilience/outsourcing risks and ensure wind-down plans sufficiently address outsourcing complications (related: Wind-down Planning Guide)

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