

FSRA Consultation Paper No. 5/2022

Introduction

The Financial Services Regulatory Authority (“FSRA”) of Abu Dhabi Global Market (“ADGM”) issued a consultation paper on 26th September 2022 to seek views on proposed amendments to its Rulebook on regulating the provision of over-the-counter (OTC) leveraged products to retail clients. The aim of these amendments is to protect retail clients who do not have the required level of financial knowledge or experience to take prompt action to limit losses resulting from adverse market movements, which directly impact the underlying assets. This risk is particularly prevalent given the high leverage associated with these products.

Who should read this paper?

Entities within ADGM that are offering or intend to offer OTC leveraged products to retail clients.

When will these rules take effect?

The FSRA is in the process of reviewing the industry’s feedback on the consultation. Upon publication of the new rules, a 6-month transition period will be given to existing Authorised Persons to comply with the new requirements.

Which rulebooks and rules will be affected?

The FSRA proposals will affect the rulebooks and rules listed below:

Rulebook	Rules
Glossary (“GLO”)	Definition of “OTC” Leveraged Products”
Conduct of Business Rules (COBS)	<ol style="list-style-type: none">1. Margin close-out requirements for retail clients2. Prohibition on referrals by unregulated persons3. Prohibition on funding account through a credit card or a third-party credit facility4. Liquidity Providers5. Additional Restrictions relating to OTC Leveraged Products

Prudential – Investment, Insurance Intermediation and Banking Rules (“PRU”)	Increasing the Base Capital Requirement for Category 3A firms
Fees (“FEES”)	New Authorisation and Supervision Fees

Impact assessment of the proposed amendments

Proposed Amendment	FSRA Proposed Rules	Impact and actions to be taken
Glossary (“GLO”)		
1. Definition of “OTC” Leveraged Products”	<p>a) Prohibit the sale and offering of binary options by authorised persons to retail clients.</p> <p>b) Change the definition of “OTC leveraged Products” to encompass only:</p> <ul style="list-style-type: none"> • Leveraged contracts for differences; • Leveraged rolling sport forex contracts; and • Any other leveraged Investments similar in nature which are not prohibited under COBS 23.12.1. 	<p>a) Authorised Persons must update their systems and contracts with liquidity providers and other relevant third-parties to exclude binary options and analogous products.</p> <p>b) Staff of Authorised Persons must be trained to recognise and identify products that are permitted under the new amendments.</p>
Conduct of Business Rules (“COBS”)		
1. Margin close-out requirements for Retail Clients	<p>a) Authorised Persons must ensure that “net equity¹” of a retail client in an account used to trade OTC Leveraged Products does not fall below 50% of the margin requirement, required to maintain the retail Client’s open positions.</p> <p>b) Where the net equity of a retail Client falls below 50% of the margin requirement², the Authorised Person must close the retail client’s open position(s) in OTC Leveraged Products as soon as market conditions allow.</p>	<p>a) Authorised Persons must update their policies and procedures to incorporate the 50% margin requirement and the appropriate action to be taken once the requirement is breached (close the position).</p> <p>b) Authorised Persons must have a system in place that monitors the net equity positions of its retail clients and be able to close the position automatically.</p>
2. Prohibition on referrals by	a) The FSRA proposes prohibiting Authorised Persons from	a) Authorised Persons must amend their marketing policy

¹ Sum of the deposited margin and the unrealised net profit and loss on open positions in that account

² The margin requirements of each financial instrument are indicated in the appendix

<p>unregulated persons</p>	<p>accepting referrals of retail clients from unregulated third parties, e.g. call centres, for reward.</p> <p>b) Authorised Persons are prohibited from offering promotions, bonuses, or other inducements to retail clients in connection with the offer or sale of OTC Leveraged Products, whether monetary or non-monetary in nature.</p> <p>c) Authorised Persons must ensure that introducing brokers are not actively promoting OTC Leveraged Products that retail client acquisition does not involve the provision of investment advice or portfolio management.</p>	<p>and client acquisition strategy as to not include references to their OTC leveraged products in their promotional campaigns. The marketing of the products to retail clients must not include incentives.</p> <p>b) Staff of Authorised Persons who are responsible for the marketing and onboarding of clients must be trained on how to approach the marketing of these products to retail clients.</p>
<p>3. Prohibition on funding account through a credit card or a third-party credit facility</p>	<p>a) Prohibition on retail clients funding their accounts using credit cards and/or credit facilities.</p> <p>b) The new proposed rules require Authorised Persons to assess, amongst other things, that the offering of OTC Leveraged Products to retail clients is appropriate given their financial situation and in the light of the high level of losses suffered by the target market.</p> <p>c) The proposed amendments will require that the assessment be conducted by Authorised Persons:</p> <ul style="list-style-type: none"> (a) on an annual basis; or (b) where there is any material change in the financial situation or risk tolerance of the retail client, if that change occurs prior to the annual reassessment. 	<p>a) Authorised Persons should amend their retail client onboarding process to include an assessment of the retail client's understanding of risks they are exposed to.</p> <p>b) Authorised Persons would have to develop a system and procedure for undertaking the assessment including the objective criteria and information to be used in the assessment. The criteria should include:</p> <ul style="list-style-type: none"> • The trading history of the retail client, including the volume of that trading, • Relevant professional qualifications the retail client might have. • Information concerning the liquid financial resources of the retail client. <p>c) The policies and procedures must be amended to ensure that retail clients may not use credit facilities to fund accounts used for trading in OTC leveraged products. The</p>

		firm's system must not accept credit cards or other forms of credit facility as a means of payment.
4. Liquidity Providers	<p>Authorised Persons should:</p> <ul style="list-style-type: none"> a) Undertake a suitability assessment of its liquidity providers; b) Ensure best price is available for its retail clients; c) Retain more than one liquidity provider at all times; and d) Conduct an independent monitoring of the quality of orders executed by liquidity providers. 	<ul style="list-style-type: none"> • Authorised Persons should assess the quality of their liquidity providers using the following factors: <ul style="list-style-type: none"> a. Proven history of good pricing and competitive spreads. b. Lack of expensive fee structures allowing for more attractive net prices. c. Reliable data feeds with few or no spikes or gaps. d. High-quality bids that are stable through market uncertainty. e. Compliant conduct, with transparent reporting f. Secure technology platform. • Furthermore, firms should approach different liquidity providers and update their system and policy to ensure that more than one liquidity provider is available at any point in time.
5. Additional Restrictions relating to OTC Leveraged Products	a) Authorised Persons must not offer or arrange for retail clients to subscribe to "copy trading," "mirror trading," or similar services unless it holds a Financial Services Permission to undertake the Activity of Managing Assets.	a) The Authorised Persons not undertaking the activity of Managing Assets, should amend their trading system as to not offer their retail customers "copy trading" of leveraged OTC products.
Prudential – Investment, Insurance Intermediation and Banking Rules ("PRU")		
1. Changing the Base Capital Requirement for Category 3A	a) Authorised Persons under Category 3A who intend to conduct the activity of "Dealing in Investments as Principal (only as Matched Principal) in relation to OTC leveraged Products with retail	b) Entities that intend to undertake this activity should devise a plan to increase their capital to the new threshold within the stated transition period (6 months).

	clients will have their minimum base capital requirement raised from \$500K to \$2millions.	
Fees ("FEES")		
1. New Authorisation and Supervision Fees	a) New authorization and annual license fees have been proposed that differentiate between authorised persons offering their services to retail clients and those that do not.	a) Existing entities that offer OTC leveraged products will be subjected to a new annual license fee of \$40K if their customers include retail clients or \$5K if they offer the products to non-retail client exclusively.

Supplementary Guidance

Furthermore, the FSRA has proposed to issue supplementary, non-Rulebook-based guidance that sets out the minimum required experience and qualifications of individuals who wish to apply to become an Authorised Person.

1. Minimum Qualification Criteria for Senior Management

	<u>Experience Requirement</u>	<u>Academic & Professional Requirements</u>
Senior Executive Officer	<u>10 years</u>	holding a directly relevant qualification and membership of appropriate professional body.
Licensed Director	<u>7 years</u>	
Senior Managers	<u>5 years</u>	
Compliance Officer, Money Laundering Reporting Officer	<u>5 years</u>	

Appendix

Margin Requirements

(a)	3.33% for major currency pairs and relevant sovereign debt.
(b)	5% for non-major currency pairs, gold, and major equity indices.
(c)	10% for commodities, excluding gold, and non-major equity indices.
(d)	20% for individual equities.
(e)	50% for virtual assets.