

MFSA

MALTA FINANCIAL SERVICES AUTHORITY

Feedback Statement

PROPOSED POLICY AS APPLICABLE TO
ONLINE BUSINESS MODELS DISTRIBUTING
OR INTENDING TO DISTRIBUTE CONTRACTS
FOR DIFFERENCES (CFDs) AND/OR
ROLLING SPOT FOREX CONTRACTS UNDER
THE MARKETS IN FINANCIAL
INSTRUMENTS DIRECTIVE (MIFID)
REGIME

[MFSA REF: 12-2016]

3 April 2017

1. Background

On 17 October 2016, the MFSA issued a [Consultation Document](#) on the proposed policy for online business models distributing or intending to distribute contracts for differences (CFDs) and/or rolling spot forex contracts, under the Markets in Financial Instruments Directive (MiFID) regime.

On 30 July 2015, the MFSA issued a [public notice](#), wherein it set out the updated criteria regarding the licencing of entities that would wish to provide online forex trading to clients. The referred Notice was issued following various issues that the MFSA had come across in handling applications in this sector as well as various risk warnings issued at EU level alerting retail investors to the main risks involved in forex trading. This public notice is currently only applicable to applicants for a Category 2 or Category 3 Investment Services Licence that would like to provide online trading of complex products in terms of the Investment Services Act, Cap. 370.

The purpose of the Consultation Document was to propose that online forex investment firms licenced prior to the 30th July 2015 would be brought within the scope of the public notice such that the requirements of this policy would also apply to these firms as well as the new and/or revised requirements which were consulted upon in the document (relating to leverage and slippage). In this way, all investment firms licensed in Malta providing online trading in CFDs and other complex products will be subject to the same level of requirements in terms of the public notice issued on 30/07/2015 and to the other requirements indicated in the Consultation Paper.

Further to the said Consultation Document, the MFSA is issuing a Feedback Statement on the comments received. An outline of the main comments received and the MFSA's position in relation thereto is provided below.

For the purpose of this Consultation Paper, the term *firm*, shall mean a Category 2 or Category 3 Investment Services Licence Holder authorised or in the process of being authorised to distribute *complex speculative products*. The MFSA is of the understanding that the majority of the referred *firms* resort to an online business model to distribute such *complex speculative products*. The MFSA also notes that although the population of firms offering these products is quite diverse, there are two main types of firm that offer *complex speculative products*: (i) *firms* acting as the client's counterparty, which offer the *complex speculative products* directly to retail clients; and (ii) *firms* acting as intermediaries between retail clients and liquidity providers.

2. Main Comments received on the proposed amendments to the Policy and the MFSA's position

2.1 Share Capital Increase (as part of the Transitional Arrangements)

Policy proposition: *“Companies applying for a Category 2 licence will be subject to a higher minimum initial capital requirement of €730,000, similar to the initial capital requirement for Category 3 licence holders in light of the risks associated with this kind of business and potential loss of retail clients' money. The said capital should be satisfied on an ongoing basis and not just at licensing stage.”*

Industry comment: Some industry respondents showed reservations in having the capital requirement for both Category 2 firms and Category 3 firms set at €730,000. In particular since the risk and operational complexity of a Category 3 firm is greater than that of a Category 2 firm.

Moreover, the industry outlined that this proposition is not in line with what other regulators are proposing and thus puts Malta as a financial services centre at a competitive disadvantage.

In this respect, the industry highlighted that the increase in capital requirement will not play a big role in addressing investor protection. Additionally, there are alternative measures that can be taken in order to ensure investor protection.

MFSA position: As outlined in both the public notice and the consultation document, CFDs and/or rolling spot forex contracts are considered to be complex products.

The MFSA has noted the industry's proposals that it can consider other measures as additional tools to ensure investor protection. Nonetheless, the MFSA is still of the position that the capital requirement for Category 2 firms is set at €730,000. This is because in effect, the Category 2 firms would still be assuming a significant element risk as Category 3 investment firms, albeit for a very short period of time until such instruments are transferred to the respective counterparty.

2.2 Leverage Limits

Policy proposition: *“firms are required to set the leverage limits for retail and professional clients to a maximum of 1:50. This leverage limit shall be applicable across all platforms as made available to retail and professional clients on the firm’s website(s).”*

Industry comment: Some industry respondents expressed that there is the need to make a distinction between retail and professional clients and that these clients should not be treated equally.

It was stated that imposing leverage limits of 1:50 for both retail and professional clients will have a negative impact on the competitiveness of Malta’s licensed firms, especially if other jurisdictions do not adopt similar limits.

It was further outlined that restricting professional investors’ leverage limit will threaten the Maltese market because such clients are already well aware of the more flexible limits set in other jurisdictions. It was stated that this will jeopardise any professional client acquisition for Maltese firms. Moreover, the industry explained that most of these professional clients are classified as funds or other licence holders and setting such limits would essentially drive these clients out and push them towards less regulated jurisdictions.

In fact, certain industry respondents stated that setting the leverage limit at 1:50 would be the lowest leverage limit in the EU.

The industry also noted that certain Maltese firms, which are not licensed to deal in CFDs and which however have access to external platforms that deal in similar or same products, will not be subject to the same leverage constraints. This, in turn would appear to put local forex firms at a competitive disadvantage.

The industry stated that the majority of retail clients are aware of the risks found in trading CFDs and thereby the option of allowing wider leverage limits *“affords these same individuals the liquidity to trade these instruments with significantly lower risk than they would in an unleveraged and an unhedged trading environment”*.

The general notion was that imposing tighter leverage limits will have a negative impact on licenced firms operating online business models. The industry was of the opinion that licence holders should be responsible enough to focus on investor disclosure and ensure clients’ investments’ suitability and/or appropriateness are adhered to, rather than imposing such leverage limits. It was stated that by setting such leverage limits, the Authority is de-risking rather than safeguarding investors’ interests.

Certain industry respondents proposed that a maximum leverage limit of 1:200 is set for retail clients and no limit is imposed for professional clients.

MFSA's position: The MFSA's aim is to protect all types of clients. The operations of online business models offering MiFID investment services in relation to *complex speculative products* pose a high risk for retail customers who may not be fully conversant with the risks associated with such speculative trading.

Leverage alters the exposure of clients to the underlying financial instrument and amplifies the financial outcome of the investment – be it positive or negative. It thus exposes clients to potential losses that can exceed their initial deposited funds.

The proposed leverage limit of 1:50 should help firms manage their risk and ensure that retail clients are not exposed to the risks which are not suitable to them. The reason for setting such leverage limits is to diminish the risk of retail clients making losses greater than the investment made. Studies show that retail clients suffer on a consistent basis when trading in CFDs and/or rolling spot forex contracts since they do not always understand the high risk, complexity and speculative nature of such products which are being offered to them ,online, by investment firms.,

The MFSA is of the view that retail clients are invariably being subject to increased risk by being exposed to high leverage levels. Accordingly, by setting the proposed leverage limits of 1:50, the MFSA intends to protect retail clients from entering into transactions which are not within their risk profile.

The MFSA has also taken account of the concerns raised by the industry on this matter, in particular with respect to leverage limits for professional clients. However, the MFSA is nonetheless concerned with the possibility of retail clients opting to be treated by firms as professional clients in terms of MIFID, as transposed in the MFSA's Rules, in particular, since such clients will be opting out of the protections which are afforded to them under MIFID.

In view of the above, the Authority has set the following maximum leverage limits to be adopted by firms:

- For retail clients – 1:50;
- For retail clients electing to be treated as professional clients in terms of MIFID – 1:100;
and
- For all other clients – no leverage limits are being imposed.

In this context, it is important for firms to ensure that the procedures envisaged in SLCs 2.03-2.12, dealing with the option to be granted to retail clients to be treated as professional are adhered to.

Furthermore, firms will be requested to indicate, in their respective COREP returns, a breakdown in the classification of their clients, including the number of retail clients electing to be treated as professional.

3. IT Audit.

The MFSA is also considering the introduction of a requirement for investment firms whose business model involves the distribution of CFDs and/or Rolling Spot Forex Contracts to submit to the Authority, on an annual basis an audit of the IT systems used. Further details on this requirement will be issued by the MFSA in due course.

4. Conclusion

The attached policy, updating that of the 30 July 2015, stating the revised requirements are to be adhered to by firms. This will come into effect within six (6) months from today. It is the intention of the Authority to incorporate the requirements of the aforementioned policy in its Rules, in due course.

Contacts

Any queries or requests for clarifications in respect of the above should be addressed by email on communications@mfsa.com.mt.

Communications Unit
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