ABU DHABI GLOBAL MARKET
سوق أبوظبي العالمي

CONSULTATION PAPER
NO. 5 OF 2022

PROPOSALS FOR DEALING IN OTC LEVERAGED PRODUCTS IN RELATION TO RETAIL CLIENTS

26 SEPTEMBER 2022

TABLE OF CONTENTS

ADGM Authorities Building, ADGM Square, Al Maryah Island, PO Box 111999, Abu Dhabi, UAE
مبنى سلطات سوق أبوظبي العالمي، مربعة سوق أبوظبي العالمي، جزيرة الماريه، ص ب 111999، أبوظبي، الإمارات العربية المتحدة

T +971 2 333 8888 adgm.com

Introduction

Why are we issuing this paper?

1. The Financial Services Regulatory Authority ("FSRA") of Abu Dhabi Global Market ("ADGM") has issued this consultation paper to seek views on proposed amendments to the Conduct of Business Rules ("COBS"), the Prudential – Investment, Insurance Intermediation and Banking Rules ("PRU") and those relating to fees ("FEES") for Authorised Persons. The amendments to the COBS, PRU and FEES Rulebooks proposed within this paper include a formalisation, through Rulebook provisions, of currently existing conditions placed on the licences of Authorised Persons offering over-the-counter leveraged products ("OTC Leveraged Products") to Retail Clients. In addition, we are proposing further regulatory enhancements that have been benchmarked against standards established by peer regulators and international standard-setting bodies.

2. Unless otherwise defined, capitalised terms used in this paper have the meanings attributed to them in the Financial Services and Markets Regulations 2015 ("FSMR") or the Glossary Rulebook ("GLO").

Who should read this paper?

3. This Consultation Paper should be of particular interest to all entities in ADGM offering OTC Leveraged Products to Retail Clients, and also to potential entrants to this area.

How to provide comments

4. All comments should be made in writing and sent to the address or the email address specified below. If sending your comments by email, please use the Consultation Paper number in the subject line. If relevant, please identify the organisation you represent when providing your comments. The FSRA reserves the right to publish, including on its website, any comments you provide, unless you expressly request otherwise at the time of submitting those comments. Comments supported by reasoning and evidence will be given more weight by the FSRA.

What happens next?

5. The deadline for providing comments on the proposed framework is 28 October 2022. After receiving comments, we shall consider whether any modifications are required to the proposals and the Board of ADGM and the FSRA will then proceed to enact the proposals in their final form as rules and associated guidance. You should not act on these proposals until final rules and guidance are issued by the FSRA, at which time we shall issue a notice on our website.

ADGM Authorities Building, ADGM Square, Al Maryah Island, PO Box 111999, Abu Dhabi, UAE
مبنى سلطات سوق أبوظبي العالمي، مربعة سوق أبوظبي العالمي، جزيرة الماريه، ص ب 111999، أبوظبي، الإمارات العربية المتحدة

T +971 2 333 8888 adgm.com

Comments to be addressed to:

Consultation Paper No. 5 of 2022
Abu Dhabi Global Market
ADGM Square
Al Maryah Island
PO Box 111999
Abu Dhabi, UAE
Email: consultation@adgm.com

Background

1. Firms authorised in ADGM to offer OTC Leveraged Products to Retail Clients are currently subject to more than twenty specific license conditions, imposed by the FSRA through the Financial Services Permissions ("FSP conditions") of those firms. The conditions are stringent and aimed at providing robust protection for Retail Clients as the risk of using such products has the potential to result in substantial losses. Alongside existing FSP holders in this area, there has been continued interest from firms wishing to offer OTC Leveraged Products to Retail Clients and we now wish to formalise the conditions, as explicit Rulebook provisions, that both groups will have to meet as authorised entities.

2. Our proposals are also aligned with international best practices from peer regulators and international standard-setting bodies. In particular, our proposals take into consideration the findings from a survey undertaken in 2016[1] and the resulting recommendations published in 2018[2] by the International Organization of Securities Commissions ("IOSCO") in relation to retail OTC Leveraged Products, covering products comprising (i) rolling-spot forex contracts, (ii) contracts for differences and (iii) binary options. The risks to Retail Clients have been further highlighted by IOSCO members in two recently published consultation reports in the areas of "Retail Distribution and Digitalisation"[3] and "Retail Market Conduct"[4].

3. Currently, the FSP conditions cover, amongst other requirements: limitations on the types of products that may be offered by such firms; an increased Base Capital Requirement, enhanced margin requirements; the risk disclosures that must be made by the firms to Retail Clients; product governance and appropriateness requirements; prohibitions on specified promotions; and caps on the maximum losses that might be incurred by those clients (i.e. so-called "negative balance protection").

4. For example, in respect of enhanced margin requirements, an Authorised Person must require a Retail Client to have initially posted minimum margin of the following proportion of the value of the exposure of the Retail Client:

   - 3.33% for major currency pairs and relevant sovereign debt;
   - 5% for non-major currency pairs, gold and major equity indices;
   - 10% for commodities, excluding gold, and non-major equity indices;
   - 20% for individual equities; or
   - 50% for Virtual Assets.

[1] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD550.pdf
[2] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD613.pdf
[3] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD695.pdf
[4] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD698.pdf

ADGM Authorities Building, ADGM Square, Al Maryah Island, PO Box 111999, Abu Dhabi, UAE
مبنى سلطات سوق أبوظبي العالمي، مربعة سوق أبوظبي العالمي، جزيرة الماريه، ص ب 111999، أبوظبي، الإمارات العربية المتحدة
T +971 2 333 8888 adgm.com

5. We are proposing that the current FSP conditions, and a small number of additional conditions outlined below, be incorporated into Rules and associated Rulebook guidance in a new chapter 23 of COBS ("COBS 23", see Appendix 1), and that the increased Base Capital Requirement is reflected in PRU (see Appendix 2).

Topic	Proposed	Rationale
Definition of "OTC Leveraged Products"	GLO	To clarify scope of instruments falling within scope of COBS 23
Margin close-out requirements for Retail Clients	COBS 23.7.1	To provide greater detail on closure of client's open positions
Prohibition on referrals by unregulated Persons	COBS 23.10.2 and 23.10.3	To prevent mass marketing to potential Retail Clients outside the target market and thereby reduce the risk of mis-selling
Prohibition on funding account through a credit card or a third-party credit facility	COBS 23.12.3	To reinforce the appropriateness assessment requiring the Retail Client to have "liquid financial resources sufficient to absorb potential losses resulting from trading in OTC Leveraged Products" (COBS 23.5.1(b))

Definition of "OTC Leveraged Products"

6. The proposed definition of OTC Leveraged Products explicitly encompasses the first two product groups addressed by IOSCO (i.e. rolling-spot forex contracts and contracts for differences), but omits explicit mention of binary options. However, we are proposing that the offering or sale of binary options and analogous products to Retail Clients should be prohibited under proposed COBS 23.12.1, which will also include analogous products. This mirrors the approach taken by the Financial Conduct Authority in the UK, which issued an explicit ban in April 2019 on the sale, distribution and marketing of binary options to retail clients.

Question 1

Do you agree with the proposed definition of "OTC Leveraged Products", given the prohibition on the offering or sale of binary options and analogous products to Retail Clients proposed in COBS 23.12.1?

Additional requirement and prohibitions

7. The proposed requirement under COBS 23.7, relating to the available margin that triggers close-out of a Retail Client's open position(s), is derived from the IOSCO recommendations. It is designed to protect Retail Clients as they do not have the knowledge, experience and ability to take prompt action to limit losses resulting from adverse market movements relating to the class of underlying assets, particularly given the high leverage involved in such products. This is a common feature employed across the benchmarked jurisdictions.

Question 2

In the proposed COBS 23.7 is the figure of 50% of the margin requirement appropriate?

8. The FSRA proposes prohibiting Authorised Persons from accepting referrals of Retail Clients from unregulated third parties, e.g. call centres, for reward. The FSRA considers such a prohibition to be appropriate as the practices of those parties encouraging Retail Clients to invest in OTC Leveraged Products may be opaque to an Authorised Person. The use of such third parties might see them identify an inappropriate target market, alongside the possibility of inducements being offered to potential clients to invest in OTC Leveraged Products, neither of which practices may be detected by Authorised Persons; again, this is a measure referenced by IOSCO in its final report from 2018.

Question 3

Should Authorised Persons offering OTC Leveraged Products be allowed to accept referrals, for reward, from unregulated third parties of Retail Clients seeking those products?

9. The proposed prohibition on Retail Clients funding their accounts using credit cards and/or credit facilities, is designed to work alongside the existing FSP condition on account appropriateness, the latter being proposed as COBS 23.5.1. This requires the Authorised Person 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. Using a credit card or credit facility to fund an account used for trading in OTC Leveraged Products may encourage Retail Clients to make speculative investments in these products with money they do not possess, and thereby increase the client's future debt burden. Some jurisdictions have adopted this prudent approach in terms of protecting Retail Clients from further excessive losses.

ADGM Authorities Building, ADGM Square, Al Maryah Island, PO Box 111999, Abu Dhabi, UAE
مبنى سلطات سوق أبوظبي العالمي، مربعة سوق أبوظبي العالمي، جزيرة الماريه، ص ب 111999، أبوظبي، الإمارات العربية المتحدة
T +971 2 333 8888 adgm.com

Question 4
Should Retail Clients be allowed to fund their accounts using credit cards and/or credit facilities?

Transition period

10. For existing FSP holders in this area at the time that the proposals are implemented, we propose granting a six-month transition period in relation to their meeting of the proposed introduction of margin close-out requirements and the prohibitions on referrals by unregulated third-parties and the use of credit cards and/or credit facilities.

Question 5
Do you believe that a six-month transition period for to enable existing FSP holders to meet the additional requirement and prohibitions, if they are introduced, is appropriate?

11. Amendments are also proposed for the FEES Rulebook (see Appendix 3) to reflect that authorising firms wishing to offer those products and subsequently supervising them is more resource-intensive for the FSRA than for other firms that offer more traditional products. The application fee and annual supervision fee for these firms are each set at US$40,000 to reflect this and these fees are reflected in the existing FSP conditions.

Proposed Supplementary Guidance

12. Alongside the material proposed for the Rulebooks, we propose to issue supplementary, non-Rulebook guidance (see Attachment 1) that will aid potential applicants in understanding our expectations in relation to the experience and qualifications of individuals proposed for senior positions and further operational considerations.

Question 6
Do you believe that the proposed Supplementary Guidance covers all areas relevant to firms offering or selling OTC Leveraged Products to Retail Clients or should it be expanded? If it should be expanded, which areas should be covered?

ADGM Authorities Building, ADGM Square, Al Maryah Island, PO Box 111999, Abu Dhabi, UAE
مبنى سلطات سوق أبوظبي العالمي، مربعة سوق أبوظبي العالمي، جزيرة الماريه، ص ب 111999، أبوظبي، الإمارات العربية المتحدة

T +971 2 333 8888 adgm.com

Appendices and Attachment

- Appendix 1: Proposed amendments to COBS
- Appendix 2: Proposed amendments to PRU
- Appendix 3: Proposed amendments to FEES
- Appendix 4: Proposed amendments to GLO
- Attachment 1: Proposed Supplementary Guidance – "*Regulatory Framework for Authorised Persons dealing in OTC Leveraged Products for Retail Clients*"

ADGM Authorities Building, ADGM Square, Al Maryah Island, PO Box 111999, Abu Dhabi, UAE
مبنى سلطات سوق أبوظبي العالمي، مربعة سوق أبوظبي العالمي، جزيرة الماريه، ص ب 111999، أبوظبي، الإمارات العربية المتحدة
T +971 2 333 8888 **adgm.com**