

CP (2015-03)

**Consultation Paper of the Cyprus Securities and Exchange Commission
regarding a proposed circular about trading benefits**

In the context of establishing effective arrangements and procedures for consultation with market participants regarding proposed changes in the regulatory framework, the Cyprus Securities and Exchange Commission ('the CySEC') is circulating this document for consultation.

CySEC has prepared this circular in order:

1. to bring to the attention of the Cyprus Investments Firms ('the CIFs') particular practices followed by CIFs when granting trading benefits, which do not seem to fall under the spirit and the letter of the Investment Services and Activities and Regulated Markets Law, and
2. to clarify the practices CySEC expects the CIFs to abide by.

The proposed circular is attached as **Appendix 1**.

The CySEC invites you to submit your comments/suggestions, in word format, by Tuesday March 10, 2015 to the electronic address supervision@cysec.gov.cy.

FROM : Cyprus Investments Firms
TO : Cyprus Securities and Exchange Commission
DATE : XX
CIRCULAR NO : Cxx
SUBJECT : Granting trading benefits to clients

Following Circular with number CI144-2014-02 on granting trading benefits to clients, the Cyprus Securities and Exchange Commission (the "CySEC") wishes to inform the Cyprus Investment Firms ('CIFs') the following:

1. It has been observed that CIFs are granting trading benefits (eg gift, bonus) to their clients under conditions and are following such practices, which do not seem to be consistent with the spirit and the letter of the Investment Services and Activities and Regulated Markets Law of 2007, as in force ("the Law") and the Directive DI144-2007-02 of 2012 for the professional competence of Investment Firms ('the Directive').

In particular, these conditions and practices do not seem to be consistent with:

- i. Section 36 of the Law (Conduct of business obligations when providing services to clients).
 - ii. The provisions of the Directive.
2. Examples of conditions / practices that do not seem to fall within the spirit and the letter of Section 36(1) of the Law and the Directive, which are not exhaustive, are:
 - i. No explanation or insufficient explanation of the conditions of the trading benefit to the client in a clear and understandable way

It has been observed that the conditions of the trading benefit are not explained, or are not sufficiently explained, to the client with a clear and understandable way.

Before the granting of a trading benefit, the conditions of it must be explained to the client in a clear and understandable way, using, *inter alia*, simple examples, so that the client is able to make investment decisions based on accurate and adequate information. The same applies in case an additional trading benefit is granted.

The CIF must, before granting a trading benefit, assess the client, especially in case of a retail client, and evaluate whether he is aware and fully understands the conditions of the trading benefit. If not, the CIF must warn about and consider not granting such a trading benefit to the client.

In case the CIF chooses to have standardized processes in place to inform its clients about the conditions of the trading benefit, it cannot simply use this process as a self-assessment exercise performed by the client and the obligation of CIF to undertake the assessment remains. For example, a long and complicated explanation of the conditions of the trading benefit, followed by a 'tick box' that the client has understood them, is unlikely to indicate clearly that the client has indeed understands the conditions.

ii. Granting trading benefits, and / or granting additional trading benefits, without client's consent

It has been observed in some cases that the trading benefit is granted without the consent of the client. The same is followed in the case of the granting of an additional trading benefit.

The CIF must always obtain the written consent of the client, before granting any trading benefit, including the granting of an additional trading benefit, regardless of whether the client had initially consented.

The acceptance by default of the trading benefit cannot be considered as consent of the client.

iii. Different treatment of profit and loss resulting from transactions

It has been observed that a different treatment of profit and loss resulting from transactions is followed when a client makes a request for withdrawal of funds before reaching the minimum trading volume within the specified time limit laid down in the conditions of the trading benefit.

In particular, it has been observed that profits are canceled, either in their entirety or in part, without taking into account that all or part of the profits have arisen from the funds of the client. Unlike in the case of losses, these are attributed to the client.

As profits/losses come from transactions made by the client himself, all profits and losses, whether related to client's funds or to trading benefit, are awarded to the client.

iv. Setting short timeframe for fulfilling the conditions of the trading benefit

It is observed that the time limit set for the fulfillment of the conditions of the trading benefit is too small to achieve these. Therefore, there is pressure/incentive for clients to carry out a large number of transactions in a short period of time in order to fulfill the conditions of the trading benefit.

In case of setting a time frame, this must be reasonable under the circumstances and commensurate with the capability to fulfill the requirements of the trading benefit.

v. No segregation of funds – trading benefit

It has been observed that sometimes in the client's account there is not a clear segregation between the outstanding balance available for withdrawal and the amount corresponding to the trading benefit, so the client does not know, at all times, the available for withdrawal, balance.

The client must, at all times, know the balance of his account which is available for withdrawal.

Regarding the trading benefit, if it is not available for withdrawal before fulfilling the conditions, it must be shown separately in the client's account, as well as the expiration date of each trading benefit. It is provided that the balance of each trading benefit is deleted from the client's account immediately after its expiration.

vi. Modification of the conditions of the trading benefit without the consent of the client

It has been observed that the conditions of the trading benefit are modified without the consent of the client.

In case of modifying the conditions of the trading benefit, the CIF must inform its clients to whom a trading benefit has been granted and obtain their consent in advance. In the absence of consent, the CIF must give its clients the right to remain under the existing conditions. If this is not possible, the CIF must give its clients the right to withdraw the benefit without any cost and without to be considered that the conditions of the trading benefit are not fulfilled.

vii. High charges in case of withdrawal of funds before fulfilling the conditions

It has been observed that high charges are set in the event of withdrawal of funds before fulfilling the conditions.

The CIF must not impose any charges to clients when the latter ask withdrawal of his funds, including all profits derived from his transactions.

3. The CIF must maintain in each client's records all the evidence supporting the implementation of the above.
4. The CySEC considers that the above mentioned conditions/practices, and/or similar to those, do not deemed to be consistent with the spirit and the letter of the Law and the Directive.

The CySEC pays particular attention to investors' protection and the professional competence of CIFs and therefore, it will deplete its rigor regarding sanctions when it identifies such attitudes as the above.