

**TO** : **Cyprus Investment Firms**

**FROM** : **Cyprus Securities and Exchange Commission**

**DATE** : **07 July 2020**

**CIRCULAR No** : **C398**

**SUBJECT** : **Thematic review on the inactivity fees charged by Cyprus Investment Firms**

---

The Cyprus Securities and Exchange Commission ('CySEC') has carried out a review of the circumstances that are considered by Cyprus Investment Firms (the 'CIFs') when applying inactivity fees to clients ('the Review') to ensure compliance with the provisions of Article 25(1) of the Investment Services and Activities and Regulated Markets Law ('the Law').

The Review included also an assessment of the ex-ante information disclosed by CIFs to potential clients or clients regarding inactive clients and/or clients' trading accounts and the relevant fees in order to ensure compliance with the provisions of paragraphs (3)(a) and 4(a) of Article 25 of the Law.

The Review has shown that almost all CIFs that apply inactivity fees, have set out the circumstances under which a client and/or his trading account may be considered as inactive. Additionally, the Review has indicated that a number of CIFs has taken steps to ensure that the ex-ante disclosures made to potential clients or clients regarding the inactivity fees are fair, clear and not misleading and, are provided in good time. However, the Review also uncovered several areas of concern that CySEC wishes to highlight to all CIFs, despite the fact that the Review covered only a sample of CIFs.

This Circular sets out CySEC's key findings and requests all CIFs to consider whether they comply with their obligations as per paragraphs 1, (3)(a) and 4(a) of Article 25 of the Law when applying inactivity fees, and, where appropriate, to take corrective measures.

#### **A. Relevant Regulatory Framework**

The applicable regulatory framework with regard to the Review is annexed to this document.

## **B. Objective of the Review – Sample reviewed**

1. The objective of the Review was to assess the degree of CIFs' compliance with the provisions of paragraphs 1, 3(a) and 4(a) of Article 25 of the Law when applying an inactivity fee.
2. Characteristics of the sample reviewed:
  - i. A sample of 35<sup>1</sup> CIFs were reviewed.
  - ii. The CIFs reviewed were mostly providers of CFDs.
  - iii. The CIFs sample was selected based on both the size of the CIF's client base and the CIF's risk.
  - iv. The Review was carried out through a blend of desk-based analysis based on information provided by the CIFs to CySEC, as well as information provided by CIFs to potential clients or clients via their websites. This information included data relating to the amount of inactivity fees and a description of the circumstances that should take place for such a fee to apply.
  - v. The reference period for the information provided by CIFs to CySEC was July 2019 – November 2019.

## **C. KEY FINDINGS**

### Inactivity fee circumstances

3. Almost all CIFs that apply an inactivity fee had included in the ex-ante disclosures to clients or potential clients the circumstances and the parameters under which a trading account and/or client is considered inactive. However, from the Review the following weaknesses have been identified:
  - i. Several CIFs did not provide adequate information about the circumstances under which a client and/or a client's trading account is considered inactive/dormant. For example, the information found on the Terms and Conditions and/or Client Agreements section/tap of the websites of some CIFs, included references only to the charge of an inactivity fee when the client's trading account is inactive/dormant, without giving further explanation of the circumstances and the parameters under which a trading account is considered as such. A large number of CIFs had informed potential clients or clients that a trading account is considered inactive when there is no "trading activity", but did not expressly state what constitutes 'activity'.
  - ii. When assessing the trading activity of a client's trading account, a small number of CIFs linked this activity to the number of trades executed, not the act of trading itself. For example, a client's trading account was deemed as inactive if the number of trades within a period of 60 days was less than 5 trades per month.

---

<sup>1</sup> Only 3 out of the 35 CIFs selected did not apply an inactivity fee.

- iii. A limited number of CIFs linked “Know-Your-Client” (KYC) documentation requirements with the circumstances under which a client’s trading account was considered inactive. For example, one CIF stated that in the event that KYC documents expired and the client failed to provide updated KYC documents, then his/her account would be considered inactive. In addition, a practice was identified whereby a CIF stated in its Terms & Conditions that in the event of a client deposit not being verified within a timeframe of 15 days, or he/she failed to provide all the information required by the CIF, the CIF could charge an inactivity fee.

#### Size of inactivity fees

4. With regard to the size of the inactivity fees applied by the CIFs to all types of clients, it was observed that in general the CIFs did not clarify the quantitative and qualitative factors (e.g. maintenance/administrative costs) taken into consideration for calculating the size of the inactivity fee. It was further identified that a small number of CIFs applied excessively high inactivity fees (e.g. €100 or more) on a monthly basis, without providing sound reasoning for the imposition of such a fee, nor adequate explanation for its calculation.
5. Taking into consideration the nature of inactivity fees, the factors that may be considered for charging such fees and the size of CIFs, the following results raised concerns:
  - i. For several CIFs, the amount received from inactivity fees for the six-month period from July 2019 to November 2019 was excessively high, ranging from €1 million to €1,4 million.
  - ii. For a number of CIFs, the amount received from inactivity fees for the six-month period from July 2019 to November 2019 seemed to represent a significant proportion of revenue<sup>2</sup> generated for a six-month period, in limited cases as high as 18% - 31%.
6. A small number of CIFs had charged inactivity fees retroactively. This meant clients were charged at the start of the period over which no activity was identified in the client’s trading account, and not after the period that had to pass for the client, and/or his trading account, to be considered inactive.

#### Ex-ante disclosure of inactivity fees

7. Almost all CIFs had included, either in the Terms and Conditions or the Client’s Agreement, the circumstances under which a client and/or his trading account is considered inactive, as well as the size of the relevant fee. However, it was identified that for several CIFs, this information was not easily accessible on their websites by the potential clients or clients.

---

<sup>2</sup> The revenue from the CIFs audited financial statements for 2018 was used and it was assumed that this was evenly spread over the months of a calendar year.

8. A limited number of CIFs had included unclear and conflicting statements in their Terms and Conditions when describing the circumstances under which a client's trading account was considered inactive. For example, one CIF stated in its Terms and Conditions that the term "Inactive Account" meant: (a) if the client did not deposit funds into his/her account and did not log into his/her account for a period of at least 120 days; and (b) if the client did not deposit funds into his/her account and did not log into his/her account for a period of at least 12 months.
9. A very limited number of CIFs did not disclose the amount of the inactivity fee to the clients either in their documents uploaded on their websites or on their dedicated link for costs and charges.
10. The majority of CIFs failed to disclose to potential clients or clients whether the client would be informed when they and/or their trading accounts were categorized 'inactive', and if the client would be informed before the first inactivity fee is charged to his/her account.

#### **D. Good practices**

11. The following practices were identified that were seen as good examples for the CIFs' application of inactivity fee:
  - i. clients were considered inactive when no login was detected on the clients' accounts for a period of at least 12 months.
  - ii. the time period over which a client's account was considered inactive was set to 12, or more, consecutive months and the size of the relevant inactivity fee was low e.g. €5 – €10 per month;
  - iii. inactivity fees increased over time (e.g. different inactivity fees applied during the first year of being inactive, the second year, etc.) but overall remained relatively low over time;
  - iv. where a client had more than 1 trading accounts and at least one of his trading accounts was active, then no inactivity fee applied even where one or more of the client's trading accounts was deemed inactive;

#### **E. Next Steps**

All CIFs should consider the issues raised in this circular against their policies and arrangements in place in relation to their application of the inactivity fee as well as to the relevant disclosures made to potential clients or clients. If, when reviewing the policies and arrangements in place, CIFs identify any weaknesses - they must take immediate actions to ensure compliance.

In the context of its ongoing supervision monitoring and given the above key findings, CySEC will continue the assessment of the CIFs' policies and arrangements relating to the inactivity fees and will consider, if deemed necessary, taking further actions (e.g. enforcement investigations). Up to today, the CySEC Board has decided to call upon a

CIF to submit its written representations for the possible violation of Article 25(1) of the Law due to the unfair size of inactivity fees applied to its clients.

Yours sincerely,

Demetra Kalogerou  
Chairman, Cyprus Securities and Exchange Commission

## Annex

### Applicable Regulatory Framework

1. Article 25(1) of the Law states that:

*“(1) A CIF must, act honestly, fairly and professionally when providing investment services, or, where appropriate, ancillary services, to clients, in accordance with the best interests of its clients, and comply, in particular, with the principles set out in section 26.”*

2. Article 25(3)(a) of the Law states that:

*“(3) CIFs must ensure that:  
(a) all information, including marketing communications, addressed to clients or potential clients are fair, clear and not misleading...”*

3. Article 25(4)(a) of the Law states that:

*“(4)(a) A CIF ensures that appropriate information is provided in good time to clients or potential clients with regard to the CIF and its services, the financial instruments and proposed investment strategies, execution venues and all costs and related charges...”*