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Dear Chief Executive,

Our Contracts for Difference (CFD) strategy

This letter sets out our views on the key risks arising from CFD providers, what we think drives those risks, and summarises the FCA's intended areas of supervisory focus over the next two-year cycle. We expect you and your Board to discuss the contents of this letter, consider how the risks highlighted apply to your business and ensure you manage them effectively, taking action as necessary. Firms, and where applicable their wider 'groups', which fail to appropriately address these key risks can expect us to take swift and assertive action.

The CFD providers portfolio

The criteria for inclusion in this portfolio are that your firm/'group' predominantly deals with 'natural persons' (potentially both 'Retail' and 'Professional' client type) *and* generates a significant percentage of its total revenue from CFDs. For these purposes, 'group' means not only formal/legal groups but looser and less formal groups, e.g. where firms are connected through the same Ultimate Beneficial Owner. This letter uses CFDs as a generic term to reference not just actual Contracts for Difference, but also Spread Bets and Rolling Spot Forex.

The portfolio primarily consists of CFD 'providers' trading as principal to their clients at firm or 'group' level but also contains a small number of 'distributor' firms acting as introducers to providers which might also provide ancillary services. It includes substantial providers offering CFDs based on a broad range of underlying markets including single stocks, and a number of smaller firms primarily focused on CFDs with FX as the underlying. Given the range of firms' product offerings and business models, the issues raised in this letter need to be considered in context and may not all be relevant to your firm.

A major focus of our previous CFD strategy was mitigating the key risks arising from former-passporting EEA firms. None of the 100 CFD firms from EEA countries that entered the UK's temporary permissions regime (TPR) in January 2021 have obtained permanent authorisation within our regime, and we have already increased our focus on UK firms.

What our CFD provider strategy will focus on

Our strategy for the next two-year cycle aims to build on previous work and further reduce the potential harm CFDs present when marketed inappropriately or with inadequate controls. While we will remain agile in our response to new emerging issues over the period, our current planned proactive work is as follows:

1. Consumer Duty

With the Consumer Duty now in force for all open and closed products and services, we expect firms to be able to evidence that they are delivering good outcomes for retail consumers and are complying with all rules.

CFD firms should particularly focus on ensuring that:

- they only target consumers who are able to absorb losses, given the high percentage of consumers who lose money trading CFDs;
- consumers fully understand and accept the risks they face trading CFDs;
- consumers are not inappropriately opted-up to 'elective professional' status and, where firms do opt-up, those consumers have fully understood the regulatory protections they will have lost; and
- vulnerable consumers are identified and well-supported, given the potentially addictive nature of some types of CFD trading.

We will continue to test the embedding of the Consumer Duty in our firm-specific work. We also plan to conduct a multi-firm review focusing on the Duty's 'price and value' outcome and draw your attention to our publication which will assist firms with fair value assessments.

Our review will consider whether firms are able to demonstrate consideration and delivery of fair value in areas including spreads, overnight funding charges and commissions (where applicable). Any firm-specific concerns identified will be addressed using the full range of regulatory tools available to us. We anticipate publishing our general findings, including examples of good and poor practice. Extensive FCA Consumer Duty resources are available here.

2. Market integrity - 'market abuse'

CFDs remain a high-risk product for financial crime, as evidenced by the high number of Suspicious Transaction and Order Reports (STORs) reported by firms in the portfolio. Most STORs received relate to potential insider dealing activity, involving lone individuals or Organised Criminal Gangs (OCGs) potentially routing suspicious trades through mule accounts. As explained in our recently-published Market Watch 80, some firms have unwittingly facilitated further suspicious trading for previously off-boarded clients who route trades through 'Obfuscated Overseas Aggregated Accounts'. In addition to insider dealing, we also see CFDs used for market spoofing activity such as narrowing the spread on an illiquid stock. We have seen this done via copy trading, with multiple accounts copying the master account initiating the activity. Firms should consider this when designing their surveillance arrangements and parameters.

We will continue to act assertively against perpetrators of market abuse and ensure firms have robust systems in place to identify and report trade activity of concern. This will include work designed to improve the identification of market abuse in the portfolio. Our firm-specific targeted reviews of surveillance arrangements will continue, and we will also focus on transaction reporting. Firms should monitor relevant updates in Market Watch and we will consider further market abuse specific round tables as necessary.

3. Reducing harm from firm failure

No firm in this portfolio is too big to fail, but we want any failure to be orderly, with minimum impact on consumers. To this end, we focus both on the adequacy of firms' capital and liquidity and the arrangements for holding client funds deposited to support trade activity, whether in client money segregated accounts or under Title Transfer Collateral Arrangements (TTCA).

Capital and liquidity

The introduction of the Investment Firms Prudential Regime (IFPR) in January 2022 means that all firms in the portfolio should have reviewed and updated their capital and liquidity requirements through their Internal Capital Adequacy and Risk Assessment (ICARA). While all firms are subject to appropriate routine scrutiny, we will continue to prioritise firms that hold the bulk of client money and assets.

We will continue to assess firms' implementation of IFPR, using regulatory returns and targeted data requests to identify outliers, and will act where we identify prudential weaknesses or misreporting. We will also oversee the progress of smaller firms on their MIFIDPRU capital glide paths and take action where firms have inadequate plans to increase capital in line with minimum glide path expectations. We will also act where we identify material weaknesses in firms' consideration of their capital and liquidity needs; this may include the setting of Individual Capital Guidance ('ICG') and Individual Liquidity Guidance ('ILG') and Board effectiveness reviews.

During our recent work on firms with deficient liquidity risk management frameworks, we identified inadequate consideration and quantification of liquidity risks and a failure to implement dynamic forward-looking daily stress testing. This means some firms are failing to capture the next day's business-as-usual and stressed liquidity requirements, such as margin calls and rapid client money outflows. Such inadequacies resulted in underestimated Liquid Assets Threshold Requirements ('LATR'). Liquidity risks are exacerbated when firms' business models are dependent on TTCA funding and/or where firms do not promptly return excess TTCA funds.

Client assets

In parallel with our prudential focus, firms' client assets arrangements remain a priority. We will continue to follow-up with firms that have potential weaknesses to ensure the appropriate segregation of retail consumers' client money, which is critically important when firms fail.

We have identified that around 40% of firms in the portfolio hold 'professional' client money under TTCAs. We are concerned about potential over-reliance on TTCA monies to fund hedges in a manner which is non-compliant and/or creates counterparty risk that is not properly considered in the firm's ICARA. This concern is exacerbated when Retail clients are opted-up to Professional client status inappropriately, signed up simultaneously for TTCA, and/or high percentages of their funds are placed with offshore counterparties which may be connected 'group' entities. We have seen two recent firm failures that led to shortfalls in TTCA funds held, and one of these had all funds placed with an offshore counterparty. Firms should ensure they are not using TTCAs/opting up clients in a way that breaches or circumvents FCA Rules. Where we identify these kinds of arrangements, we will closely scrutinise all aspects of the use of TTCA, including the client journey relating to both opt-up and TTCA agreements.

Our July 2020 Dear CEO Letter on inappropriate use of TTCAs is relevant to CFD firms. Common errors include holding money or assets under TTCA without considering client obligations, holding all of a client's money or assets under TTCA without an obligation to the firm, and inappropriate arrangements for the prompt return of collateral to clients, or to segregate it as required by CASS. Our concerns extend to firms which are not permitted to safeguard and administer investments and to those which are prevented from holding client money.

4. 'Halo' firms

Around 20% of firms in the portfolio appear to be conducting little or no activity, and thus not using their permissions enough to justify continued authorisation. Some of these firms appear to exist purely to provide an FCA 'halo' to wider 'groups'. This gives false comfort to global retail clients who see the FCA association but contract with an offshore 'group' entity rather than the UK authorised firm, without UK regulatory protection. Where we identify UK firms that do not conduct material regulated activity, we will continue to invite them to cancel their permissions and robustly challenge them on their future plans where they do not accept this invitation.

More generally, we continue to maintain a strong gateway to all entry routes into the CFD portfolio, including changes-in-control ('CiC'). This has resulted in multiple withdrawals of CiC applications on largely inactive 'halo' firms, where we are concerned that potentially unscrupulous actors may be seeking to acquire a UK firm to give customers of overseas 'groups' false comfort that they are protected by UK regulation. In some cases, we have seen multiple CiC applications on the same firm. We regard a CiC on a regulated firm which is making little or no use of its permissions to be little different to a new authorisation application and will closely scrutinise CiC notifications bearing these characteristics. We will also use the next regulatory cycle to challenge 'halo' firms still in the portfolio and expect them either to apply to cancel their authorisation or to demonstrate, with a credible business plan containing realistic revenue projections, that they are ready, willing and organised to start meaningful regulated activity.

Related to this, we will continue to scrutinise loss-making, largely inactive firms that meet minimum prudential requirements via 'last minute' injections of funds from controllers and consider whether this amounts to renting an FCA 'halo'.

5. Diversification

A small number of firms in the portfolio have diversified their product offerings in recent years. Typically, these firms have moved into stocks, often including fractional shares, as part of moves to provide lower minimum-account-size access to investment markets. The take-on rate of new less-financially-experienced retail clients has, in some cases, significantly changed the profile of these firms.

While we welcome competition and innovation that leads to appropriately marketed and priced investment opportunities for retail consumers, we note that many of these new customers have been younger investors with lower levels of financial literacy and resilience. We become concerned where we see inappropriate marketing of 'zero commission' without transparency on other costs, the use of 'gamification' and/ or other digital engagement practices to encourage short term speculative trading, and/ or inadequate consideration of Consumer Duty obligations, including those under the 'price and value' outcome when firms/'groups' internalise pricing of client trades.

Prudential risks increase and more capital and liquidity are generally needed where firms expand rapidly, by growing customer numbers and/or adding a diverse range of additional features such as stock lending, Investment and Cash ISA wrappers, stock options and high interest rates on cash ISAs and uninvested cash in Investment ISAs. Where the pace of expansion of client take-on and product diversification is not matched by commensurate increases in firms' financial and non-financial resources, this can lead to excessive risks of consumer harm in the event of firm failure, particularly when consumers are not aware that a product or offering is not, or may not be, covered by the Financial Services Compensation Scheme (e.g. some e-money accounts). We will, therefore, continue to ensure that fast-growing firms hold adequate capital and liquidity. We will also monitor whether such firms' wider systems and controls are commensurate with growth or anticipated growth.

We are also exploring the business models of a sample of firms – not just CFD providers - that use mobile apps to facilitate trading by retail clients. As explained in a recent Press Release, that work is ongoing, with further communications on findings to follow in due course.

6. Distributors and Appointed Representatives (ARs)

Our previous work on Distributors and ARs and an accompanying Dear CEO Letter published in 2018 led to a significant off-boarding or deregistering of Distributors by CFD providers and of ARs by Principal firms. Since then, we have focused on the inappropriate use of ARs, and intervention action resulted in the deregistration of most of the small number remaining in the portfolio. We also continue to focus on Distributors, with four firms cancelled in the last year.

However, we are concerned that some of the remaining Distributor firms may either be 'halo' firms, or not sufficiently adding value to justify consumers' additional costs when accessing CFDs through them. We will, therefore, conduct deep-dive business model analysis on all remaining Distributors to identify those not meaningfully using their Permissions or delivering good consumer outcomes, and we will act to mitigate material risks identified.

We remind CFD providers/Principal firms of their responsibilities to conduct adequate due diligence and provide oversight, at both onboarding and periodically, of their Distributors and/or ARs. This must include a focus on how they are meeting relevant Consumer Duty obligations.

7. Operational Resilience and Outsourcing

CFD firms' business models are highly dependent on stable and resilient IT platforms and are especially vulnerable to operational weaknesses that fail to mitigate the impact of cyberattacks and customer volume spikes. We, therefore, remind relevant firms of their obligations to ensure operational resilience, in order to minimise preventable harm to consumers and markets. Firms not formally in scope for PS 21/3 are encouraged to consider it as good practice.

Some firms in the portfolio rely heavily on outsourcing arrangements both with third-party providers and/or other 'group' affiliates. Firms are reminded of their responsibilities to conduct adequate due diligence and oversight of all outsourced operations. We expect ICARA processes and documentation to reflect adequately the additional complexities of outsourcing arrangements (see FG 20/1). Firms should also assess the adequacy of financial resources to mitigate operational resilience/outsourcing risks and ensure wind-down plans sufficiently address outsourcing complications (see Wind-down Planning Guide).

Next steps

As CEO, the Senior Managers and Certification Regime makes you responsible for ensuring that relevant staff at your firm understand our rules and principles for businesses, and for ensuring that your firm complies with them. If your firm is not meeting those rules and standards, you must notify the FCA immediately, setting out what is being done to remedy any breaches. By 31 January 2025, we expect all CEOs of CFD firms to have discussed this letter with their fellow directors and/or Board and to have agreed next steps.

If you have any queries about this letter, please contact our Supervision Hub on 0300 500 0597. This is the primary contact for your firm's day-to-day interactions with the FCA. Further details of how we can be reached are available on our website at https://www.fca.org.uk/contact. We recognise there may be occasions when your firm faces urgent issues of strategic importance. In such circumstances, please contact the CFD Supervision Team Manager: malcolm.peters@fca.org.uk.

Yours faithfully

Mark Francis - Interim Director, Wholesale Sell-Side