



For Public Consultation:

## **GUIDANCE NOTES ON ELECTIVE PROFESSIONAL CLIENT (RULE 25) OF THE CONTRACTS FOR DIFFERENCES RULES, 2020**

The Securities Commission of The Bahamas (the Commission), in its capacity as the regulator of investment funds, securities and the capital markets, has issued the Guidance Notes on Elective Professional Client (Rule 25) of the Contracts for Differences Rules, 2020, for public consultation.

The Guidance Notes may be found on the Commission's website: <http://www.scb.gov.bs/consultation.html>.

### **Summary**

The Guidance Notes are designed to assist Contracts For Differences registered firms comply with Rule 25 of the Contracts For Differences Rules, 2020. Rule 25 allows a non-accredited investor to elect to reclassify as an accredited investor.

### **Consultation Period**

The consultation period commences **Wednesday 4 November 2020** and ends on **Friday 13 November 2020**, during which time the Commission invites the public to share comments with regard to the Guidance Notes. Comments received within this period will be taken into account.

### **Comments**

Comments may be submitted via email to [info@scb.gov.bs](mailto:info@scb.gov.bs). Alternatively, comments may be submitted to:

The Executive Director  
Securities Commission of The Bahamas  
Poinciana House North Building  
2<sup>nd</sup> Floor, 31A East Bay Street  
P.O. Box N-8347  
Nassau, The Bahamas  
Tel: (242) 397-4100  
Fax: (242) 356-7300

**Securities Commission of The Bahamas  
Guidance Notes  
Contracts For Differences Rules, 2020  
Elective Professional Client – Guidance Notes (Rule 25)**

**I. Purpose**

The Securities Commission of The Bahamas (the “Commission”) issues these Guidance Notes to assist Contracts For Differences registered firms (“CFD firms”) in complying with Rule 25 - Elective Professional Client (“EPC”) of the Contracts For Differences Rules, 2020 (“CFD Rules”), which were adopted and officially gazetted in The Bahamas on 26 May, 2020.

**II. Summary of Rule 25**

Rule 25 allows a non-accredited investor to elect to reclassify as an accredited investor. The CFD firm must, however, conduct both a qualitative and quantitative assessment, that considers, among other things, whether the client possesses sufficient expertise, education and knowledge of contracts for differences and the nature of the other services or transactions offered by the CFD firm.

Pursuant to the functions of the Commission, as prescribed in section 12, Securities Industry Act, 2011, the Commission is of the view that to promote an understanding by the public and market participants in complying with rule 25 of the CFD Rules, the Commission should publicly issue guidance notes and explanations for review and public consultation.

In particular, the Commission should address the following:

- 1) The Commission’s expectations of CFD firms in complying with rule 25;
- 2) The composition of the Initial Assessment (qualitative and quantitative);
- 3) The definition of “significance” as it relates to trading size (quantitative);
- 4) The process by which CFD firms may obtain a written confirmation from a client; and
- 5) The process for reclassifying an investor from an EPC to a retail investor and vice versa.

**III. Recommended EPC Policy and Guidance Notes**

**Initial Assessment Expectations**

The Commission expects that rule 25 will require CFD firms to clearly distinguish between retail and non-retail investors and will require that CFD firms make its own initial assessment of the investor by obtaining the requisite investor due diligence information to support the classification. Additionally, unlike the Commission’s existing accredited investor definition<sup>1</sup>, which only considers the financial net

---

<sup>1</sup> Regulation 2 – Securities Industry Regulations, 2012.

## FOR CONSULTATION PURPOSES ONLY

worth of an investor, the Commission expects that CFD firms will assess an investor using both quantitative (financial/net worth thresholds) and qualitative (education/experience or trading experience) criteria.

Copies of all assessment documents, including scoring methodologies and results, should be stored in accordance with the Commission's record location retention requirements<sup>2</sup> and should be maintained in accordance with the client account opening form and documentation.<sup>3</sup> Initial assessment documents should be made available to the Commission either upon request, or during the course of a Commission examination.

### **Rule 25(1) EPC Status**

A change to EPC status is initiated solely at the request of the investor. The Commission expects that CFD firms will have remuneration policies that prioritize customer best interest, separate any conflict of interests and do not create incentives or pressures to recommend CFPs, especially when other products are available that may be more suitable for the investor. Additionally, CFD firms should not offer an inducement or incentive of any kind to cause an investor to reclassify to EPC status.

The Commission further expects that before deciding to accept a request for reclassification to an EPC, a CFD firm must take all reasonable steps to ensure that the investor requesting to be treated as an EPC satisfies the qualitative test and the relevant quantitative test.

An EPC is responsible for keeping the CFD firm informed about any change that could affect their current categorisation. However, the Commission expects that if a CFD firm becomes aware that an investor no longer fulfils the initial criteria that made the client eligible for categorisation as an EPC, then the CFD firm must take appropriate action. Where the appropriate action involves reclassification the investor as a retail investor, the CFD firm must notify the investor of the new classification.

Via written communication to, and without penalty from the CFD firm, either an accredited investor, or an EPC can, at any time, elect to be reclassified as a retail investor.

At least annually, a CFD firm should obtain updated information from an EPC to revalidate whether the EPC continues to meet the criteria for classification as an EPC.

### **Rule 25(1) Initial Assessment (Suitability)**

Irrespective of the classification of an investor as a retail or professional, CFD firms should have a comprehensive on-boarding process that includes providing the potential investor with the appropriate disclosures about the risks of all investment products offered.

CFD firms are required to act honestly, fairly and professionally and to take reasonable steps to manage or mitigate conflicts of interest through implementing appropriate procedures in the distribution of complex financial products, and where there exists a potential risk of damage to the investor's interest, the CFD firm should, where appropriate, be required to clearly disclose the risk.

In addition to the prescribed on-boarding process, investors that elect to be considered as an EPC are required to complete an assessment, specific to the particular services, products or transactions offered by the CFD firm, to determine whether they have a reasonable understanding of the firm's

---

<sup>2</sup> Regulation 20 – Securities Industry Regulations, 2012.

<sup>3</sup> Regulation 68 – Securities Industry Regulations, 2012.

## FOR CONSULTATION PURPOSES ONLY

products, transactions or services. The test should be sufficiently detailed and robust to provide reasonable assurance to the CFD firm about an investor's knowledge.

CFD firms that administer a suitability assessment to clients as part of the normal due diligence and Know Your Client ("KYC") procedures before taking on a client may elect to use the suitability assessment to satisfy rule 25, if the client subsequently elects to be treated as an EPC.

The Commission does not propose to mandate specific guidelines for the form, substance and structure of a firm's initial assessments and scoring methodologies. However, generally, firms should consider whether the assessment is fit for purpose and, at a minimum should consider and/or incorporate the following when creating an evergreen and appropriate initial assessment:

1. Are there a sufficient number of questions? (minimum 10)
2. Do the questions clearly relate to the features, risks, structures, initial and ongoing costs that are inherent to the business of the CFD firm?
3. Does the methodology or scoring system correctly take into account information collected from the investor?
4. Is the "pass" score a reasonable indicator of an investor's knowledge/expertise?
5. Did the investor complete the assessment without assistance?
6. Does the CFD firm frequently change the assessment questions?
7. Does the CFD firm allow sufficient time period to elapse prior to re-testing an investor? (minimum six months)

### **Rule 25(1) Applicability (Execution-only services)**

A CFD firm is not required to ask a potential client to provide information or assess appropriateness if the service only consists of execution and/or the reception and transmission of client orders.

### **Rule 25(1) Applicability (Technology and Platform-based services)**

Initial assessments are not exempt because of financial technology use. Further, online CFD firm's KYC process must amount to a meaningful discussion with the investor, even if that discussion is not in the form of a face-to-face conversation and must comply with the Commission's prescribed requirements.<sup>4</sup> Additionally, systems should prompt investors to update their personal information online, at least annually, and more often if there has been a material change in their circumstances.

### **Rule 25(2)(a) EPC criteria**

In addition to successfully completing the initial assessment, an investor that elects to be treated as an EPC must comply with two of three prescribed criteria. This guideline provides the Commission's expectations regarding the assessment of the significance of a transaction (Criteria one).

An investor must demonstrate that over the past four quarters, he/she has engaged in transactions of a significant size. The investor is required to provide confirmation to the CFD firm and CFD firms are required to undertake reasonable steps to confirm that the investor has conducted significant transactions, at an average frequency of ten transactions per quarter over the previous four quarters.

Regarding the 'significance' test, though there is no one size fits all to determine whether a transaction is significant to an investor, generally, the Commission's guidance is that a significant transaction is

---

<sup>4</sup> Regulation 67 – Securities Industry Regulations, 2012.

## FOR CONSULTATION PURPOSES ONLY

one that involves a minimum of 6% real value (not nominal) of the investor's net worth. For the avoidance of any doubt, each transaction must involve a minimum of 6% real value (not nominal) of the investor's net worth.

### **Rule 25(3)(b) Warning of loss of protection**

CFD firms are required to inform an EPC that as a result of electing professional client classification, they will lose certain protections afforded to retail investors. Additionally, at a minimum, an EPC must be informed of the following loss of protections:

**Financial Disclosures on Promotions** – the CFD firm will not be obliged to comply with the Commission's rules relating to restrictions on, and the required contents of, offering financial promotions. Promotions directed at professional clients are simply subject to the highest level requirements in that they are fair, clear and not misleading.

**Risk Warnings** - the CFD firm will not be required to provide an EPC with the written risk warnings and notice required for retail investors in relation to transactions in complex financial products, in particular derivatives and warrants.

**Appropriateness** - the CFD firm may have regard to your expertise as an EPC when complying with the requirement to ensure that transactions are appropriate.

**Disclosure of information** – the CFD firm will not be required to disclose in writing before conducting any designated business on an EPC's behalf the basis or amount of charges for conducting that business (for example on costs, commissions, fees and charges, foreign exchange conversion rates and information on managing investments), or the amount of remuneration or commission or other income payable to the CFD firm or any of its affiliates for conducting the regulated business.

### **Rule 25 Written confirmation**

Written confirmation may include a letter or any form of electronic confirmation, such as that obtained via the investor's registered email address or client portal, provided that such confirmation is appropriately recorded in the CFD firm's systems, or any other form of communication as may be prescribed by the Commission.

## **IV. Conclusion**

If you have any questions or comments concerning the above guidance notes, then please email us at [info@scb.gov.bs](mailto:info@scb.gov.bs), or contact the Registered Firms Unit, Supervision Department at 397-4100.