



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

I. Purpose

Pursuant to the functions of the Securities Commission of The Bahamas (the “Commission”) as prescribed in section 12, Securities Industry Act, 2011, the Commission issues these Guidance Notes to assist Contracts For Differences registered firms (“CFD firms”), market participants, and the public, in understanding and 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 experience, expertise, education and knowledge of contracts for differences and the nature of the services or transactions offered.

Scope

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

Application of rule 25 requires CFD firms – (i) to clearly distinguish between retail and non-retail investors; and (ii) to make their own initial assessment of the investor by obtaining the requisite

investor due diligence information to support the classification.¹ For EPC classification, section 25 also requires that CFD firms assess an investor using both quantitative (financial/net worth thresholds) and qualitative (education/experience or trading experience) criteria. In making the quantitative assessment a CFD firm may rely on their client's self-certification as evidence of compliance with the criteria.

Copies of all assessment documents, including scoring methodologies and results, should be stored in accordance with the Commission's record retention requirements³ and should be maintained in accordance with the client account opening form and documentation requirements.⁴ 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 should be initiated solely at the request of the investor. The Commission expects that CFD firms will have remuneration policies that prioritize customer best interest 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 encourage an investor to reclassify to EPC status.

The Commission further expects that before deciding to accept a client request for reclassification to an EPC, a CFD firm will take all reasonable steps to ensure that the investor requesting to be treated as an EPC satisfies the requisite qualitative and quantitative criteria referred to in rule 25(2).

An EPC is responsible for keeping the CFD firm informed about any change that could affect their categorisation as an EPC. Where a CFD firm becomes aware that an investor no longer fulfils the criteria for categorisation as an EPC, the Commission expects that within a reasonable time, the CFD firm will take appropriate action (i.e. reclassification, termination of account, etc). Where the appropriate action involves reclassifying the investor as a retail investor, the CFD firm must by written communication notify the investor of the new classification.

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

A CFD firm should obtain updated information from an EPC, at least annually, to confirm 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 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 policies and procedures in the distribution of complex financial products. The relevant policies and procedures should provide

¹ Regulations 67 – 69, Securities Industry Regulations, 2012.

³ Regulation 20 – Securities Industry Regulations, 2012.

⁴ Regulation 68 – Securities Industry Regulations, 2012.

that where there are potential risks of damage to the investor's interest, the CFD firm is 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 an adequate understanding of the firm's products, transactions or services. The assessment 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 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 from the CFD firm or any of its employees?
6. Does the CFD firm review and update the assessment questions periodically (for example, annually)?
7. Does the CFD have policies for reassessment of an investor and/or allowing a sufficient time period to elapse prior to reassessment of an investor?

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

CFD firms that either operate exclusively on digital platforms, or utilize financial technology to conduct their initial on-boarding process are not exempt from the Commission's initial assessment expectations. Further, online CFD firms' 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.⁵ Additionally, CFD firms should implement reasonable measures to 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).

⁵ Regulation 67 – Securities Industry Regulations, 2012.

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. Determination of the significance of the transaction should take account of:

1. The client's net worth in relation to the size of the transaction;
2. The size of the transaction compared with the usual size of transaction conducted by the client; and
3. Any other reasonable considerations the CFD firm considers relevant.

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

In cases where an EPC will lose certain protections afforded to retail clients, CFD firms are required to inform EPCs that as a result of electing professional client classification, they will lose such 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 required by the Commission.

IV. Conclusion

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

Published: 2 February 2021