



ESMA agrees on product intervention measures in relation to CFDs and binary options offered to retail investors. June 2018.

Article 40 of Regulation (EU) 600/2014 of the European Parliament and of the Council, of 15 May 2014, on markets in financial instruments (known as MiFIR), which came into force on January 3 of this year, grants the European Securities and Markets Authority (ESMA) temporary intervention powers. These powers allow ESMA under certain conditions to temporarily prohibit or restrict in the European Union (EU) the marketing, distribution or sale of certain financial instruments or financial instruments with certain specific features, or a type of financial activity or practice.

Among the conditions to be met for ESMA to take a decision in this respect is that the proposed measure must address a significant investor protection concern.

In line with the foregoing, on 23 March ESMA agreed to adopt certain temporary intervention measures for a period of three months relating to the marketing, distribution and sale of binary options and contracts for differences (CFD) to retail investors. These measures will come into force one month and two months respectively after their publication in the Official Journal of the European Union.

A **contract for differences (CFD)** is one in which an investor and a financial institution agree to exchange the difference between the purchase price and the sale price of an underlying asset (marketable securities, indices, currencies, interest rates or other financial assets). It is a product which may be leveraged and carry a high risk, and may give rise to losses greater than the capital initially invested.

Meanwhile, **binary options** enable investors to obtain a fixed, predetermined pay-out if an underlying asset meets certain predetermined conditions, normally in a certain period of time. One usual form of binary option consists of receiving a fixed payment if the price of the underlying asset (an exchange rate, a share, or a commodity) reaches a specified level. If it fails to reach that level the investor loses all the money invested.

CFDs have existed for years in some jurisdictions, although they have been marketed as a short-term speculative investment product aimed at certain niches of specific clients. However, in recent years, they have been marketed on a far greater scale to retail clients due, among other reasons, to the current environment of low interest rates, which encourages clients to look for new products with **more attractive returns than traditional products, and also due to the aggressive forms of marketing** developed by many of the platforms marketing them (often online). Something similar has happened with the marketing and distribution of binary options, where studies show that, on average, retail investors tend to lose money. Furthermore binary options do not provide investors with any clear investment purpose (for example, to hedge the risk of a portfolio of shares or other products).

These products are **not suitable for retail investors due to their complexity and lack of transparency**. Among other factors, CFDs tend to have excessive leverage while binary options have a structurally negative expected return and an embedded conflict of interest between providers and their clients. Furthermore, both share features that accentuate their unsuitability for retail investors, such as the disparity between the expected return and the risk of loss, and issues related to their marketing and distribution.

The analyses performed by several NCAs (National Competent Authorities) on CFD trading across different EU jurisdictions show that 74-89% of retail investment accounts typically lose money on their investments, with average losses per client ranging from €1,600 to €29,000. **In Spain**, according to figures from the latest CNMV survey, **in the period from 1 January 2015 to 30 September 2016, 82% of the clients who traded with CFDs suffered losses amounting to a total 142 million euros**, including associated costs and fees.

The first warnings from ESMA and some NCAs regarding these products date back to 2013. However, in recent

years concerns have heightened regarding the rapid growth in the EU of the marketing, distribution and sale of these products, and the risks for retail investors.

Consequently, in July 2015 it was decided to set up a joint working group, coordinated by ESMA, called the **CFD Task Force**, to address issues related to certain providers of CFDs and other speculative products to retail investors in various EU countries, and to supervise their provision to retail investors throughout the EU. In July 2016, ESMA decided to publish a new warning ([Warning about CFDs, binary options and other speculative products](#)) about trading in CFDs, binary options, and other speculative products.

In 2017, ESMA's and the NCAs' activity in this respect was stepped up. As a result of the work carried out by the CFD Task Force, ESMA published in March a Q&A document on the subject ([Questions and Answers. Relating to the provision of CFDs and other speculative products to retail investors under MiFID](#)). In June ESMA published a new statement ([Statement on preparatory work of the European Securities and Markets Authority in relation to CFDs, binary options and other speculative products](#)) announcing internal discussions on the possible use of its new MiFIR product intervention powers, since it considered that the initiatives adopted thus far had not succeeded in either reducing or controlling the risks arising from these products. In December of same year, ESMA published a new [statement](#) updating the one made in June, expressing again its intention to make use of its intervention powers and detailing the potential set of measures considered for adoption in relation to the marketing, distribution and sale of these speculative products. At the same time ESMA announced the launch of a public consultation on the content of those measures in January of 2018.

The consultation ([Call for evidence. Potential product intervention measures on contracts for differences and binary options to retail clients](#)) started on 18 January aiming at gathering information from interested parties on the impact of the potential measures proposed.

On conclusion of the consultation in February, after taking into account the various answers received and despite the different initiatives adopted to date, ESMA considered that the inherent risks associated with these products still represented a threat to investor protection in the EU. For this reason on 23 March, ESMA's Board of Supervisors finally approved the adoption of the aforementioned temporary intervention measures.

Temporary measures adopted for CFDs

In the case of CFDs and rolling spot forex contracts, ESMA establishes that, during the three months that the intervention measures are in force, the **marketing, distribution and sale of CFDs to retail investors will only be permitted provided that the following protections are provided:**

- **Leverage limits on the opening of a position set from 30:1 to 2:1, varying according to the volatility of the underlying asset**, as indicated below:
 - 30:1 for major currency pairs
 - 20:1 for non-major currency pairs, gold, and major equity indices
 - 10:1 for commodities other than gold and non-major equity indices
 - 5:1 for individual equities and any other reference values
 - 2:1 for cryptocurrencies

These leverage limits have been set so that retail investors in CFDs will face comparable levels of risk whatever the underlying asset. In particular, higher leverage will be permitted for CFDs on relatively stable assets (such as currencies or major stock market indices) whereas in the case of relatively volatile assets the permitted leverage level will be lower.

- The **obligation to close out positions on a per account basis at 50% of minimum required margin.**
- A **negative balance protection mechanism** on a per account basis
- A **prohibition of incentives from providers** of these products aimed at encouraging clients to trade more in them
- A **standardised warning of the level of losses incurred by the clients of each CFD provider.**

Measures adopted for binary options

With regard to binary options, **ESMA has prohibited the marketing, distribution and sale of binary options to retail investors for three months** from the date the measure comes into force. This covers **all types of binary options offered to retail investors.**

Despite the fact that in recent years a significant number of domestic level measures have been adopted in various countries in relation to binary options (for example, in Belgium, where the marketing of binary options has been prohibited since August 2016, or in France, where advertising binary options has been banned since January 2017), the **cross-border dimension of the services provided in relation to binary options and the need to ensure a minimum common level of investor protection throughout the EU** has prompted ESMA to make use of its intervention powers by temporarily prohibiting their marketing, distribution and sale to retail investors.

The measure is considered to be proportionate and necessary in view of the characteristics and inherent risks of these products and the serious harm they can cause to retail investors.

Entry into force of the measures and their duration

The measures must now be translated into all the official languages of the EU and published in the Official Journal of the EU. The measure relating to binary options will come into force one month after publication and the measure relating to CFDs two months after publication.

As stated earlier, the two measures **will last for three months and may be renewed on expiry**.

The measures are applicable to whoever markets, distributes or sells CFDs (whenever it does not provide the protections imposed) or binary options to retail investors in the EU, and to who requires an authorisation to do so in accordance with MiFID II provisions. This means that investment firms and credit institutions are also included.

Affected entities will have to comply with these measures from day one of their entry into force, and the NCAs will be responsible for ensuring compliance with them.

Link of interest:

[ESMA agrees to prohibit binary options and restrict the marketing, distribution and sale of CFDs to protect retail investors](#)