EUROPEAN SECURITIES AND MARKETS AUTHORITY DECISION (EU) 2018/1636

of 23 October 2018

renewing and amending the temporary restriction in Decision (EU) 2018/796 on the marketing, distribution or sale of contracts for differences to retail clients

THE EUROPEAN SECURITIES AND MARKETS AUTHORITY BOARD OF SUPERVISORS,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC ([1]), and in particular Articles 9(5), 43(2) and 44(1) thereof,

Having regard to Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 ([2]), and in particular Article 40 thereof,

Having regard to Commission Delegated Regulation (EU) 2017/567 of 18 May 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council with regard to definitions, transparency, portfolio compression and supervisory measures on product intervention and positions ([3]), and in particular Article 19 thereof,

Whereas:

(1) By its Decision (EU) 2018/796 ([4]), the European Securities and Markets Authority (ESMA) restricted the marketing, distribution or sale of contracts for differences (CFDs) to retail clients with effect from 1 August 2018 for a period of three months.

(2) In accordance with Article 40(6) of Regulation (EU) No 600/2014, ESMA must review a temporary product intervention measure at appropriate intervals and at least every three months.

(3) ESMA's review of the restriction on CFDs has been informed by, inter alia, a survey among national competent authorities ([5]) (NCAs) on the practical application and impact of the product intervention measure as well as additional information provided by NCAs and stakeholders.

(4) NCAs detected only limited examples of non-compliance with the ESMA product intervention measure, which mainly related to the risk warnings.

(5) NCAs reported an overall decrease in the number of CFD retail client accounts, trading volume and total retail client equity over the month of August 2018 in comparison with August 2017. The share of profitable retail client accounts decreased slightly, but this appears to be mainly arising from the soaring prices of cryptocurrencies in August 2017 ([6]). Comparing client outcomes over time is not only impacted by the product

([1]) OJ L 331, 15.12.2010, p. 84.
([2]) OJ L 173, 12.6.2014, p. 84.
([3]) OJ L 87, 31.3.2017, p. 90.
([4]) European Securities and Markets Authority Decision (EU) 2018/796 of 22 May 2018 to temporarily restrict contracts for differences in the Union in accordance with Article 40 of Regulation (EU) No 600/2014 of the European Parliament and of the Council (OJ L 136, 1.6.2018, p. 50).
([5]) 23 NCAs have responded: Financial Services and Markets Authority (BE – FSMA), Czech National Bank (CZ – CNB), Finanstilsynet (DK-Finanstilsynet), Bundesanstalt für Finanzdienstleistungsaufsicht (DE – BaFin), Central Bank of Ireland (IE – CBI), Ελληνική Επιτροπή Κεφαλαιαγοράς (EL-HCMC), Comisión Nacional del Mercado de Valores (ES – CNMV), Autorité des Marchés Financiers (FR – AMF), Commissione Nazionale per le Società e la Borsa (IT – Consob), Cyprus Securities and Exchange Commission (CY-CySEC), Finanšu un kapitāla tirgus komisija (LV — FKTK), Commission de Surveillance du Secteur Financier (LU – CSSF), Magyar Nemzeti Bank (HU – MNB), Malta Financial Services Authority (MT – MFSA), Autoriteit Financiële Markten (NL-AFM), Financial Market Authority (AT – FMA), Komisja Nadzoru Finansowego (PL — KNF), Comissão do Mercado de Valores Mobiliários (PT – CMVM), Romanian Financial Supervisory Authority (RO – FSA), Agencija za trg vrednostnih papirjev (SI — ATVP), Finnish Financial Supervisory Authority (FI – FSA), Financial Conduct Authority (UK- FCA), Fjármálaeftirlitið (IS — FME).
([6]) For example, for Bitcoins the percentage change in price from 31 July 2017 to 31 August 2017 was + 65,8 % in comparison to – 9,3 % over the same period in 2018 (Available at Coindesk.com – https://www.coindesk.com/).

intervention measures, but also for example by market conditions. Market conditions in August 2017 were bullish in comparison to August 2018. Furthermore, the population of retail clients changed ([1]). Finally, NCAs reported a decrease in the number of automatic close-outs and the occurrences that accounts went into negative equity ([2]).

(6) NCAs also reported an increase in the number of clients treated as professional clients on request over the month of August 2018 in comparison with August 2017. ESMA is aware that some CFD providers are advertising to retail clients the possibility of becoming professional clients on request. However, a retail client may request to be treated as a professional client when, in particular, the client submits a request in writing in accordance with all the requirements set out in the applicable legislation. Providers should ensure that they comply at all times with those requirements ([3]). ESMA is also aware that some third-country firms are actively approaching Union clients or that some CFD providers in the Union are marketing the possibility for retail clients to move their accounts to an intra-group third-country entity. However, without authorisation or registration in the Union, third-country firms are only allowed to offer services to clients established or situated in the Union at the client's own exclusive initiative. Finally, ESMA is aware that firms are starting to provide other speculative investment products. ESMA will continue to monitor the offer of these other products to determine whether any other Union measures are appropriate.

(7) During the review period, ESMA did not obtain evidence contradicting its overall finding of a significant investor protection concern identified in Decision (EU) 2018/796. ESMA has therefore concluded that the significant investor protection concern identified in Decision (EU) 2018/796 would persist if its decision to restrict the marketing, distribution or sale of CFDs to retail clients is not renewed.

(8) Since the adoption of that Decision, the applicable existing regulatory requirements under Union law have not changed and continue not to address the threat identified by ESMA. Furthermore, NCAs have not taken action to address the threat or the actions taken do not adequately address the threat. In particular, since the adoption of the Decision, no NCA has adopted its own national product intervention measure under Article 42 of Regulation (EU) No 600/2014 ([4]).

(9) The renewal of the restriction set out in Decision (EU) 2018/796 does not have a detrimental effect on the efficiency of financial markets or on investors that is disproportionate to the benefits of the action and does not create a risk of regulatory arbitrage for the same reasons set out in that Decision.

(10) If the temporary restriction is not renewed, ESMA considers it is likely that CFDs will again be offered without adequate measures to sufficiently protect retail clients against the risks related to those products that gave rise to the consumer detriment identified in Decision (EU) 2018/796.

(11) In view of these reasons, taken together with the reasons set out in Decision (EU) 2018/796, ESMA has decided to renew the restriction for a further three-month period to address the significant investor protection concern.

(12) In renewing the restriction, ESMA has carefully considered any new relevant information that has emerged during the review period. In this respect, ESMA obtained information that, in certain cases, CFD providers experience technical difficulties in using the abbreviated risk warning due to the character limits imposed by third party marketing providers for communications other than through a durable medium or a webpage. Therefore, a reduced character risk warning should be introduced in this renewal.

([1]) Also due to the re-categorisation of retail clients as professional clients on request or active retail clients that may have moved their account to third country providers.

([2]) In August 2018, the negative balance protection was in force. However, market gapping can lead to the client initially being closed out at a price that creates negative equity, with the account then re-credited back to zero equity by the provider to meet the new requirement of negative balance protection. This was also the case for those providers that offered negative balance protection in August 2017.

([3]) Annex II, Section II of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (OJ L 173, 12.6.2014, p. 349). See also Section 11 of ESMA's Questions and Answers on MiFID II and MiFIR investor protection and intermediaries topics (ESMA35-43-349), where ESMA has identified forms of practices that investment firms should not use when applying the legal requirements on the categorisation of clients as professionals on request. Section 11 was last updated on 25 May 2018.

([4]) On 4 June 2018, a competent authority of an EEA EFTA State, NO-Finanstilsynet, adopted national product intervention measures that have the same terms and dates of application of ESMA's measures.

(13) The reduced character risk warning is not intended to replace the abbreviated risk warning. The new warning is envisaged to be used only for cases where the third party relied on by a CFD provider to market the product imposes a character limit that is not compatible with the number of characters comprising the risk warnings.

(14) The reduced character risk warning provides retail clients with information on the percentage of CFD retail accounts losing money. However, in order to fully draw clients' attention to whether they can afford the high risk of losing their money when investing in CFDs, this renewal requires that any communication containing the reduced character risk warning also includes a direct link to a webpage of the CFD provider where the warning required for durable media or webpages is shown.

(15) As the proposed measures may, to a limited extent, relate to agricultural commodities derivatives, ESMA has consulted the public bodies competent for the oversight, administration and regulation of physical agricultural markets under Council Regulation (EC) No 1234/2007 ([1]). None of those bodies has raised any objections to the proposed renewal of the measures.

(16) ESMA has notified NCAs of the proposed renewal Decision,

HAS ADOPTED THIS DECISION:

Article 1

Definitions

For the purposes of this Decision:

(a) 'contract for differences' or 'CFD' means a derivative other than an option, future, swap or forward rate agreement, the purpose of which is to give the holder a long or short exposure to fluctuations in the price, level or value of an underlying, irrespective of whether it is traded on a trading venue, and that must be settled in cash or may be settled in cash at the option of one of the parties other than by reason of default or other termination event;

(b) 'excluded non-monetary benefit' means any non-monetary benefit other than, insofar as they relate to CFDs, information and research tools;

(c) 'initial margin' means any payment for the purpose of entering into a CFD, excluding commission, transaction fees and any other related costs;

(d) 'initial margin protection' means the initial margin determined by Annex I;

(e) 'margin close-out protection' means the closure of one or more of a retail client's open CFDs on terms most favourable to the client in accordance with Articles 24 and 27 of Directive 2014/65/EU when the sum of funds in the CFD trading account and the unrealised net profits of all open CFDs connected to that account falls to less than half of the total initial margin protection for all those open CFDs;

(f) 'negative balance protection' means the limit of a retail client's aggregate liability for all CFDs connected to a CFD trading account with a CFD provider to the funds in that CFD trading account.

Article 2

Temporary restriction on CFDs in respect of retail clients

The marketing, distribution or sale to retail clients of CFDs is restricted to circumstances where at least all of the following conditions are met:

(a) the CFD provider requires the retail client to pay the initial margin protection;

(b) the CFD provider provides the retail client with the margin close-out protection;

(c) the CFD provider provides the retail client with the negative balance protection;

([1]) Council Regulation (EC) No 1234/2007 of 22 October 2007 establishing a common organisation of agricultural markets and on specific provisions for certain agricultural products (Single CMO Regulation) (OJ L 299, 16.11.2007, p. 1).

(d) the CFD provider does not directly or indirectly provide the retail client with a payment, monetary or excluded non-monetary benefit in relation to the marketing, distribution or sale of a CFD, other than the realised profits on any CFD provided; and

(e) the CFD provider does not send directly or indirectly a communication to or publish information accessible by a retail client relating to the marketing, distribution or sale of a CFD unless it includes the appropriate risk warning specified by and complying with the conditions in Annex II.

Article 3

Prohibition of participating in circumvention activities

It shall be prohibited to participate, knowingly and intentionally, in activities the object or effect of which is to circumvent the requirements in Article 2, including by acting as a substitute for the CFD provider.

Article 4

Entry into force and application

This Decision enters into force on the day following that of its publication in the *Official Journal of the European Union*.

This Decision shall apply from 1 November 2018 for a period of 3 months.

Done at Paris, 23 October 2018.

For the Board of Supervisors

Steven MAIJOOR

The Chair

ANNEX I

INITIAL MARGIN PERCENTAGES BY TYPE OF UNDERLYING

(a) 3,33 % of the notional value of the CFD when the underlying currency pair is composed of any two of the following currencies: US dollar, Euro, Japanese yen, Pound sterling, Canadian dollar or Swiss franc;

(b) 5 % of the notional value of the CFD when the underlying index, currency pair or commodity is:

(i) any of the following equity indices: Financial Times Stock Exchange 100 (FTSE 100); Cotation Assistée en Continu 40 (CAC 40); Deutsche Bourse AG German Stock Index 30 (DAX30); Dow Jones Industrial Average (DJIA); Standard & Poors 500 (S&P 500); NASDAQ Composite Index (NASDAQ), NASDAQ 100 Index (NASDAQ 100); Nikkei Index (Nikkei 225); Standard & Poors/Australian Securities Exchange 200 (ASX 200); EURO STOXX 50 Index (EURO STOXX 50);

(ii) a currency pair composed of at least one currency that is not listed in point (a) above; or

(iii) gold;

(c) 10 % of the notional value of the CFD when the underlying commodity or equity index is a commodity or any equity index other than those listed in point (b) above;

(d) 50 % of the notional value of the CFD when the underlying is a cryptocurrency; or

(e) 20 % of the notional value of the CFD when the underlying is:

(i) a share; or

(ii) not otherwise listed in this Annex.

ANNEX II

RISK WARNINGS

SECTION A

Risk warning conditions

1. The risk warning shall be in a layout ensuring its prominence, in a font size at least equal to the predominant font size and in the same language as that used in the communication or published information.

2. If the communication or published information is in a durable medium or a webpage, the risk warning shall be in the format specified in Section B.

3. If the communication or published information is in a medium other than a durable medium or a webpage, the risk warning shall be in the format specified in Section C.

4. By way of derogation to paragraphs 2 and 3, if the number of characters contained in the risk warning in the format specified in Section B or C exceeds the character limit permitted in the standard terms of a third party marketing provider, the risk warning may instead be in the format specified in Section D.

5. If the risk warning in the format specified in Section D is used, the communication or published information shall also include a direct link to the webpage of the CFD provider containing the risk warning in the format specified in Section B.

6. The risk warning shall include an up-to-date provider-specific loss percentage based on a calculation of the percentage of CFD trading accounts provided to retail clients by the CFD provider that lost money. The calculation shall be performed every three months and cover the 12-month period preceding the date on which it is performed ('12-month calculation period'). For the purposes of the calculation:

   (a) an individual retail client CFD trading account shall be considered to have lost money if the sum of all realised and unrealised net profits on CFDs connected to the CFD trading account during the 12-month calculation period is negative;

   (b) any costs relating to the CFDs connected to the CFD trading account shall be included in the calculation, including all charges, fees and commissions;

   (c) the following items shall be excluded from the calculation:

      (i) any CFD trading account that did not have an open CFD connected to it within the calculation period;

      (ii) any profits or losses from products other than CFDs connected to the CFD trading account;

      (iii) any deposits or withdrawals of funds from the CFD trading account.

7. By way of derogation from paragraphs 2 to 6, if in the last 12-month calculation period a CFD provider has not provided an open CFD connected to a retail client CFD trading account, that CFD provider shall use the standard risk warning in the format specified in Sections E to G, as appropriate.

SECTION B

Durable medium and webpage provider-specific risk warning

CFDs are complex instruments and come with a high risk of losing money rapidly due to leverage.

[*insert percentage per provider*] % of retail investor accounts lose money when trading CFDs with this provider.

You should consider whether you understand how CFDs work and whether you can afford to take the high risk of losing your money.

SECTION C

Abbreviated provider-specific risk warning

[*insert percentage per provider*] % of retail investor accounts lose money when trading CFDs with this provider.

You should consider whether you can afford to take the high risk of losing your money.

SECTION D

Reduced character provider-specific risk warning

[*insert percentage per provider*] % of retail CFD accounts lose money.

SECTION E

Durable medium and webpage standard risk warning

CFDs are complex instruments and come with a high risk of losing money rapidly due to leverage.

Between 74-89 % of retail investor accounts lose money when trading CFDs.

You should consider whether you understand how CFDs work and whether you can afford to take the high risk of losing your money.

SECTION F

Abbreviated standard risk warning

Between 74-89 % of retail investor accounts lose money when trading CFDs.

You should consider whether you can afford to take the high risk of losing your money.

SECTION G

Reduced character standard risk warning

74-89 % of retail CFD accounts lose money.