

## **OPINION OF THE EUROPEAN SECURITIES AND MARKETS AUTHORITY**

**of 24 June 2019**

### **on the product intervention measures relating to contracts for differences proposed by the Financial Conduct Authority of the United Kingdom**

Having regard to Article 43(2) of 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 <sup>(1)</sup>,

Having regard to Article 44(1) of 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 <sup>(2)</sup>,

THE EUROPEAN SECURITIES AND MARKETS AUTHORITY BOARD OF SUPERVISORS  
HAS ADOPTED THIS OPINION:

#### **1. Introduction and legal basis**

- (1) National competent authorities (NCAs) may take product intervention measures in accordance with Article 42 of Regulation (EU) No 600/2014. At least one month before a measure is intended to take effect, an NCA must notify all other NCAs and the European Securities and Markets Authority (ESMA) of the details of its proposed measure and the related evidence, unless there is an exceptional case where it is necessary to take urgent action.
- (2) In accordance with Article 43 of Regulation (EU) No 600/2014, ESMA performs a facilitation and coordination role in relation to such product intervention measures taken by NCAs. In particular, after receiving notification from an NCA of its proposed measure, ESMA must adopt an opinion on whether it is justified and proportionate. If ESMA considers that the taking of a measure by other NCAs is necessary, it must state this in its opinion.

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<sup>1</sup> 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 (OJ L 173, 12.6.2014, p. 84).

<sup>2</sup> 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 (OJ L 331, 15.12.2010, p. 84).

- (3) The Financial Conduct Authority of the United Kingdom (FCA) notified ESMA on 25 January 2019 of its intention to take product intervention measures under Article 42 of that Regulation (national measures). Upon request from ESMA, the FCA provided further information on the content of its notification.
- (4) The national measures consist of a permanent restriction on the marketing, distribution or sale to retail clients in or from the UK of contracts for differences (CFDs) as well as products referred to by the FCA as 'CFD-like options'.
- (5) ESMA has taken product intervention measures restricting the marketing, distribution or sale to retail clients of CFDs in Decisions (EU) 2018/796 <sup>(3)</sup>, (EU) 2018/1636 <sup>(4)</sup>, (EU) 2019/155 <sup>(5)</sup> and 2019/679 <sup>(6)</sup>.
- (6) The first of these Decisions took effect on 1 August 2018. 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. These measures have been amended once and renewed three times. If they are not renewed again, the currently applicable measures in ESMA's Decision (EU) 2019/679 (ESMA's measures) will automatically expire at the end of the day on 31 July 2019.
- (7) The FCA informed ESMA that the national measures are the same as ESMA's measures at national level, with the differences that the national measures would: (i) also capture products referred to by the FCA as 'CFD like-options', which are not included in ESMA's measures; (ii) set a leverage limit of 30:1 for CFDs and CFD-like options referencing certain government bonds <sup>(7)</sup>, instead of the 5:1 leverage limit provided for in ESMA's measures; (iii) include minor amendments to the initial margin protection requirement in ESMA's measures; (iv) include minor amendments to the risk warnings in ESMA's measures. The national measures are expected to take effect on 1 August 2019, except for the part of the measures concerning CFD-like options, which is expected to take effect on 1 September 2019 to allow CFD-like option providers sufficient time to prepare.
- (8) The FCA notified ESMA that it has complied with the conditions in Article 42 of Regulation (EU) No 600/2014, including that it has assessed the relevance of all the factors and

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<sup>3</sup> 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).

<sup>4</sup> 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 (OJ L 272, 31.10.2018, p. 62).

<sup>5</sup> European Securities and Markets Authority Decision (EU) 2019/155 of 23 January 2019 renewing the temporary restriction on the marketing, distribution or sale of contracts for differences to retail clients (OJ L 27, 31.1.2019, p. 36).

<sup>6</sup> European Securities and Markets Authority Decision (EU) 2019/679 of 17 April 2019 renewing the temporary restriction on the marketing, distribution or sale of contracts for differences to retail clients (OJ L 114, 30.4.2019, p. 22).

<sup>7</sup> A debt issuance, issued by or on behalf of (a) the government of the United Kingdom; (b) the Scottish Administration; (c) the Executive Committee of the Northern Ireland Assembly; (d) the National Assembly of Wales; (e) a Member State of the EU that has adopted the Euro as its currency; (f) the United States of America; (g) Japan; (h) Canada; or (i) Switzerland.

criteria listed in Article 21 of Commission Delegated Regulation (EU) 2017/567<sup>(8)</sup> and taken into consideration all those that are relevant. In particular, the FCA notified ESMA that it shares the reasoning given in ESMA's measures on the existence of a significant investor protection concern, as relevant to the UK and the conditions in Article 42 of Regulation (EU) No 600/2014. More specifically, the FCA indicated that it concluded that:

- (a) retail clients find it difficult to value CFDs accurately, given the impact of leverage and associated costs and charges;
  - (b) CFDs are sold with high leverage, which causes retail clients to suffer significant losses. For example, prior to ESMA's temporary measures, the FCA observed that, based on a study which it conducted in 2016 and 2017 within the population of firms offering CFDs under an advisory and discretionary managed account, 76% of retail clients lost money, experiencing an average loss of GBP 9 000. Furthermore, the FCA observed that, on average, a typical retail client investing under an advisory and discretionary managed account lost around GBP 4 100<sup>(9)</sup>;
  - (c) firms have sold CFDs outside their appropriate target market using aggressive marketing and distribution practices. For example, prior to ESMA's temporary measures, the FCA observed that, based on firm data received in Q1 2017, at some of the largest retail CFD providers in the UK (representing approximately 70% of the relevant UK market), approximately 50% of clients had failed the appropriateness test but continued to trade after receiving an enhanced risk warning<sup>(10)</sup>.
- (9) In respect of the CFD-like options which the national measures plan to capture, the FCA has observed that these are offered under a variety of labels, including 'turbo certificates', 'knock out options' and 'delta one options'. The national measures would define these products as options that meet the following cumulative conditions: (i) they are in the money at the point of sale; (ii) their value is determined by one-to-one fluctuations in the value or price of the underlying asset; and (iii) their value is not significantly affected by the time to expiry. The FCA informed ESMA that this definition was subject to public consultation in the UK<sup>11</sup> and confirmed that the intention of this definition is to capture financial instruments that provide the same payoff profile to the investor as a CFD.
- (10) Furthermore, the FCA informed ESMA that the proposed restrictions on CFD-like options would apply, in respect of the marketing of those products, to all providers marketing those products in or from the UK and, in respect of the sale and distribution of those products, to UK providers as well as UK branches and tied agents of providers authorised

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<sup>8</sup> 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 (OJ L 87, 31.3.2017, p. 90).

<sup>9</sup> See Recital 35(ix) of Decision (EU) 2018/796.

<sup>10</sup> See Recital 42 of Decision (EU) 2018/796.

<sup>11</sup> Consultation Paper (CP) 18/38, Appendix 1, Annex A.

in other Member States distributing or selling those products in or from the UK. The FCA considers that this would enable UK retail clients to continue to open accounts to trade unrestricted CFD-like options with product providers established in other Member States other than through a UK branch or tied agent, provided that such providers had not actively marketed the products in the UK.

- (11) The CFD-like options which the national measures would capture are not in scope of ESMA's measures. However, as noted in Recitals 10 and 145 of ESMA's Decision (EU) 2018/796, ESMA acknowledged that there are similarities between CFDs and these products, but the products also differ in various respects and that ESMA and NCAs would closely monitor whether detrimental consequences for retail clients would arise in respect of products which have similar or comparable features to CFDs. The FCA has observed that, despite little demand in the UK for CFD-like options, the client outcomes from trading these products are similar to those from trading CFDs. In particular, the FCA has observed that these products are priced in the same manner as CFDs and offered with high leverage, which lead to detrimental consequences for retail clients. Based on firm data, the FCA has found that 67% of retail clients lost money trading CFD-like options and the average outcome from trading was a loss of GBP 2 620.
- (12) Furthermore, the FCA has observed that three UK providers of CFDs started to offer products with similar features to CFDs to avoid the application of ESMA's temporary restrictions on CFDs. The FCA has also reported that UK providers of CFDs indicated that they would begin offering CFD-like options to circumvent the permanent restrictions on CFDs in the national measures. Also considering the size of the UK market, the FCA considers that not including CFD-like options in the national measures would significantly increase the risk of circumvention by these UK providers, giving an opening to offer, at high leverage limits, products with similar features to CFDs and which pose an inherent risk for retail investors.
- (13) With regard to the proposed leverage limit of 30:1 for CFDs referencing certain government bonds, the FCA has observed that these instruments are predominantly used by UK retail clients for hedging purposes. The FCA has received feedback from firms that indicated that UK retail clients have complained that the leverage limit of 5:1 in ESMA's measures is disproportionate given that the main government bonds are less volatile than most major FX pairs. The FCA observed that, although these specific CFDs were not a significant asset class, for one firm it constituted a significant portion of its business. The FCA indicated that it conducted a quantitative analysis which follows a methodology consistent with the approach taken by ESMA in setting leverage limits as part of its temporary measures, subject to available data. Based on this analysis the FCA proposed a 30:1 leverage limit for CFDs referencing certain government bonds. The FCA also indicated this limit would not exceed the highest of ESMA's leverage limits for other asset classes.
- (14) With regard to the proposed minor amendments to the initial margin protection requirement in ESMA's measures, the FCA's proposal amends the wording of the initial

margin protection requirement to expressly state that initial margin is to be calculated based on the exposure provided by the ultimate underlying of a CFD. The FCA has observed that some UK providers of CFDs attempted to avoid the application of the leverage limits in ESMA's measures by calculating the initial margin according to the value of the funds at risk.

- (15) Finally, in respect of the proposed amendments to the risk warnings in ESMA's measures, the national measures plan to amend the wording in the risk warnings to refer to CFDs and CFD-like options. Firms can exclude the reference to CFD-like options in case they do not offer those products to retail clients. Furthermore, the national measures plan to replace reference to the specific percentage range of retail client accounts that lose money in the standard risk warnings in ESMA's measures with a reference to, for the durable medium and webpage standard risk warning and the abbreviated standard risk warning, 'the vast majority of retail client accounts' and, for the reduced character standard risk warning, 'CFD-retail client accounts generally lose money'.
- (16) The FCA has observed that the percentages of loss-making CFD retail client accounts disclosed by UK providers through the provider-specific risk warnings in ESMA's measures have been both higher and lower than the percentage range in the standard risk warnings of ESMA's measures. Therefore, the FCA considers that such percentage range is not entirely appropriate for the UK. Furthermore, the FCA considers that, given the permanent nature of the national measures, an approach whereby it continuously updates the percentage range quarterly or annually would not provide a sufficient benefit to consumers in comparison to the generic wording selected.
- (17) The FCA shares the reasons given in ESMA's measures that the existing applicable regulatory requirements under Union law, which have not changed since the adoption of ESMA's measures, do not address the concern. The FCA also considers that improved supervision or enforcement of the existing requirements would not better address the concern identified. In particular, the FCA informed ESMA that it has taken into account the supervisory and enforcement experiences of other NCAs as referred to in ESMA's measures and that its supervisory practices take into account the relevant guidance provided by ESMA, including the 'Opinion on MiFID practices for firms selling complex products' <sup>(12)</sup>, the 'Opinion on structured complex products – good practices for product governance arrangements' <sup>(13)</sup> and the 'Joint Position of the European Supervisory Authorities on manufacturers' product oversight and governance processes' <sup>(14)</sup>. Nonetheless, the FCA considers that the significant investor protection concern continues to exist.
- (18) Moreover, the FCA shares the analysis on proportionality in ESMA's measures and, in particular, has concluded that the national measures are proportionate taking into

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<sup>12</sup> ESMA/2014/146.

<sup>13</sup> ESMA/2014/332.

<sup>14</sup> JC-2013-77.

account the nature of the risks identified, the level of sophistication of investors or market participants concerned and the likely effect of the action on investors and market participants. In the case of one-off costs, the FCA considers that, as the national measures are the same as ESMA's measures except for the differences described above, any one-off costs that may be incurred by product providers to comply with the national measures are likely to be minimal.

- (19) Furthermore, the FCA indicated that including CFD-like options in the national measures is proportionate, having regard to its national supervisory experience and the limited demand of such products from retail clients in the UK. The FCA estimated that the total trading volume of CFD-like options in the UK is less than GBP 230 million per year. There are only two UK firms providing these products, but both informed the FCA that CFD-like options are not a significant, material part of their business.
- (20) The FCA notified ESMA that it has consulted NCAs in three other Member States <sup>(15)</sup> that may be significantly affected by its national measures in relation to CFD-like options. The FCA received information from the AMF that it had received limited consumer complaints in respect of CFD-like options and that it considers that the features of those products, together with the fact that they are not aggressively marketed, significantly mitigate the risk of detriment to retail clients. Furthermore, the AMF informed the FCA that, in its view, the FCA should make further use of its existing supervisory and enforcement tools before restricting CFD-like options and that it is important to maintain a consistent approach across the Union. The FCA also received information from BaFin that it recognises the FCA's concerns regarding CFD-like options being offered to avoid the application of the restrictions on CFDs. However, BaFin informed the FCA that it does not have sufficient evidence of detriment to retail clients for these products to include them in its forthcoming national measures.
- (21) Following its consultation, the FCA expects that the costs for providers in these Member States are likely to be low. Despite the information provided by the AMF and BaFin, the FCA considers that the risks of consumer detriment related to CFD-like options, including the risk of those products being offered to avoid the application of the restrictions on CFDs, outweigh the benefits of permitting these products in the UK without any restriction. The FCA has also notified ESMA and the other NCAs of the national measures not less than one month before they are intended to take effect.
- (22) The FCA considers that the national measures do not pose a serious threat to the orderly functioning and integrity of the national physical agricultural market. In particular, the FCA considers that the national measures are the same as ESMA's measures, except for the differences described above, and that ESMA consulted the national public bodies competent for the oversight, administration and regulation of physical agricultural markets

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<sup>15</sup> Autorité des Marchés Financiers (AMF) in France; Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) in Germany and De Autoriteit Financiële Markten (AFM) in the Netherlands.

under Council Regulation (EC) No 1234/2007 <sup>(16)</sup>. None of those bodies raised any objections to ESMA's Decisions (EU) 2018/796, (EU) 2018/1636, (EU) 2019/155 or (EU) 2019/679.

## **2. Whether the national measures are justified and proportionate**

- (23) The significant investor protection concern raised by the offer of CFDs to retail clients led to the adoption of ESMA's Decisions (EU) 2018/796, (EU) 2018/1636, (EU) 2019/155 and (EU) 2019/679. However, ESMA's measures are temporary. According to the information provided by the FCA, the significant investor protection concern raised by these products continues to exist at national level and needs to be addressed on a longer-term basis to avoid the detrimental consequences that would arise from their unrestricted offer to retail clients. As the national measures are the same as ESMA's measures, except for the differences described above, ESMA has taken into account the reasons for ESMA's measures referred to by the FCA as well as the additional information and reasons given by the FCA.
- (24) Unlike ESMA's measures, the national measures would capture CFD-like options. In ESMA's measures, ESMA acknowledged that these products, despite differing in various respects from CFDs, also have similarities with CFDs and that ESMA and the NCAs would monitor whether detrimental consequences for retail clients similar to those observed in relation to CFDs would also arise in respect of products with similar or comparable features to CFDs. For the purposes of the national measures, ESMA has assessed the relevance of the FCA's supervisory experience, in particular the evidence concerning the significant losses of UK retail clients when trading CFD-like options and the likelihood of the circumvention of the restrictions on CFDs by UK product providers. In the light of these national specificities, ESMA considers that it is justified and proportionate for the national measures to include CFD-like options.
- (25) In relation to the planned application of the restrictions on CFD-like options to all providers marketing those products in or from the UK and to UK providers and UK branches of providers authorised in other Member States distributing or selling those products in or from the UK, ESMA considers that the proposed distinction does not adequately address the consumer detriment which the FCA has observed for UK retail clients in respect of CFD-like options. That is because the distinction would still permit UK retail clients to trade CFD-like options with providers established in other Member States and experience significant losses. In particular, the FCA has not adequately demonstrated that the fact that providers established in other Member States would not be able to market CFD-like options into the UK would be sufficient to adequately protect UK retail clients from the risk of detriment that the FCA has observed in respect of the trading of those products by UK retail clients. Therefore, ESMA considers that the restrictions on CFD-like option

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<sup>16</sup> 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).

providers should be applied equally to providers authorised in the UK as well as to providers authorised in other Member States. Therefore, the FCA's proposed application of the restrictions to CFD-like option providers authorised in other Member States only in respect of the marketing of CFD-like options, and not in respect of the sale or distribution of those products, is not justified and proportionate.

- (26) With regard to the proposed leverage limit of 30:1 for CFDs referencing certain government bonds, ESMA acknowledges that this proposal is based on quantitative analysis which follows a methodology consistent with the approach taken in ESMA's measures, subject to available data, and that 30:1 does not exceed the highest leverage limit for other asset classes in ESMA's measures, which may mitigate competition amongst providers that are subject to a stricter leverage limit. ESMA notes further that the FCA proposed introducing a new asset class (namely certain government bonds) for the purpose of leverage limits based on evidence from stakeholders regarding the UK retail market for CFDs.
- (27) However, in ESMA's view the proposed leverage limit for CFDs referencing certain government bonds is not justified and proportionate. The proposed leverage limit would result in divergence from the leverage limits applied by product providers subject to other national measures under Article 42 of Regulation (EU) No 600/2014 based on ESMA's measures. The asset classes identified in ESMA's measures were based on a balanced level of granularity. Furthermore the leverage limits in ESMA's measures were set taking into account available data, including from NCAs across the Union, and they represent a common basis for NCAs to take product intervention measures. Since the cross-border distribution of CFDs is common in this market and ESMA's opinion is that NCAs should adopt measures that are at least as stringent as ESMA's measures, allowing higher leverage limits for a new indicated asset class would result in divergence within the Union and potential regulatory arbitrage.
- (28) With regard to the proposed minor amendments to the initial margin protection requirement in ESMA's measures, ESMA considers these amendments to be consistent with its interpretation of the requirement. In particular, as clarified in Q&A 5.7 of ESMA's Q&A document on product intervention <sup>(17)</sup>, the initial margin has to be calculated on the basis of the exposure that a CFD provides, taking into account the value of the ultimate underlying. While ESMA considers that its measures, which have been used as the basis for the national measures of other NCAs, is sufficiently clear in this respect, ESMA acknowledges the FCA's supervisory experience of attempted circumvention by UK providers of the initial margin protection in ESMA's measures. For these reasons, ESMA considers that the FCA's proposed clarifications to the initial margin protection requirement in ESMA's measures are justified and proportionate.

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<sup>17</sup> Questions and Answers on ESMA's temporary product intervention measures on the marketing, distribution or sale of CFDs and Binary options to retail clients (ESMA35-36-1262).



- (29) Finally, in respect of the differences in the risk warnings between the national measures and ESMA's measures, ESMA considers that the proposed amendments to refer in the risk warnings also to CFD-like options is consistent with the FCA's proposed extension of the national measures also to CFD-like options.
- (30) In respect of the proposed amendments to the standard risk warnings, as noted in ESMA's Opinion on the proposed national measures relating to CFDs of the Financial Market Authority (FMA) of Austria <sup>(18)</sup>, ESMA considers that its measures have been used as the basis for the national measures of other NCAs. Therefore, ESMA considers that any differences in the national measures may lead to additional costs for CFD providers that would have to adjust the relevant risk warnings when offering CFDs in or from the UK. ESMA encourages NCAs to take measures that use a common Union risk warning to avoid such costs. Nonetheless, taking into account that the proposed risk warnings are substantially the same as those in ESMA's measures and that the standard risk warning is, in any event, only to be used in exceptional cases where a provider has not provided an open CFD connected to a retail client CFD trading account in the last 12-month calculation period, ESMA considers that the proposed risk warnings in the national measures sufficiently inform retail investors about the risks related to trading in CFDs. ESMA has also taken into account that the differences in the FCA's risk warnings are aligned with the differences in the FMA's risk warnings.

### **3. Whether the taking of a measure by other competent authorities is necessary**

- (31) For the reasons explained in ESMA's measures, the significant investor protection concern raised by the offer of CFDs to retail clients is a cross-border issue. As evidenced by practices to date, product providers are able to offer these products through online trading accounts and passport their services throughout the Union. To effectively address the significant investor protection concern and avoid the risk of regulatory arbitrage, it is essential that product providers cannot exploit differences in treatment by NCAs across Member States. On the expiry of ESMA's measures, product providers may again seek to offer such products in or from a Member State that has not taken a measure at least as stringent as ESMA's measures. Therefore, it is essential that NCAs take concerted action to address this risk.

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<sup>18</sup> Opinion of the European Securities and Markets Authority of 3 May 2019 on the product intervention measures relating to contracts for differences proposed by the Financial Market Authority of Austria (ESMA35-43-1906).

#### 4. Conclusion

(32) In conclusion, ESMA is of the opinion that:

- (a) the national measures are justified and proportionate except for:
  - (i) the FCA's proposal not to apply the national restrictions to CFD-like option providers authorised in other Member States other than through a UK branch or tied agent in respect of the sale or distribution of those products to UK retail clients; and
  - (ii) the FCA's proposal to apply a 30:1 leverage limit for CFDs referencing certain government bonds, instead of the 5:1 leverage limit in ESMA's measures; and
- (b) it is necessary for the NCAs of other Member States to take product intervention measures that are at least as stringent as ESMA's measures.

This opinion will be published on ESMA's website in accordance with Article 43(2) of Regulation (EU) No 600/2014.

Done at Paris, 24 June 2019

For the Board of Supervisors  
Steven Maijor  
The Chair