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ESMA Renews Intervention Measures which restrict the sale of CFDs

On 23 October 2018, the European Securities and Markets Authority ("**ESMA**") adopted a Decision under Article 40 of Regulation (EU) No 600/2014 ("**MiFIR**") to restrict the marketing, distribution or sale of contracts for differences ("**CFDs**") to retail clients, in effect since 1 August, from 1 November 2018 for a further three-month period. The Decision renews and amends ESMA Decision (EU) 2018/796.

Under MiFIR, ESMA can introduce temporary prohibitions or restrictions concerning certain financial instruments, financial activities or practices to address consumer protection measures in the EU.

The renewal was agreed by ESMA's Board of Supervisors on 26 September 2018 in response to investor protection concerns regarding the offer of CFDs to retail clients. CFDs have continued to attract regulatory scrutiny, both from ESMA and other regulatory bodies (incl. the Central Bank of Ireland).

CFDs are considered to give rise to significant investor protection concerns due to their complexity, lack of transparent information at the point of sale, risk of significant loss for investors and the deployment of aggressive marketing techniques by providers and distributors of the products.

What are CFDs?

CFDs are arrangements made in a futures contract whereby differences in settlement are made through cash payment, rather than by the delivery of physical goods or securities. CFDs are

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said to provide investors with the all the benefits and risks of owning a security without actually owning it.

ESMA has defined a CFD as *"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".*

Renewal of Restriction on CFDs

The Decision includes renewing the following:

1. Leverage limits on the opening of a position by a retail client from 30:1 to 2:1, which vary according to the volatility of the type of underlying:

    - 30:1 for major currency pairs;
    - 20:1 for non-major currency pairs, gold and major indices;
    - 10:1 for commodities other than gold and non-major equity indices;
    - 5:1 for individual equities and other reference values; or
    - 2:1 for cryptocurrencies.

2. A margin close out rule on a per account basis. This will standardise the percentage of margin (at 50% of minimum required margin) at which providers are required to close out one or more retail client's open CFDs;

3. Negative balance protection on a per account basis. This will provide an overall guaranteed limit on retail client losses;

4. A restriction on the incentives offered to trade CFDs; and

5. A standardised risk warning, including the percentage of losses on a CFD provider's retail investor accounts.

In addition to renewing the requirements set out in the original measures, ESMA has agreed to introduce the following reduced character risk warning:

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

This follows technical difficulties encountered by CFD providers in using the risk warnings due to the character limitations imposed by third party marketing providers.

The restrictions set out are directly applicable in EU Member States, and compliance will be supervised by national competent authorities. The Central Bank of Ireland in a press release published back in March 2018 welcomed the ESMA CFD measures and stated that *"the measures will provide greater investor protection across the EU by ensuring a common minimum level of protection for retail investors."*

Next Steps

On 31 October 2018, the Decision was published in the Official Journal of the EU started to apply from 1 November 2018 for a period of three months.

Under MiFIR, ESMA can only introduce the temporary intervention measures on a three month basis and has confirmed that it will consider, before expiry, the need to extend the intervention for a further three months.

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