



European Securities and
Markets Authority

Questions and Answers

On ESMA's temporary product intervention measures on the marketing, distribution or sale of CFDs and Binary options to retail clients

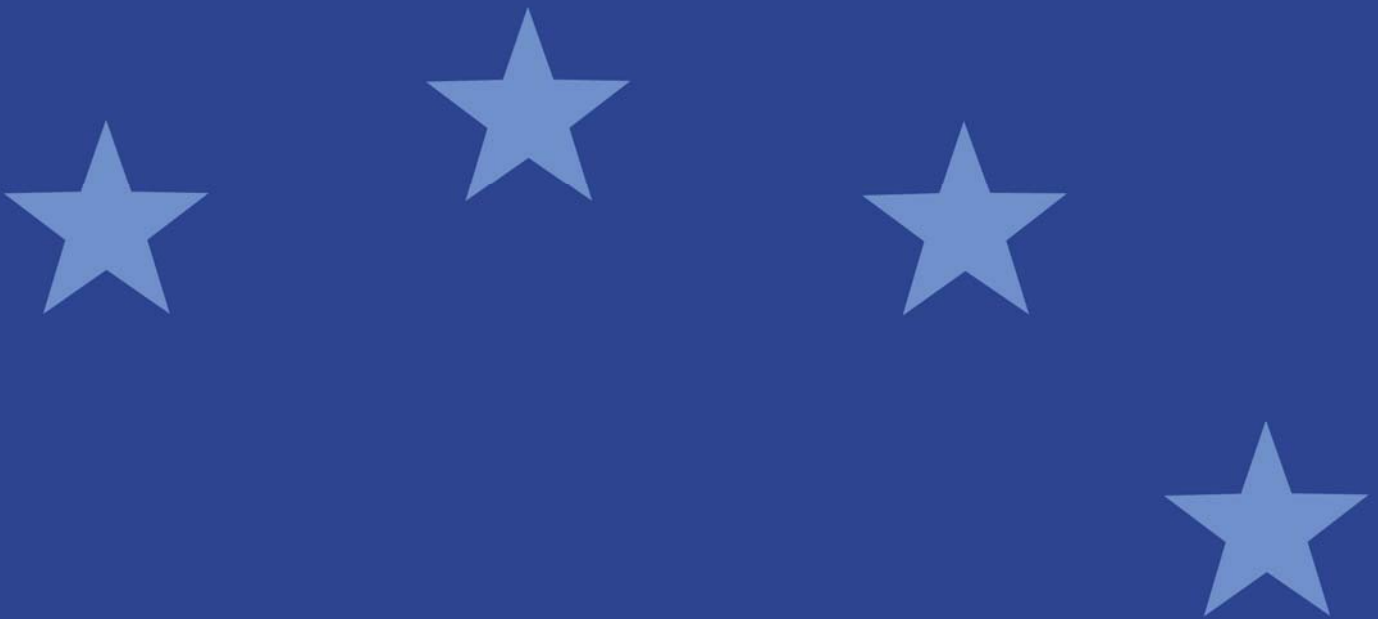


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1. Purpose and status

1. The purpose of this document is to promote common, uniform and consistent supervisory approaches and practices in the day-to-day application of ESMA's temporary product intervention measures on the marketing, distribution or sale of CFDs and binary options to retail clients. It does this by providing responses to questions asked by the public, financial market participants, competent authorities and other stakeholders. The question and answer (Q&A) tool is a practical convergence tool used to promote common supervisory approaches and practices under Article 29(2) of the ESMA Regulation. Further information on ESMA's Q&A process is available on our website.
2. ESMA intends to update this document on a regular basis and, for ease of reference, ESMA provides the date each question was first published as well as the date/s of amendment beside each question. A table of all questions in this document and dates is provided in Section 4.
3. Additional questions on ESMA's temporary product intervention measures on the marketing, distribution or sale of CFDs and binary options to retail clients may be submitted to ESMA through the Q&A tool on our website. Please see the guidance available on our website before submitting your question.

2. Legislative references and abbreviations

Legislative references

| | |
|------------------------|---|
| <i>ESMA Regulation</i> | 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 |
| <i>MiFID I</i> | Directive (EU) No 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC ² |
| <i>MiFID II</i> | Directive (EU) No 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 (recast) ³ |
| <i>MiFIR</i> | 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 ⁴ |

Abbreviations

| | |
|---------------------|--|
| <i>BO</i> | Binary Option |
| <i>BO Decision</i> | ESMA Decision 2018/795 to temporary prohibit the marketing, distribution or sale of binary options to retail clients. |
| <i>CFD</i> | Contracts for differences |
| <i>CFD Decision</i> | ESMA Decision 2018/796 to temporary restrict the marketing, distribution or sale of contracts for differences to retail clients. |

¹ OJ L 331, 15.12.2010, p. 84

² OJ L 145, 30.04.2004, p. 1

³ OJ L 173, 12.6.2014, p. 349

⁴ OJ L 173, 12.6.2014, p. 84



EU

European Union

ESMA

European Securities and Markets Authority

Q&A

Question and Answer

3. Background

On 22 May 2018, ESMA adopted two temporary product intervention decisions based on Article 40 of Regulation (EU) No 600/2014 (the Markets in Financial Instruments Regulation, MiFIR).

ESMA Decision 2018/795 provides for a temporary prohibition of the marketing, distribution or sale of binary options to retail clients. ESMA published a notice (ESMA35-42-1135) to this effect on its website on 1 June 2018. ESMA Decision 2018/795 will enter into application one (1) month after its publication in the Official Journal of the European Union.

ESMA Decision 2018/796 provides for restrictions in relation to marketing, distribution or sale of contracts for differences (CFDs) to retail clients. ESMA published a notice (ESMA35-42-1135) to this effect on its website on 1 June 2018. ESMA Decision 2018/796 will enter into application two (2) months after its publication in the Official Journal of the European Union.

4. Summary table

| Subject | Q | Topic of the Question | Decisions | Last updated |
|------------|------|---|--|--------------|
| CFD and BO | | | | |
| Decisions | 5.1 | Existing contracts | ESMA Decision 2018/795 ESMA Decision 2018/796 | 01/06/2018 |
| | 5.2 | Payments *modified* | ESMA Decision 2018/796 | 09/11/2018 |
| | 5.3 | Margin close-out protection | ESMA Decision 2018/796 | 01/06/2018 |
| | 5.4 | Aggregate liability | ESMA Decision 2018/796 | 01/06/2018 |
| | 5.5 | Monetary benefits | ESMA Decision 2018/796 | 01/06/2018 |
| | 5.6 | Binary options | ESMA Decision 2018/795 | 01/06/2018 |
| | 5.7 | CFDs referencing futures | ESMA Decision 2018/796 | 01/06/2018 |
| | 5.8 | Guaranteed stop loss orders | ESMA Decision 2018/796 | 01/06/2018 |
| | 5.9 | Clients established outside the Union and non-Union nationals | ESMA Decision 2018/795 ESMA Decision 2018/796 | 12/07/2018 |
| | 5.10 | Securitized derivatives | ESMA Decision 2018/796 | 30/07/2018 |
| | 5.11 | Structured finance products | ESMA Decision 2018/795 ESMA Decision 2018/796 | 30/07/2018 |
| | 5.12 | Rolling spot forex | ESMA Decision 2018/796 | 28/09/2018 |
| | 5.13 | Risk warning *new* | ESMA Decision 2018/796 | 09/11/2018 |

5. Questions and Answers on the prohibition of the marketing, distribution or sale of binary options and the restriction of the marketing, distribution or sale of contracts for differences to retail clients

Existing contracts

Updated: 01 June 2018

Q5.1 *How should firms apply these restrictions to existing retail client accounts with open CFD contracts and binary option contracts entered into prior to the date of entry into application?*

A5.1 The prohibition of the marketing, distribution or sale of binary options to retail clients and the restrictions on the marketing, distribution or sale of CFDs to retail clients apply from the moment that the measures in Decision 2018/795 and Decision 2018/796 come into application.

Firms are not required to apply the product intervention measures to CFDs sold to retail clients prior to this date. The restrictions on the marketing, distribution or sale of CFDs apply to CFD positions entered into from the date the product intervention measures come into application. Firms are required to cease the marketing, distribution or sale of binary options from the date the product intervention measures in relation to binary options come into application.

In relation to CFDs, firms are required to apply the *margin close-out protection* and the *negative balance protection* under Article 1(e) and 1(f) of Decision 2018/796 to new CFD positions when the measures come into effect. Firms may choose to create separate sub-accounts for CFD positions opened prior to the implementation date. Alternatively, firms may choose to extend the *margin close-out protection* and the *negative balance protection* to existing CFD positions. Firms should inform clients of the changes in the terms and conditions of their account in a durable medium in good time before the changes apply.

Firms exercising their discretion to close retail clients' open CFD and binary option positions, other than in accordance with existing terms and conditions, prior the measures coming into effect without the express consent of their retail clients will not be considered as acting in the best interests of the client as required under Article 24 of MiFID II.

Retail clients are not required to post additional margin for existing CFD positions to meet the initial margin protection requirement under Article 1(d) and Annex I of Decision 2018/796.

Retail clients are only required to provide margin required under Article 1(d) and Annex I for CFD positions entered into after the date of application.

Payments ***modified***

Updated: 09 November 2018

Q5.2 What is considered “payments for the purpose of entering into a CFD”?

A5.2 The definition of initial margin in the CFD Decision refers to payments for the purpose of entering into a CFD, excluding commission, transaction fees, and any other related costs. **Payment** for the purpose of entering into a CFD is **limited to cash** ~~an example of a payment in this regard.~~

“Payments” do not include **firms crediting cash to the client’s account based on collateralised cash from other assets, held owned by the retail client being used as collateral, whether such assets are** within or separate to the CFD trading account.

Margin close-out protection

Updated: 01 June 2018

Q5.3 What is considered to be the ‘sum of funds in the CFD trading account’ and the “unrealised net profits of all open CFDs connected to that account’ for the purposes of margin close-out protection?

A5.3 The sum of funds in the CFD trading account means any cash credited to the client’s relevant CFD trading account and cash only. No other type of asset (e.g. other financial instruments) within or separate to the CFD trading account may be taken into account.

The unrealised net profits of all open CFDs connected to that account means the sum of unrealised gains and losses of all open CFD positions recorded in the relevant account.

Aggregate liability

Updated: 01 June 2018

Q5.4 What is considered the retail client’s aggregate liability in relation to negative balance protection?

A5.4 Negative balance protection means firms must limit the retail client’s aggregate liability

for all CFDs connected to a CFD trading account to the funds in that CFD trading account. This implies that a client can never lose more money than the funds specifically dedicated to CFD trading.

Funds in a CFD trading account are limited to the cash in the CFD trading account and unrealised net profits from open positions. Funds in the CFD trading account do not include any funds or other assets held in client accounts for purposes other than CFD trading. Open CFD positions means *contracts for differences* contracts (as defined in Article 1(a) of the CFD Decision) entered in to by the client.

This does not prevent firms from using the profits from the closure of open positions, as required by *margin close-out protection* as defined in Article 1(e) of the CFD Decision.

Monetary benefits

Updated: 01 June 2018

Q5.5 What is considered a “monetary benefit” in relation to the prohibition made to investment firms providing retail clients with a payment, monetary or non-excluded monetary benefit in relation to CFDs?

A5.5 The CFD Decision prohibits any form of monetary and non-monetary benefits that aim at incentivising retail investors to trade CFDs or to trade larger volumes of CFDs. The scope of the prohibition includes monetary benefits such as, but not limited to, the offering of bonuses in relation to the opening a new account or the offering of rebates on fees, including volume-based rebates, charged by an investment firm to its retail clients.

Monetary benefits that do not constitute an incentive for retail investors to trade CFDs or to trade larger volumes of CFD, such as lower fees, not linked to volumes, for all retail clients (i.e. competition on price), are allowed.

Binary options

Updated: 01 June 2018

Q5.6 How does ESMA define a binary option? In particular, is it limited to instruments with only two outcomes?

A5.6 The temporary prohibition on the sale, marketing or distribution of binary options in respect of retail clients applies to binary options when the payment is limited to a predetermined fixed amount or zero if the underlying of the derivative meets one or more predetermined conditions, and *vice versa*.

In addition to the contracts described in the recitals of the BO Decision, this includes contracts in which payment is contingent on multiple events occurring. For example, a contract in which the client receives a EUR 2,000 payout for a EUR 500 investment (premium) if the DAX30 reaches 12,035, the USD/EUR pair 0.8235, and Brent Crude reaches USD 70.40.

This also includes contracts in which the payment to the client increases if certain events occur. For example, it includes a contract according to which the holder receives a payout of EUR 600 if the USD/EUR pair reaches 0.8235 plus an additional payout (bonus) of EUR 200 if the USD/EUR pair reaches 0.8300. In other words, the holder receives a total payout of EUR 600 if the USD/EUR pair reaches 0.8235 but not 0.8300, and a total payout of EUR 800 if the USD/EUR pair reaches 0.8300.

CFDs referencing futures

Updated: 01 June 2018

Q5.7 Why are CFDs referencing futures contracts not separately identified in Annex I to the CFD Decision to temporarily restrict contracts for differences in the Union in accordance with Article 40 of MiFIR?

A5.7 Annex I to the ESMA CFD Decision sets out the different initial margin percentages by type of underlying. The different types of underlyings do not explicitly refer to CFDs referencing futures contracts. Nevertheless, as futures also give the holder an exposure to a specific underlying this specific underlying should be considered for the purpose of the ESMA CFD Decision. For example, the minimum initial margin percentage for a CFD on a future on the USD/EUR pair is 3.33% of the notional value of the CFD. For this purpose ESMA considers a CFD on the future on the USD/EUR to have a type of underlying that is a major currency.

Guaranteed stop loss orders

Updated: 01 June 2018

Q5.8 How should firms apply the margin close-out rule for CFDs where they also offer guaranteed stops or limited risk protection on a per position basis?

A5.8 ESMA is aware that some firms currently offer guaranteed stop loss orders or limited risk features on a per position basis. In such cases, current market practice is for firms to typically charge the client margin commensurate to the maximum loss they would incur at the guaranteed stop level. Firms also ring-fence margin dedicated to a position with a guaranteed stop from consideration of whether a margin close-out event is triggered across the rest of a client's leveraged CFD positions (based on the firm's terms and conditions).

The margin close-out rule applies on an account basis across all open CFD positions in a client's account based on 50% of the initial margin required. This includes positions with a guaranteed stop loss order or limited risk protection.

ESMA recognises that this will create situations in which a client's position operating with a guaranteed stop could be closed out prior to the guaranteed stop level being reached as firms are required to close out one or more open CFDs at 50% of the initial margin protection required per account for all those open CFD positions. This would most likely occur where the guaranteed stop is set at a point where a client would be losing more than 50% of the initial margin required for all open CFD positions, although the guaranteed stop would still have value in a market gap event in which the margin close-out could not be executed without price slippage. Guaranteed stops set closer to the market than 50% of initial margin required will continue to provide enhanced protection, in addition to the protection provided by negative balance protection at account level mandated in the intervention measures.

ESMA expects firms to explain to their clients in a clear, fair and not misleading manner how the intervention measures will impact the operation of their account if they currently use guaranteed stops or limited risk protection, including by amending their terms and conditions as necessary in advance of the application of the measures. Firms may need to consider whether costs or charges levied by the firm for guaranteed stops should be revised to reflect the potentially reduced value they have for clients.

Clients established outside the Union and non-Union nationals

Updated: 01 June 2018

Q 5.9 Do the BO Decision and CFD Decision apply to retail clients established outside the Union or to retail clients who are non-Union nationals?

A 5.9 Yes, both the BO Decision and the CFD Decision apply, in common with other investor protection requirements in the regime established by MiFID II and MiFIR, in respect of investment services and activities provided by investment firms or credit institutions authorised in the Union, without discriminating on the basis of the location or nationality of their clients.

Securitised derivatives

Updated: 30 July 2018

Q 5.10 Are turbo certificates within the scope of the CFD Decision?

A 5.10 The CFD Decision explains in Recital 10 that *inter alia* turbo certificates are not within its scope because, although similar to CFDs, they have different product features.

ESMA clarifies that turbo certificates, unlike CFDs, have all of the following features:

- Turbo certificates are not margined products and the investor cannot change the leverage of the turbo certificate by adding margin to or detracting margin from a specific trading account. Investors buy the turbo-certificate and are charged transactional fees, for entering the contract;
- Turbo certificates do not have a contingent liability for the retail client. In other words, after the purchase of the product, the retail client has no possibility of being liable for a further payment when the transaction is completed or the position is closed (other than commission, transaction fees or other related costs);
- Turbo certificates qualify as a transferable security as defined in Article 4 (1) (44) (c) of MiFID; and
- Turbo certificates are typically listed and traded on a regulated market or MTF, which includes additional transparency requirements.

However, ESMA acknowledges that turbo certificates have comparable features to CFDs, such as leverage. Firms should pay particular attention to the leverage made available to retail clients and consider whether the product is offered on terms that act in the best interests of the client. ESMA and NCAs will closely monitor whether new distribution trends in respect of turbo certificates raise similar investor protection concerns for retail clients and whether any firms attempt to circumvent ESMA's CFD Decision and will act as necessary.

Structured finance products

Updated: 30 July 2018

Q 5.11 Are structured finance products within the scope of the BO Decision or the CFD Decision?

A 5.11 No, structured finance products are not within the scope of the BO Decision or the CFD Decision.

“Structured finance products” are defined in Article 2(1)(28) of MiFIR as “those securities created to securitise and transfer credit risk associated with a pool of financial assets entitling the security holder to receive regular payments that depend on the cash flow from the underlying assets”. Article 1(a) of the CFD Decision, on the other hand, defines a CFD as a derivative with a “long or short exposure to fluctuations in the price, level or value of an underlying”.

These are therefore two distinct types of products, one type that provides a payment originating from the cash flow of the underlying assets (structured finance products) and another type that

provides a payment from the CFD provider based on differences in the price, level or value of an underlying and which depends on whether a long or short position has been taken (CFDs).

Rolling spot forex

Updated: 28 September 2018

Q 5.12 Do ESMA's product intervention measures in relation to CFDs (in the CFD Decision) also apply to rolling spot forex?

A 5.12 Article 1(a) of the CFD Decision provides that a CFD is 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.

Paragraph 8 of the CFD Decision clarifies that rolling spot forex products are in scope. The CFD Decision applies to rolling spot forex that do not qualify as an option, future, swap or forward rate agreement. A forex derivative which uses the spot price as reference value and automatically rolls over at the end of the contract period and allows a party to terminate the contract other than by reason of default or another termination event is a CFD for the purposes of Article 1(a) of the CFD Decision.

Risk warning prominence **new**

Updated: 09 November 2018

Q 5.13 How should a firm ensure the prominence of the appropriate risk warning specified in Annex II of the CFD Decision?

A 5.13 Pursuant to Article 2(e) of the CFD Decision, a firm must not send a communication directly or indirectly to a retail client, 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 complying with the conditions in Annex II.

The first paragraph of Section A of Annex II provides: "*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*".

Firms are also required to comply with Article 44 of Commission Delegated Regulation (EU) 2017/565⁵, which specifies that information addressed to, or disseminated in such a way that it is likely to be received by, a retail client must give a fair and prominent indication of any relevant risks when referencing any potential benefits of an investment service or financial instrument.

In the context of internet-based marketing, giving prominence to the risk warning implies that it is displayed on the relevant webpages in a way that would signal that the message is of importance and makes it unlikely that a client or a prospective client would not notice it. It should attract attention, for instance, by virtue of its size or position on the webpage.

In deciding whether a particular risk warning is 'prominent', firms should consider the target audience, the characteristics of CFDs and the likely information needs of the average recipient of the communication.

Examples of good practice that will indicate firms have given sufficient prominence to a risk warning include:

- Warnings are shown using easily readable font styles (at least in the predominant font size of the respective communication, letters displayed in a discernible font colour) across a neutral background.
- The size of the warning occupies a noticeable portion of the text displayed, taking into account the content, size and orientation of the communication as a whole.
- Warnings are contained within their own distinct border, drawing the reader's attention to them.
- In the context of web pages, warnings remain fixed on the screen even when the customer scrolls up and down respective web page.
- Warnings are repeated on linked pages further into the website product chain.
- In other communications than web pages, warnings are clearly stated within the main body of the communication.
-

Examples of poor practice, that will indicate firms have given insufficient prominence to a risk warning include:

- Warnings are obscured through the close proximity of promotional illustrations and/or additional text.
- Warnings are diminished due to their location being outside of the main advertisement border.
- Warnings are diminished through the use of small font sizes and unclear type styles.
- Warnings are contained within a 'pop-up' box that only appears on the user's first visit to a website.
- Warnings are difficult to locate within a website or placed under a separate section or heading that may be overlooked, such as 'FAQs', 'Legal Information' or 'Disclaimers'.
- Firms have not taken into account the different-sized browsers of consumers when positioning risk information (i.e. it is necessary to scroll down to access the information).
- Warnings are superimposed across coloured or patterned backgrounds, which lessens their visual impact.

⁵ Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (OJ L 87, 31.3.2017, p. 1).