

Briefing

March 2018

CFDs and Retail Clients: *3-month restriction on marketing, distribution and sale will take effect in the coming months*

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Europe Awards

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ESMA will restrict the marketing, distribution and sale of CFDs to retail investors for an extendable 3 month period. It will also ban the marketing, distribution and sale of binary options to retail investors for the same, extendable, 3-month period.

This is the first exercise, by ESMA, of its new product intervention powers under MiFIR, and had been signposted by ESMA in its [January 2017 Call for Evidence on potential product intervention measures](#).

Under Article 40 of the Markets in Financial Instruments Regulation (**MiFIR**), ESMA can temporarily restrict or ban the marketing, distribution or sale of particular financial instruments for various reasons, including investor protection concerns, threats to the financial markets, or threats to the stability of the financial system.

WHAT ARE CONTRACTS FOR DIFFERENCE (CFDs)?

CFDs are complex financial products which allow investors to speculate on short-term movements of underlying reference assets. CFDs are highly leveraged, and investors may be exposed to unlimited losses.

Both ESMA and various national

competent authorities (including the Central Bank of Ireland) have issued repeated warnings highlighting the risks that CFDs pose for retail investors, and those who do not have wide-ranging experience of investing in volatile markets. For further information on those warnings, read our previous briefing ([CFDs and Retail Clients](#)).

ESMA will impose 5 key restrictions on the marketing, distribution and sale of CFDs to retail investors.

CFD Restriction 1: Leverage Limit

The first restriction will be a leverage limit on the opening of a position by a retail client, varying from 30:1 to 2:1 depending on the volatility of the underlying asset.

By way of example, the leverage limit where the underlying asset is a cryptocurrency will be 2:1. This means that, on the opening of a CFD with a cryptocurrency as the underlying asset, the retail client will need to post initial margin of 50% of the initial total exposure.

The strictest leverage limit (2:1) will be applied in respect of cryptocurrencies.

Gold, seen as a less volatile underlying asset, will have a leverage limit of 20:1.

CFD Restriction 2: Margin Close-Out Rule

The second restriction will be a margin close-out rule on a *'per account'* basis.

Under this rule, if the total margin in an account falls below 50% of the initial margin that was required, the CFD provider must close the account to reduce the risk of loss to the retail investor.

CFD Restriction 3: Negative Balance Protection

The third restriction will be negative balance protection on a *'per account'* basis.

This will most likely apply in rare cases where there is a sudden price movement that could cause the protection that is meant to be afforded by the margin close-out rule not coming into effect quickly enough.

In those cases, negative balance protection will operate as a backstop, and will effectively guarantee the limit on the losses that a retail investor will suffer, capping those losses at the total sum invested.

CFD Restriction 4: No Incentives

The fourth restriction will prevent CFD providers from offering incentives (monetary and non-monetary benefits) to retail investors to trade CFDs.

ESMA was concerned that such incentives are encouraging retail investors to invest in CFDs where they might not ordinarily have done so.

CFD Restriction 5: Risk Warnings

Communications to retail investors regarding the marketing, distribution or sale of a CFD will also be required to contain an appropriate risk warning.

Each such risk warning must contain the percentage of the CFD provider's retail accounts that have lost money in the previous 12 months.

WHAT ARE BINARY OPTIONS?

Binary options allow an investor to receive a predetermined fixed pay-out if an underlying asset (such as a share) meets certain predetermined conditions, generally within a particular time-frame. They are highly speculative, and ESMA is concerned that retail investors generally lose money on these investments.

Binary Option Prohibition

In light of its concerns, ESMA is prohibiting the marketing, distribution or sale of binary options to retail investors for an extendable 3-month period.

WHAT HAPPENS NEXT?

The above product intervention measures must first be translated into

all EU official languages and then published in the Official Journal.

The restriction on CFDs will apply 2 months after publication of the prohibition in the Official Journal.

The prohibition on binary options will apply 1 month after publication of the prohibition in the Official Journal.

Both the restrictions and the prohibition will last for 3 months, following which they may be renewed by ESMA. It seems likely, given the work ESMA has done on this topic, that the restrictions and the prohibition will be renewed on a rolling basis.

The restrictions and the prohibition will apply to all persons that require authorisation under MiFID II to market, distribute or sell CFDs or binary options to retail investors in the EU (this will include banks and investment firms).

The restrictions and the prohibition will be directly applicable in EU Member States, and compliance will be supervised by national competent authorities.

CENTRAL BANK OF IRELAND

The Central Bank has welcomed the new ESMA measures. For the time being, the Central Bank has not introduced measures to restrict or prohibit the marketing, distribution or sale of CFDs to retail investors following its [March 2017 Consultation on the Protection of Retail Investors in relation to the Distribution of CFDs](#), pending ESMA's decision on whether to use its product intervention powers under Article 40 of MiFIR to address retail investor protection concerns in this space.

USEFUL INFORMATION

[ESMA Press Release: ESMA agrees to prohibit binary options and restrict CFDs to protect retail investors](#)

[ESMA: Additional information on the agreed product intervention measures relating to contracts for differences and binary options](#)

[ESMA FAQ on its new product intervention measures](#)

[Central Bank Press Release: Central Bank warns against Binary Options and CFDs](#)



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