Group Briefing
June 2019

Retail Clients: *Central Bank to restrict sale of CFDs and ban binary options*

Ireland Law Firm of the Year 2019
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Ireland Client Service Law Firm of the Year 2018
Chambers Europe Awards

Ireland Law Firm of the Year 2018
International Financial Law Review (IFLR) Europe Awards

Advised on Equity Deal of the Year 2018 – Allied Irish Banks IPO
International Financial Law Review (IFLR) Europe Awards

Ireland Law Firm of the Year 2018
Who's Who Legal

Ireland Law Firm of the Year 2017
Chambers Europe Awards

Best Firm in Ireland 2018, 2017 & 2016
Europe Women in Business Law Awards

Best National Firm for Women in Business Law 2018, 2017 & 2016
Europe Women in Business Law Awards

Best National Firm Mentoring Programme 2018, 2017 & 2016
Europe Women in Business Law Awards

Best National Firm for Minority Women Lawyers 2018
Europe Women in Business Law Awards

As expected, the Central Bank has confirmed that once ESMA's MiFIR product intervention measures expire, the Central Bank will use its product intervention powers under MiFIR to restrict the sale of contracts for difference, and ban the sale of binary options, to retail clients.

BACKGROUND

In March 2017, the Central Bank published CP107 Consultation on the Protection of Retail Investors in relation to the Distribution of CFDs, looking for industry feedback as to whether it should prohibit the sale or distribution of contracts for difference (**CFDs**) to retail clients, or whether it should instead implement stronger investor protection measures for those clients when investing in CFDs. CP107 focused on CFDs[1], and not on binary options[2].

In March 2018, following a number of warnings issued by it in 2013, 2014 and 2016 in relation to CFDs, ESMA exercised its powers to put in place temporary product intervention measures under the Markets in Financial Instruments Regulation (**MiFIR**) in respect of both CFDs and binary options. Those ESMA measures have been continuously renewed on a 3-monthly basis, and the following are currently in force:

- a ban on the marketing, distribution or sale of binary options to retail clients (currently in force until 1 July 2019); and
- restrictions on the marketing, distribution or sale of CFDs to retail clients, comprising varying leverage limits, a margin close-out rule on a per-account basis, negative balance protection on a per-account basis, an incentives ban, and a requirement for a standardised risk warning (currently in force until 31 July 2019).

The Central Bank had previously indicated that it was likely to exercise its own product intervention measures under MiFIR once the ESMA measures expire.

1 Complex, leveraged, derivative instruments which allow investors to speculate on the short-term price movements of an underlying reference asset.

2 Binary options are cash-settled derivatives that let investors speculate on the short-term price movements, level or value of a reference asset. The potential outcome is pre-determined – investors usually lose their initial investment if their predictions are incorrect, or receive fixed pay-outs if their predictions are correct.

CENTRAL BANK ANNOUNCEMENT

In conjunction with the publication of its CP107 Feedback Statement, the Central Bank this week formally announced its intention to ban the sale, marketing and distribution of binary options to retail clients in or from Ireland, and restrict the marketing, distribution or sale of CFDs to retail clients, once the ESMA measures expire.

Summarising the Central Bank's views, Director General (Financial Conduct) Derville Rowland highlighted the importance of containing leverage levels, and stopping the use of incentives, in respect of CFDs. Regarding the Central Bank's view of binary options, she observed that these are "*a fundamentally flawed product, which have no place in the investment plans of retail investors. They are no more an investment than betting on a horse.*"

WHAT WILL THE CENTRAL BANK'S BINARY OPTIONS BAN LOOK LIKE?

The Central Bank published its Binary Options Intervention Measure on 13 June 2019. At the moment, it provides for an effective date of 2 July 2019. For the purposes of this measure, the Central Bank has defined a binary option as a derivative which meets the following conditions (irrespective of whether or not it is traded on a trading venue):

» it 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;

» it only provides for payment at its close-out or expiry;

» its payment is limited to:

  » a predetermined fixed amount or zero if the underlying of the derivative meets one or more predetermined conditions; and

  » a predetermined fixed amount or zero if the underlying of the derivative does not meet one or more predetermined conditions.

Excluded from the prohibition are the following binary options:

» a binary option for which the lower of the two predetermined fixed amounts is at least equal to the total payment made by a retail client for the binary option, including any commission, transaction fees and other related costs;

» a binary option that meets the following conditions:

  » the term from issuance to maturity is at least 90 calendar days;

  » a prospectus drawn up and approved in accordance with the Prospectus Directive or the incoming EU Prospectus Regulation is available to the public; and

  » the binary option does not expose the provider to market risk throughout the term of the binary option and the provider or any of its group entities do not make a profit or loss from the binary option, other than previously disclosed commission, transaction fees or other related charges.

WHAT WILL THE CENTRAL BANK'S CFD RESTRICTIONS LOOK LIKE?

The Central Bank published its Contracts for Difference Intervention Measure on 13 June 2019. At the moment, it provides for an effective date of 1 August 2019, and defines an in-scope 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*"

As expected, the restrictions that the Central Bank will put in place are the same as the current ESMA restrictions which are as follows:

RESTRICTION	DETAIL
LEVERAGE LIMITS	Leverage limits on the opening of a position by a retail client range from 30:1 to 2:1, and vary according to the volatility of the underlying as follows: » 30:1 (major currency pairs) » 20:1 (non-major currency pairs, gold and major indices) » 10:1 (commodities other than gold and non-major equity indices) » 5:1 (individual equities and other reference values) » 2:1 (cryptocurrencies)
MARGIN CLOSE-OUT RULE	This rule is on a per-account basis, and standardises 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.
NEGATIVE BALANCE PROTECTION	This protection is on a per-account basis, and provides an overall guaranteed limit on retail client losses.
INCENTIVES	A restriction on the incentives offered to trade CFDs.
RISK WARNING	A standardised risk warning, including the percentage of losses on a CFD provider's retail clients' investor accounts.

Both the Binary Options Intervention Measure and the Contracts for Difference Intervention Measure set out further detail on the nature of binary options and CFDs, and the analysis undertaken by both ESMA and the Central Bank prior to introducing their respective product intervention measures. The Central Bank has also indicated that is prepared to broaden the scope of its product intervention measures if a need to do so is identified at a later date.

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