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Response to ESMA's Call for Evidence on potential product intervention measures on CFDs and binary options to retail clients

February 5, 2018
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Finance Denmark welcomes higher standards in the industry and is fully supportive of the underlying aim of ensuring better protection of clients

In general, Finance Denmark welcomes higher standards in the industry and is fully supportive of the underlying aim of ensuring better protection of clients.

MiFID II's product governance regime

MiFID II[1] has introduced product governance requirements to ensure that firms which manufacture and distribute financial instruments act in the clients' best interests during all the stages of the life-cycle of products or services. The objective of the rules is to enhance the level of protection of investors by way of requiring firms to take responsibility, from the beginning, that products and the related services are offered in the interest of clients.

In particular, under the new legal framework, firms that manufacture financial products shall specify, as part of the product approval process, a target market of end clients for whose needs, characteristics and objectives the product is intended as well as a distribution strategy which is consistent with the identified target market. Furthermore, distributors are required to understand the features of the investment products they offer or recommend and, using the information obtained from manufacturers and the information on their own clients, identify a target market of clients to whom products and services are intended to be provided.

The new legal framework is expected to have the effect that CFDs and binary options are not sold to retail clients. The reason is that the target market assess-

[1] Directive 2014/65/EU on markets in financial instruments.

ment by manufacturers and distributors is expected automatically to lead to the conclusion that the products are not suited for retail investors. In this case, a firm could define the negative target market by stating that the product or service is incompatible for any client outside the positive target market which could be limited to investors with an extremely high-risk tolerance.

On this background we strongly suggest that ESMA evaluates the effect of the new product governance rules before introducing any product intervention measures.

Product intervention measures

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However, if ESMA considers any potential intervention measures Finance Denmark has the following specific comments to ESMA's proposals. Furthermore, we support the aim of aligning the regulation within the EU as several EU countries have implemented or consider implementing measures on CFD's and binary options to retail clients.

Scope

If intervention measures are introduced by ESMA, the instruments in scope seem to be adequate. We then suggest that CFDs on cryptocurrencies are included in the scope.

Binary options

If intervention measures are introduced by ESMA, the initiatives proposed regarding binary options and a ban on sale to retail clients are proposed. However, we suggest that the final definition aims to exclude so-called "Touch options" as they are materially different from binary options.

CFDs

If intervention measures are introduced by ESMA regarding CFDs, leverage caps should also be introduced as they will likely lead to a more level playing field with increasing turning to services, platform and depth of product offering. Moreover, a standardized risk warning and inclusion of transparency on the level of conflicts of interest are supported in that case.

On the condition that ESMA introduces any measures, Finance Denmark agree with the proposal on eligible collateral and would like to stress that it is important that not only cash is accepted as it would entail more risk for the client and a lower return on the collateral. Moreover, there is a risk of growth in margin lending.

We would also like to stress that it is important that margin calls are done on a portfolio basis as margin close out per-position will prevent the client from maintaining the benefit of portfolios and trading related positions, for example hedging beta-exposure with an index. Therefore, we find it important that the negative balance is not introduced on a position level.

Moreover, it is important to introduce a cap along with the introduction of negative balance protection as some clients has larger accounts and the facilitator would not be able to cover their potential losses. An unlimited negative balance protection would also entail very high and unclear capital requirements.

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Finally, we find that conflicts of interest are not properly addressed. Overall, we would like to see more focus on conflicts of interest on situations where the facilitator takes the opposite side of clients' trades and thus systematically profiting from client losses.

Kind regards

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