



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

Feedback Statement on CP 107

Consultation on the Protection
of Retail Investors in relation to
the Distribution of CFDs

1 Introduction

Background

1. In March 2017, the Central Bank of Ireland (the Central Bank) published a *Consultation on the Protection of Retail Investors in relation to the Distribution of CFDs* (CP 107). At the time, it was noted that the consideration of the basis for introducing the proposed measures would include the product intervention powers under Regulation (EU) No 600/2014 (MiFIR).
2. On 27 March 2018 the Central Bank warned investors against contracts for difference (CFDs) and binary options¹. The Central Bank had previously highlighted the risks associated with these speculative products and published European Securities and Markets Authority (ESMA) warnings about CFDs, binary options and other speculative products in 2013 and 2016.
3. In recent years, the Central Bank has undertaken thematic and supervisory inspections of investment firms offering CFDs, which have provided strong evidence of the elevated investor protection risks arising in relation to this product.
4. CP 107 set out Central Bank concerns in relation to CFDs and outlined proposed measures aimed at protecting retail clients. Two options were presented in the consultation:
 - Option 1: the prohibition of the sale or distribution of CFDs to retail clients in and from Ireland; or
 - Option 2: the implementation of enhanced investor protection measures including a limitation on leverage and a requirement that retail clients may not lose more than the amount(s) deposited on a per-position basis.
5. MiFIR, which entered into force on 3 January 2018, granted new product intervention powers to national competent authorities (NCAs) and the European Supervisory Authorities. Due to EU-wide concerns about investor protection in relation to the sale of CFDs to retail clients, ESMA introduced a temporary EU-wide product intervention measure to restrict the marketing, distribution or sale of CFDs to retail clients (the ESMA CFD Measure)². The initial ESMA CFD Measure applied from 1 August 2018 for a three-month period and has since been renewed for subsequent three-month periods. The Central Bank supported the ESMA CFD Measures and ESMA's renewals of the measure.
6. The Central Bank delayed the publication of its feedback in relation to CP 107 due to the consideration around the putting in place of the ESMA measures.³ However, as the ESMA CFD Measure is temporary, the Central Bank is now taking action in relation to national intervention measures, given the evidence of strong investor protection concerns which arise in relation to CFDs.

¹ <https://www.centralbank.ie/news-media/press-releases/central-bank-warns-against-binary-options-and-cfds>

² ESMA's first product intervention decisions in relation to contracts for differences and binary options are available here: <https://www.esma.europa.eu/press-news/esma-news/esma-adopts-final-product-intervention-measures-cfds-and-binary-options> <https://www.esma.europa.eu/press-news/esma-news/notice-esma%E2%80%99s-product-intervention-renewal-decision-in-relation-to-contracts>

³ <https://www.centralbank.ie/publication/consultation-papers/consultation-paper-detail/cp107-consultation-on-the-protection-of-retail-investors-in-relation-to-the-distribution-of-cfds>

7. The Central Bank proposals set out at Option 2 of CP 107 are substantively aligned with the ESMA CFD Measure, which provides for leverage limits, negative balance protection, preventing the use of incentives by a CFD provider, and a firm specific risk warning delivered in a standardised way. The ESMA CFD Measure also applies a margin close out rule.
8. The Central Bank now proposes to put in place measures which are aligned with the temporary ESMA CFD Measure, once it expires.

Binary Options

9. Although CP 107 did not explicitly consult on proposed measures relating to the sale of binary options to retail clients, it did outline that the Central Bank was prepared to implement additional investor protection measures in relation to other speculative financial products where there is a need to safeguard the interests of retail clients⁴.
10. On 2 July 2018 ESMA introduced a temporary measure to prohibit the marketing, distribution or sale of binary options to retail investors. As at the date of this Feedback Statement, ESMA has renewed this temporary measure several times. The Central Bank has proactively engaged in the work which was undertaken by ESMA in this area. Accordingly, in light of investor protection concerns, the Central Bank now proposes to adopt a national measure⁵ which will prohibit the sale of binary options to retail clients in and from Ireland.

Market Monitoring

11. Although the Central Bank intends to adopt national measures to restrict the sale of CFDs and prohibit the sale of binary options to retail clients at this time, it will continue to monitor the market in accordance with the provisions of Article 39 of MiFIR and may introduce additional measures where the Central Bank is satisfied that they are justified in accordance with the provisions of Article 42 of MiFIR.

Legal Basis and Effective Date

12. Article 42 of MiFIR provides the legal basis for the Central Bank to prohibit or restrict the marketing, distribution, or sale of certain financial instruments if it is satisfied on reasonable grounds that the instrument, activity or practice gives rise to significant investor protection concerns or poses a threat to the orderly functioning and integrity of financial markets or commodity markets or to the stability of whole or part of the financial system within at least one Member State.
13. The measures proposed will apply to all relevant firms with effect from the date that the ESMA CFD Measure expires, to ensure continued protection of retail investors.

⁴ Para 1.14 of <https://www.centralbank.ie/docs/default-source/publications/consultation-papers/cp107/consultation-paper-107.pdf?sfvrsn=4>

⁵ In line with the provisions of Article 42 of MiFIR

Responses

14. The consultation period for CP 107 closed on the 29 May 2017 and ten responses were received. These responses can be categorised as follows:

- Firms 8
- Individual respondent 1
- Unregulated entity 1

15. The Central Bank would like to thank all parties who provided a response to CP 107 for their contributions. A copy of CP 107 is also available for information.

16. This feedback statement is being published in order to promote understanding of the decision-making process within the Central Bank and is not relevant to assessing compliance with regulatory requirements.

Overview of Feedback and Amendments

17. A key theme in the responses to CP107 was concerns with the proportionality of Option 1. All respondents were of the view that this option would be disproportionate and counterproductive. Comments received also indicated that pursuing Option 1 would result in Irish retail clients being exposed to additional risks by seeking overseas providers or being targeted by unregulated entities. One submission queried the scope of the measures in respect of parties active in the Single Electricity Market. This submission did not raise issues of general application or respond directly to the questions raised in CP 107. Section 2 of this document summarises the responses received to CP 107 and outlines the Central Bank's decisions in relation to the themes arising from these comments. The Central Bank has considered all responses to CP 107 and the feedback is set out below.

2 Overview of the Feedback

Questions raised in Consultation paper 107	Summary of Comments Received	Central Bank Response
<p>Q1 Which of the options outlined in this paper do you consider will most effectively and proportionately address the investor protection risks associated with the sale or distribution of CFDs to retail clients? Please give reasons for your answer.</p>	<p>All respondents were unsupportive of Option 1, on the premise that it would be disproportionate and counterproductive. They also highlighted the possibility of clients moving to unregulated firms, which may not offer the same levels of protection that exist within regulated firms operating in Ireland. The respondents were mostly in favour of proposals in Option 2.</p>	<p>The Central Bank has considered the feedback received to this question, particularly on the point of proportionality, and will not pursue Option 1. Instead, the Central Bank will apply measures, which are broadly in line with those set out in Option 2, with some amendments (and the addition of a margin close-out requirement) to align the proposed Central Bank measure to the ESMA CFD Measure.</p>
<p>2. In relation to Option 2: a) Do you agree with the proposal to restrict leverage to 25:1 for retail clients trading CFDs? Please give reasons for your answer.</p>	<p>All respondents were supportive of a limit on leverage for CFDs offered to retail clients. However, most suggested that the proposed leverage restriction was not at the right level and suggested different measures for the Central Bank to consider. Some firms suggested that the leverage limit should be set according to the underlying asset and other factors, such as client experience and net worth.</p> <p>Two respondents stated that the proposed limit was too restrictive and may lead to Irish retail clients moving to off-shore brokers.</p>	<p>The Central Bank acknowledges the support for imposing a limit on leverage for CFDs offered to retail clients.</p> <p>In relation to the leverage limits, the Central Bank considers that it is appropriate and proportionate to adopt the leverage limits set out in the ESMA CFD Measure to ensure a consistent approach across the EU.</p> <p>The ESMA CFD decision differentiates between leverage levels on each underlying, which were determined as a result of detailed analysis undertaken by ESMA, and assessed by the Central Bank. The Central Bank notes several respondents to CP 107 suggested this approach.</p>

<p>b) Do you agree with the proposal that retail clients trading CFDs should not be at risk of potentially limitless losses and that firms offering CFDs should be required to put in place negative balance protection on a per position basis? Please give reasons for your answer.</p>	<p>The majority of respondents were supportive of the negative balance protection proposal. Many were of the view that negative balance protection should apply on a per account basis, rather than a per position basis. Some respondents referred to the possibility of segmenting retail clients, based on experience, knowledge and sophistication of the retail client, so that some retail clients would be afforded negative balance protection, and others would not.</p>	<p>The Central Bank acknowledges the majority support for negative balance protection for retail clients.</p> <p>The Central Bank has considered the responses, particularly those advocating that negative balance protection should apply on a per account basis, rather than on a per position basis. The Central Bank CFD Measure will provide for negative balance protection on a per account basis; this approach is consistent with the approach taken in the ESMA CFD Measure.</p> <p>The Central Bank does not agree with the suggestion that a segment of <u>retail clients</u> should not be afforded negative balance protection and would be left at risk of potentially limitless losses when trading CFDs.</p>
<p>c) Do you agree with the proposal to prohibit all bonus promotions and trading incentives in relation to CFD client accounts? Please give reasons for your answer.</p>	<p>Most respondents were in favour of prohibiting bonus promotions and trading incentives in relation to CFD client accounts, in light of investor protection concerns.</p>	<p>The Central Bank acknowledges the support for a prohibition on bonuses and other promotions, and intends to include a restriction on the incentives offered to retail clients to trade CFDs in its CFD measure, the precise details of which will be aligned to the ESMA CFD Measure.</p>
<p>d) Do you agree with the proposal to require firms offering CFDs to retail consumers to provide a standardised risk warning to clients disclosing the percentage of active retail CFD clients who suffered a loss of equity during the previous quarter and over the previous 12-month period? Please give reasons for your answer.</p>	<p>All ten respondents supported the idea of a standardised risk warning to clients. A number of suggestions were made on the form and content of the risk warning.</p>	<p>The Central Bank acknowledges the support for a standardised risk disclosure and is of the view that it is prudent that there is consistency on this approach throughout the EU. Accordingly, the Central Bank is of the view that in line with the ESMA CFD Measure it is appropriate that CFD providers should include a standardised risk warning to retail clients.</p>

<p>3. Are there further measures, which the Central Bank should consider as part of its analysis? Please give reasons for your answer.</p>	<p>The suggestions made included:</p> <ul style="list-style-type: none"> - Four respondents were of the view that more effort should be put into client categorisation and the suitability and assessment of clients. - Segmenting retail clients, so that differing levels of protection would apply depending on experience of the retail investor. - One respondent suggested that the measures in Option 2 should include a margin close-out limit of 50%. - Further thematic reviews, and tougher guidelines and penalties were suggested. - A further proposal was that the Central Bank should consider requirements around firms having a more local presence in order to meet clients, assess suitability and ensure visibility in relation to the on boarding process. 	<p>The Central Bank has considered all further measures put forward by respondents and has considered whether the Central Bank’s significant investor protection concerns would be better addressed by improved supervision or enforcement of existing requirements.</p> <p>The Central Bank does not consider that any such steps alone would sufficiently address the investor protection concerns identified.</p> <p>At this time it is the intention to proceed with the substance of the proposal as set out in Option 2, with the addition of the margin close out rule, in relation to CFDs and, separately, a prohibition on the marketing, distribution or sale of binary options to retail clients.</p> <p>However, the Central Bank is prepared to expand the scope of the measures proposed and/or implement additional investor protection measures where a need is identified in order to safeguard the interest of retail clients.</p>
<p>4. In relation to the options outlined in this paper, are there any detrimental effects on investors or the markets or unintended consequences that you consider should be taken into account by the Central Bank? Please give reasons for your answer.</p>	<p>Respondents indicated that a prohibition as set out in Option 1 would lead to Irish retail clients choosing unregulated and off shore brokers.</p> <p>Two respondents were of the view that while Option 2 was preferable, the proposed leverage limits would cause the same outcome as Option 1.</p> <p>Some respondents referred to the online nature of CFD trading, and pointed to the need for the Central Bank to take into account the restrictions imposed on CFD providers in other EU Member States.</p>	<p>The Central Bank acknowledges that there was no support for Option 1. The Central Bank has decided not to pursue the proposal set out at Option 1 of CP 107.</p> <p>In response to the comments on the proposed leverage limits, as compared to leverage limits in other Member States, the Central Bank measures will impose leverage limits which are aligned to those in the ESMA CFD Measure.</p>



<p>5. What do you consider will be the likely effect of the options outlined in this paper on investors and market participants who may hold, use or benefit from CFDs? Please give reasons for your answer.</p>	<p>Three respondents advised that there was nothing more they could add in relation to this question.</p> <p>Four respondents stated that if there was an outright ban, there would be negative impact on clients and brokers and this would only lead to investors seeking off-shore brokers.</p> <p>Generally, respondents were of the view that the implementation of enhanced investor protection measures would benefit the market.</p>	<p>The Central Bank has considered these responses, and feedback on these points has been outlined above.</p>



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