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Response ESMA Call for Evidence – Potential product intervention measures on contracts for differences and binary options to retail clients

Dear Sir or Madam,

Please find below our response to the aforesaid Call for Evidence.

As an association of 12 leading providers offering CFDs in Germany, who represent a significant portion of the German overall market, potential product intervention measures may affect our economic and legal interests, or rather those of our members.

The members of the German association Contracts for Difference Verband e.V. ("CFD Association") are regulated by various European supervisory authorities have various business models and offer their clients various types of contracts for difference ("CFDs"). This is why individual members reserve the right to submit their own statements in this Call for Evidence.

Investor protection is a major objective of the CFD Association

One of the major objectives of the CFD Association is investor protection.

As a rule, the CFD Association and its members welcome measures to improve investor protection.

Significant investor protection concerns arising from unregulated providers

From the CFD Association's perspective, significant investor protection concerns essentially exist solely owing to the existence of unregulated CFD providers active on the European market as well as owing to misleading advertising promises by these unregulated CFD providers or by CFD providers regulated by supervisory authorities in jurisdictions with lower regulatory standards compared to those maintained by the German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, "BaFin"), such as Cyprus.

In its warning of 25 July 2016, the European Securities and Markets Authority ("ESMA") (cf. ESMA: Warning, 2016/1166, dated 25 July 2016; pp. 2 et seq. with a reference to Cyprus-based CFD providers) criticised the misconduct of Cyprus-based investment companies offering CFDs and binary options.

For France, evaluations carried out by the French securities supervisor Autorité des marchés financiers ("AMF") showed that out of a total of 1,617 complaints made by clients with regard to foreign-exchange products and binary options in the year 2015, about 1,478 cases were attributable to providers operating without a licence from a supervisor or without notification in France (cf. AMF: Rapport Annuel 2015 de l'AMF, p. 8, and Rapport du Médiateur de l'AMF, p. 19). Out of the remaining 139 complaints, 118 concerned providers with a licence issued by the Cyprus Securities and Exchange Commission ("CySec") and only 21 concerned providers with a licence from a supervisory authority in another EU Member State. This means that about 98% of all complaints made concerned unregulated providers or providers regulated (insufficiently, as it appears) by the Cypriot CySec.

In Germany, too, the risks to investor protection arise from unregulated CFD providers.

Only a small number of the complaints made to BaFin concerned regulated CFD providers.

According to information from BaFin, about 100 complaints were made in 2015 with regard to providers regulated by a supervisory authority in another EU Member State (cf. Report on the

IOSCO Survey on Retail OTC Leveraged Products, dated December 2016). Furthermore, according to an internal survey conducted by the CFD Association, the number of complaints concerning members of the CFD Association was less than 30 in 2016, for example.

In this respect, the situation in Germany is similar to that in France, with regard to regulated providers.

Based on the evaluations carried out by AMF and the above-quoted ESMA warning, it can be assumed that most of the examples of misleading advertising promises quoted by ESMA in the Q&A document (cf. ESMA: Q&A, 2016/1165, dated 11 October 2016, p. 36) are likewise attributable either to CFD providers who have been licensed by a supervisory authority in a jurisdiction with lower regulatory standards or to CFD providers operating without a licence from a supervisory authority or without notification.

We would like to emphasise that there have been no complaints in this connection against regulated CFD providers who have been licensed by a supervisory authority such as BaFin or the Financial Conduct Authority ("FCA").

According to the Final Report on the IOSCO Survey on Retail OTC Leveraged Products (dated December 2016), too, one of the major problems is that unregulated providers have offered CFDs to the entire retail market and have made misleading advertising promises in doing so.

The CFD Association and its members support clear action against unregulated or insufficiently regulated CFD providers and against misleading advertising promises by CFD providers.

Such action would lead to more investor protection and would make it more difficult for non-serious providers to act on the market. The CFD Association and its members attach great importance to improving investor protection.

Corrections to or concretisation of the statements of fact in the Call for Evidence

As for the statements of fact which are contained in the Call for Evidence launched by ESMA, the CFD Association would like to comment, correct and/or concretise as follows:

The term "retail investors"

The average CFD investor is not a typical retail investor. This definitely needs to be taken into account for the purposes of the Call for Evidence.

The average CFD investor has a wealth of experience in trading, has been trading in CFDs for several years, and spends several hours a day carrying out CFD trades. The average CFD investor's experience in trading is far greater than that of a typical retail investor.

A market survey published by the CFD Association (CFD-Marktstudie: Typologisierung von CFD-Investoren, November 2016 and December 2017) arrives at the conclusion that the average CFD investor has been trading in CFDs for about four and a half years. 39.8% of CFD investors have been trading in CFDs for three to five years. 24.8% of CFD investors have even been trading in CFDs for six to ten years. The average CFD trading time is about 3.3 hours a day and the average number of trades carried out per year is 2,190. Furthermore, 67% of the interviewed clients stated that they obtained comprehensive information before making their decision to invest. For 73.3% of the interviewed clients, the objective of trading in CFDs is to obtain an above-average return.

Profit and loss statistics of CFD Association contradict the supervisory authorities' statistics

The Call for Evidence makes reference to studies conducted by the Central Bank of Ireland and AMF showing that between 74 and 89% of clients trading in CFDs lose money. The CFD Association is aware of these studies.

In the opinion of the CFD Association, the aforesaid studies are not applicable to Germany, as the German market is dominated by highly regulated providers and has a much smaller number of unregulated providers.

The CFD Association, together with the CFin Research Center for Financial Services, has conducted its own comprehensive profit and loss study for the trade in CFDs in Germany (CFD Gewinn- und Verluststatistik, November 2016). This study has also been presented to BaFin and is available to the latter. According to said study, only 62.7% of clients lose money when trading in CFDs.

This shows again that the focus should be on regulating the marketing practices of CFD providers rather than on imposing restrictions on the product.

According to the Call for Evidence, there is a significant risk of loss (both from trading and from transaction fees), which is magnified by the effect of high leverage.

From the CFD Association's perspective, the risk of loss involved in trading in CFDs is comparable to the risk of loss involved in trading in other leveraged products, such as knock-out certificates. In addition, the transaction fees are within the customary range for similar financial products.

According to ESMA, the complexity of these products and a lack of transparent information at point of sale limit the ability of retail investors to understand the risks underlying these products.

CFDs are not complex products; or rather the performance calculation for CFDs is not a complex issue.

There is a 1:1 relationship between the performance of the CFD and the underlying price. An investor who trades a large volume can expect that the risk involved corresponds to the volume traded.

Furthermore, the view that there is a lack of transparent information at point of sale is incorrect.

Members of the German CFD Association supply investors with comprehensive information about costs of each CFD (MiFID II) and comprehensive information about the risk and performance of each CFD (PRIIPs KIDs).

Criticism about the timing of the consultation and the little time allowed for furnishing a statement

The PRIIP Regulation (Regulation (EU) No 1286 / 2014), which directly applies in all Member States of the EU, has entered into force on 1 January 2018. This Regulation provides that a key information document must be published for a PRIP or packaged retail investment product by the manufacturer of the product before the product is offered to retail investors.

CFDs are PRIPs or packaged retail investment products, according to the Regulation.

The key information document should focus on the key information that retail investors need. The key information document contains sections regarding, amongst other things, the risks of the product, potential performance scenarios, the costs and a description of the type of retail investor to whom the product is intended to be marketed, in particular in terms of the ability to bear investment loss and the investment horizon.

In addition, the Markets in Financial Instruments Directive (MiFID) 2 (Directive 2014/65/EU) on the transposing laws in the individual Member States has been applicable since 3 January 2018.

According to that Directive, a so-called product approval process is intended to specify an identified target market of end clients within the relevant category of clients for each financial instrument and to ensure that all relevant risks to such identified target market are assessed and that the intended distribution strategy is consistent with the identified target market.

In determining the target market for CFDs, the following information is of particular importance:

- Experience with and knowledge of CFDs;
- Taking of high risks with the possibility of a total loss;
- Knowledge of risks and costs;
- Knowledge of the leverage and the related disproportionately high risk;
- Capital invested and ability to bear loss; and
- High expected return and speculative trading.

Furthermore, MiFID 2 now provides for comprehensive cost transparency through ex ante information about all costs and associated charges of the financial instruments.

Against this background, and also in light of the large number of new transparency obligations and investor protection requirements in respect of financial instruments and packaged investment products for retail investors and, hence, also in respect of CFDs, the point in time chosen by ESMA for its Call for Evidence is incomprehensible and must be strongly criticised.

To date, ESMA has not gained any insights as to the implementation and impact of the relevant investor protection and transparency requirements in the case of CFDs. However, such insights imperatively need to be taken into account when exercising discretion in the context of product intervention measures.

Exercising discretion without taking such necessary and relevant new information into account would mean exercising such discretion incorrectly.

Furthermore, a product intervention by ESMA has far-reaching consequences for the rights of the parties involved, which is why said parties need to be heard comprehensively and sufficiently. In this Call for Evidence, ESMA allows a period of little more than two weeks for the delivery of statements.

Consultations launched by ESMA typically take several months. The simultaneously running public consultation on building a proportionate regulatory environment to support SME listing, for example, provides for a consultation period of clearly above two months.

Such a short period of time for statements in connection with a measure as incisive as the first product intervention intended by ESMA is inappropriate and disproportionate.

Responses to the questions raised in the Call for Evidence

Please find below our responses to the questions raised by you in your Call for Evidence.

A: Do you think that ESMA has adequately identified the instruments in the scope of its possible measures?

The effect of leverage, which has received special criticism from ESMA, also exists with numerous other packaged retail investment products (e.g. warrants, turbo-warrants, options and futures), which have been popular and frequently traded for decades. Also, the concept of unlimited personal liability is embedded in many other products like options and futures. This even extends to the example of mortgages, where the liability may exceed the value of the underlying object.

Product intervention measures in relation to CFDs would place CFDs at a disproportionate disadvantage, compared to similar financial instruments.

B: What impact do you consider that the introduction of leverage limits on the basis described above (applying to retail clients only) would have on your business? Please describe and explain any one-off or ongoing costs or benefits.

From the CFD Association's perspective, the one-off cost of implementing a leverage limit can be classified as rather low.

However, as a result of leverage being limited, there would subsequently be a very significant fall in returns. Providers and brokers of the German CFD Association expect that if leverage were reduced, up to 80% of clients would stop trading in the products with reduced leverage.

Such a loss of clients could jeopardise the continued existence of providers offering CFDs and of CFD brokers, in particular in cases where the trade in CFDs accounts for a large portion of their business, and, for the firms concerned, would constitute a significant interference with the fundamental right to carry on an established business (protected fundamental rights: freedom to choose an occupation, freedom to conduct a business and right to property).

The mere announcement by FCA to reduce leverage to a maximum of 40 resulted in the share prices of CMC Markets plc and the IG Group plc falling drastically by 36% and 38%, respectively, on 5 December 2016. It is feared that if ESMA imposes even stricter margins, the shares prices of listed companies might fall even more drastically. For smaller providers the announced measures could be existence-threatening.

Such an intervention as a "temporary" measure cannot, therefore, be proportionate.

The CFD Association expects that clients would turn to unregulated providers outside the EU. Individual members have conducted a survey among their clients. This survey clearly confirms the expected behaviour: the clients have moved, or will move their accounts to Australia, Switzerland and Dubai and many of them are waiting for the UK to Brexit, as they are convinced that the UK financial services sector will be endeavoured to position itself very attractively.

In addition, there is a substantial risk that the providers and brokers concerned, too, will relocate to non-EU-countries.

The Japanese regulator foresees a leverage limit of 50:1. The UK regulator, who already has the biggest CFD Forex companies and who will soon be the biggest and closest non-EU competitor, proposes 40:1. The US regulator foresees a leverage limit of 50:1 for Forex.

Investors staying with EU regulated distributors despite the burden of the measures and wishing to achieve an equivalent trade volume upon leverage being limited would have to invest a multiple of the capital currently invested, which would have to be withdrawn from other types of investment, such as savings accounts. Furthermore, investors trading in CFDs cover a large number of underlying assets, also for hedging purposes. Because of the larger amount of capital invested, they would now be forced to invest their capital using only one strategy or only few different strategies, which would give rise to a higher risk of loss.

There are also other products that provide for high leverage, for example, warrants or knock-out warrants offered by banks, which are often positioned to compete with CFDs. Warrants with leverage above 50:1 and 100:1 are not rare. Such products would then, unjustifiably, be preferred over CFDs.

<u>C: What impact do you consider that the introduction of a margin close-out rule on a per-position basis (applying to retail clients only) would have on your business? Please describe and explain any one-off or ongoing costs or benefits.</u>

The CFD Association expects a very high one-off cost in this regard (specification, programming and testing).

Individual providers and brokers expect one-off costs for the implementation in the amount of € 250,000 to € 1,000,000. Such sums particularly jeopardise the continued existence of comparatively small providers and brokers.

The members expect that they will need 3 to 6 months, some of them even 9 to 12 months, to implement a margin close-out rule.

Such an intervention as a “temporary” measure is, therefore, disproportionate.

In light of the very high cost of implementation and the enormous amount of time needed for this purpose, it is feared that the providers and brokers concerned will relocate to non-EU countries.

The ongoing costs of a margin close-out rule cannot be foreseen; in this respect, the providers especially state that such a rule makes reasonable hedging in relation to such positions impossible – both for the provider and for the client.

The CFD Association's members fear that the product will become more complex with such a margin close-out rule and more difficult for clients to understand. Such a rule deprives the client of the option to define its own stop-loss limits and to deliberately accept a higher potential for loss.

The CFD Association would like to use the following example to demonstrate that such a rule may result in an absolutely disproportionate interference with the investor's freedom of action and may lead to absolutely disproportionate results:

> Example:
> An investor has an account with a credit balance of € 5,000.
>
> The investor buys a position worth € 200 which requires a margin of € 40 (5:1).
> Under the proposed per-position rule, this constitutes a leveraged position. The broker must close the position immediately upon € 20 being lost.
>
> This is a loss of -10% on the position.
>
> No rule should oblige the retail investor to sell its investment when it is at -10%.
>
> Such a rule would place CFDs at a disproportionate disadvantage, compared to all other financial instruments.
>
> The introduction of a regulation forcing investors to sell, for example, their fund units or shares after a loss of only -10% is inconceivable.
>
> This would be a loss of -0.4% on the entire portfolio. Retail investors cannot be forced to immediately sell an investment when the portfolio value is at -0,4%.

This example shows that such a rule produces absolutely disproportionate results.

<u>D: What impact do you consider that the introduction of negative balance protection on a per-account basis (applying to retail clients only) would have on your business? Please describe and explain any one-off or ongoing costs or benefits.</u>

Negative balance protection on a per account basis (applying to retail clients only) has already been implemented in Germany.

E: What impact do you consider that a restriction on incentivisation of trading (applying to retail clients only) would have on your business? Please describe and explain any one-off or ongoing costs or benefits.

The CFD Association would welcome a restriction on incentivisation of trading. The CFD Association is of the opinion that incentivisation of trading primarily attracts inexperienced clients; experienced traders are less influenced by such offers.

Therefore, the CFD Association takes the view that a restriction on incentivisation of trading, when the incentivisation is generally only attracting clients to start trading or entrap the client to do more trading, would be an appropriate measure for investor protection.

A restriction on incentivisation would additionally ensure a level playing field among CFD brokers, in the opinion of the CFD Association.

Such a restriction would not give rise to one-off and/or ongoing costs and, therefore, would be likely to be both effective and proportionate, in the opinion of the CFD Association.

F: What impact do you consider that a standardised risk warning (applying to retail clients only) would have on your business? Please describe and explain any one-off or ongoing costs or benefits.

A standardised risk warning would give rise to only a small amount of one-off costs and ongoing costs.

The members of the CFD Association would welcome a standardised risk warning for all market participants with a view to creating a level playing field.

In addition the CFD Association would like to highlight that with the PRIIPs KIDs regulation being in force since 1 January 2018 the client is made aware of risk, costs and performance (even in a stress scenario) of each individual CFD.

G: Please provide evidence on the proportion of retail clients that use these products for hedging purposes and how the suggested measures will affect them.

According to the aforementioned market study conducted and published by the CFD Association, 14.5% of clients use CFDs for hedging, according to their own statement.

An increase in margin requirements and a restriction in the close out rule could make proper hedging completely impossible for clients as it would require more capital or would mean, that hedges are closed while the original position is still held.

H: What impact do you consider that a prohibition on providing binary options to retail clients would have on your business? Please describe and explain any one-off or ongoing costs or benefits.

The CFD Association is always voting against a product prohibition but suggest for better client education and information as well as restriction of aggressive marketing practices.

I: What impact do you consider that the envisaged measures would have on retail investors?

We would like to make reference to our responses to previous questions which cover this issue.

The members of the CFD Association particularly fear that a leverage limit might result in investors turning to unregulated providers outside the EU.

In connection with the Call for Evidence launched by ESMA, the CFD Association has received many emails and phone calls from investors considering potential product intervention measures an interference with the economic freedom of action of private investors and an act of patronising “responsible” citizens.

J. Do you believe that specific restrictions concerning CFDs in cryptocurrencies should be introduced? In particular, what impact do you consider that assigning a leverage limit of 5:1 to such CFDs would have on firms' business and / or any expected additional benefits for retail clients? How would such an impact compare to that from the possible alternatives of lower leverage limits such as 2:1 or 1:1, or a prohibition on the sale, marketing and distribution of such CFDs? Please describe and explain any one-off or ongoing costs or benefits.

The CFD Association is of the view that CFDs on cryptocurrencies should equally be treated as other CFD on volatile underlyings. The leverage that is to be offered by providers should solely be determined by the risk appetite of the provider. In connection with negative balance protection, client information and restriction of aggressive marketing practices the risk for retail clients will be manageable.

Legal considerations

ESMA bases its product intervention powers on Article 40 MiFIR (Markets in Financial Instruments Regulation) (Regulation (EU) No 600 / 2014) in order to address investor protection concerns in respect of such products.

Article 40 MiFIR exclusively provides for only temporary product intervention measures (cf. the first sentence of paragraph 1).

Article 40 MiFIR subsidiary and subordinated

In addition, Article 40 MiFIR is subsidiary and/or subordinated in more than just one respect. It only applies if:

a) regulatory requirements under Union law that are applicable to the relevant financial instrument or activity do not address the threat (paragraph 2(b)) and

b) a competent authority or competent authorities have not taken action to address the threat or the actions that have been taken do not adequately address the threat (paragraph 2(c)).

Article 40 MiFIR is, hence, also an expression of the principle of separation of powers and of the protection of fundamental rights. A European administrative authority should not be authorised to permanently interfere in a detrimental manner with third-party fundamental rights on the basis of a European product intervention clause.

Contingency power which is limited to exceptional cases

This is why Article 40 MiFIR should be used as a basis of authority only in really exceptional cases (cf. in particular recital 29, which explicitly emphasises more than once in this respect that ESMA should act only in “exceptional cases” – and which explicitly uses the term “contingency power”).

Consequently, very strict criteria need to be applied in determining whether the conditions for the application of this general basis of authority are fulfilled and also with respect to the exercise of discretion by the Authority – Article 40 MiFIR provides for the exercise of discretion by ESMA, cf. the first sentence of paragraph 1: “may”.

In the opinion of the CFD Association, any interference must, in light of the intended subsidiary nature of this basis of authority as an “exceptional case” and “contingency power”, be considered unlawful according to Article 40(2)(b) MiFIR as long as detailed practical knowledge about the concrete impact of the investor protection rules of MiFID 2 and the PRIIP Regulation does not exist.

Significant investor protection concerns

According to Article 40(2) MiFIR, a product intervention measure may only be taken if the proposed action addresses a significant investor protection concern or a threat to the orderly functioning and integrity of financial markets or commodity markets or to the stability of the whole or part of the financial system in the Union (cf. paragraph (2)(a)).

The fact that a significant investor protection concern is placed on an equal footing with a threat to the orderly functioning and integrity of financial markets or commodity markets or to the stability of the whole or part of the financial system in the Union shows that not all investor protection concerns justify temporary product intervention measures according to Article 40 MiFIR but only such significant investor protection concerns as are, in terms of their quality, as weighty as a threat to the orderly functioning and integrity of financial markets or commodity markets or to the stability of the whole or part of the financial system in the Union.

Criteria and factors in respect of product intervention powers

Article 19 Delegated Regulation (EU) 2017 / 567 lists and concretises the criteria and factors relating to the temporary product intervention powers of ESMA and, thus, the conditions that need to be fulfilled in order for ESMA to be able to intervene.

The CFD Association would like to elaborate on some of the criteria and factors mentioned in Article 19(2) Delegated Regulation (EU) 2017 / 567:

The degree of complexity of the financial instrument, the size of potential detrimental consequences, the type of clients to whom the financial instrument is marketed or sold, the degree of transparency of the financial instrument, the particular features or components of the financial instrument, the ease with which investors are able to sell the relevant financial instrument, and the degree of innovation of the financial instrument.

Degree of complexity of the financial instrument

When assessing the degree of complexity of the financial instrument, the following aspects should be taken into account, amongst others:

- The type of the underlying or reference assets and their degree of transparency;
- The degree of transparency of costs and charges associated with the financial instrument;
- The complexity of the performance calculation; and
- Whether the instrument is bundled with other products.

With CFDs, the underlying or reference assets are shares (as a rule, blue chips), indexes, currencies and futures. There is a high degree of transparency with regard to these assets. Detailed information about the underlying assets can be obtained everywhere.

All costs and charges in connection with the trade in CFDs are shown comprehensively in the cost information: spread, commission and over-night charges.

Furthermore, MiFID 2 provides for comprehensive cost transparency by way of ex-ante cost information about all costs and associated charges of the financial instruments.

There is a 1:1 relationship between the performance of CFDs and the underlying or reference assets and a straight-line relationship between the performance of CFDs and the volume traded, which is why the performance of CFDs is easy to understand. In addition, CFDs are not bundled with other instruments.

All aspects taken into account, the degree of complexity of a CFD can be said to be rather small, based on the aforesaid criteria.

Size of potential detrimental consequences

When assessing the size of potential detrimental consequences, the following aspects should be taken into account, amongst others:

- The number of clients, investors or market participants involved;
- The relative share of the product in investors' portfolios; and
- The scale and nature of any detriment, including the amount of loss potentially suffered.

The number of clients involved in the CFD market is negligible compared to the overall market. The CFD Association estimates that there are about 9 million share investors in Germany. In the CFD market, on the other hand, only about 65,000 to 80,000 clients are trading, holding about 180,000 accounts in total.

This means that the number of CFD investors in Germany is clearly less than one per cent of the number of German share investors and, in addition, clearly less than one tenth of a per cent of the entire German population.

Furthermore, the share of CFDs in the portfolios of those investors investing in CFDs at all is very small. The market study published by the CFD Association has shown that CFD investors invest not only in CFDs but also in a large variety of financial assets, such as savings accounts, investment funds, ETFs, shares, bonds, certificates, leveraged products, futures, currencies, insurance contracts und binary options.

The amounts of loss suffered by investors are generally small amounts of money. According to the CFD Association's profit and loss statistics, as made available to BaFin, the median is € -331.

Clients to whom the financial instrument is marketed or sold

When assessing the clients to whom the financial instrument is marketed or sold, the following aspects should be taken into account, amongst others:

- Whether the client is a retail client, a professional client or an eligible counterparty;
- Clients' skills and abilities, including the level of education, experience with similar financial instruments or selling practices;
- Clients' economic situation;
- Clients' core financial objectives; and
- Whether the instrument is being sold to clients outside the intended target market or whether the target market has not been adequately identified.

The reader of the Call for Evidence gets the impression, in the opinion of the CFD Association, that the only criterion that is of relevance to ESMA is the question of whether the client is a retail client, a professional client or an eligible counterparty.

However, Article 19(2)(c) MiFIR mandatorily requires that the other listed criteria and factors be also taken into account in the same manner.

As for the "retail investor" trading in CFDs and such retail investor's experiences and financial objectives, we make reference to our statements above.

The market study published by the CFD Association has additionally shown that CFD investors have a very high level of skill and education. According to said study, 49.9% of CFD investors have a university degree. Furthermore, the economic situation of clients is good. The average CFD investor has assets of € 50,000 to € 150,000, again according to the published market study.

In the opinion of the CFD Association, these factors and criteria suggest that the client aspect alone is a reason why an interference by ESMA for temporary product intervention purposes is to be declined – for lack of a need for protection on the part of the relevant clients, who have deliberately decided to trade in CFDs and have comprehensive knowledge in this field.

Over and above this, the CFD Association takes the view – and does not hesitate to repeat this point – that no product intervention should occur as long as ESMA is not in possession of detailed practical knowledge about the target market, which imperatively needs to be taken into account in connection with this factor and criterion.

When assessing the transparency of the financial instrument, the type and transparency of the underlying, any hidden costs and charges and the nature and risks and transparency of risks should be taken into account, amongst other aspects. In this respect, we make reference to our statements above. According to said criteria, CFDs can be classified as transparent.

It is true that when it comes to assessing the particular features and components of the financial instrument, one of the criteria and factors mentioned is leverage. However, such leverage can be found in a large number of financial instruments, see above.

Furthermore, CFDs are easy to sell: real-time prices are made available and the CFDs can be sold at any time during trading hours.

Degree of innovation of the financial instrument

The degree of innovation of the financial instrument is another relevant criterion and factor in relation to the product intervention power of ESMA.

In the 1990s, CFDs were developed in the area of investment banking with a view to evading so-called stamp duty, which had to be paid to the government in Great Britain on share transactions carried out at the London Stock Exchange.

In the opinion of the CFD Association, the contingency power of ESMA is intended to apply only in certain exceptional cases – "ESMA […] should be able to impose a prohibition or restriction on a precautionary basis before a financial instrument […] has been marketed, distributed or sold to clients a restriction is intended to be imposed on a precautionary basis before a financial instrument has been marketed, distributed or sold to clients" (cf. recital 29 MiFIR). In the opinion of the CFD Association – which opinion is supported by the criterion and factor "Degree of innovation of the financial instrument" – this is to be understood to mean that product intervention measures are intended to be taken on the basis of this power if a number of very specific and narrow conditions are met, and even then only temporarily in exceptional cases, with regard to new complex products – before such products are launched, but not with regard to financial products that have been known and accepted in the market for 30 years.

No risk of regulatory arbitrage

In order for ESMA to have product intervention powers under Article 40 MiFIR, it must additionally be ensured according to Article 40(3)(b) MiFIR that the action does not create a risk of regulatory arbitrage.

However, as stated above, such a risk particularly exists with the potential product intervention measures B – Introduction of leverage limits and C – Introduction of a margin close-out rule. It is to be feared with respect to each of these measures that CFD providers and brokers will relocate to a non-EU country because of the existential interference with their business or because of the very high cost of implementation, which may particularly jeopardise the continued existence of small providers.

The same holds true if clients themselves turn to unregulated providers in non-EU countries.

Discretionary clause

Article 40 MiFIR provides for the exercise of discretion by ESMA. The Authority must exercise its discretion in full within a first step – i.e. take all relevant conditions and criteria and factors into account.

As long as ESMA does not take into account detailed practical knowledge about the concrete impact of the investor protection provisions of MiFID 2, in particular, under the aspect of the relevant target market, and of the PRIIP Regulation in exercising its discretion, such discretion must be deemed misused for failure to take all relevant factors into account.

Furthermore, any potential product intervention by ESMA must be proportionate, the restriction must be necessary and there must not be any more moderate means.

The potential product intervention measures B – Introduction of leverage limits and C – Introduction of a margin close-out rule additionally seem to be disproportionate and unnecessary in light of the fact that fundamental rights may be affected, as stated above, namely the fundamental right of providers and brokers to carry on an established business and clients' economic freedom of action.

A restriction on incentivisation of trading and a mandatory standardised risk warning would be much less drastic interventions whilst being appropriate measures.

The CFD Association will be happy to meet with ESMA at any time face to face to further discuss this issue and offers to present ESMA on this occasion with the market study and the profit and loss statistics referred to in the present statement.

Regards,

Niklas Helmreich
Chairman of the Management Board